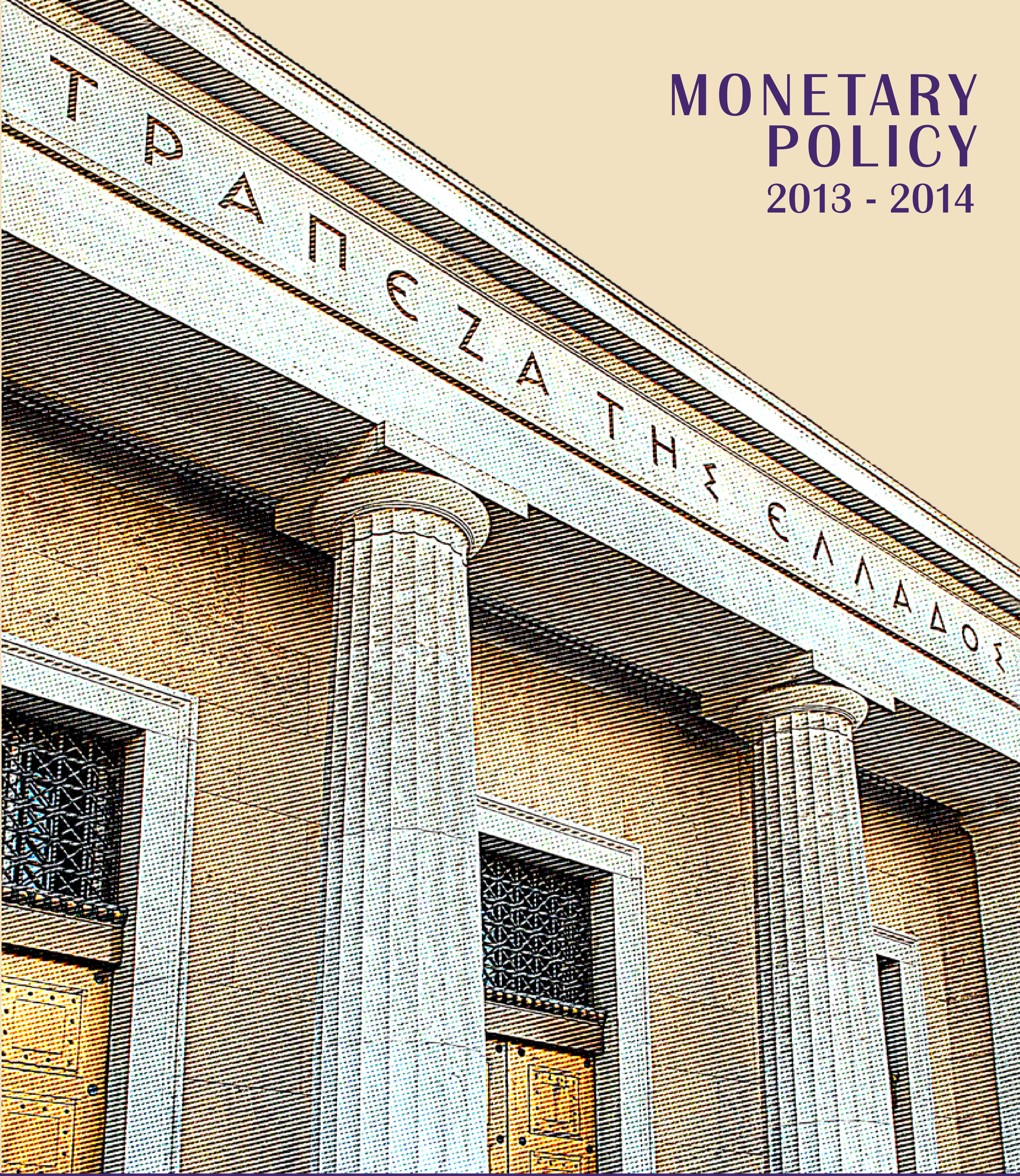
MONETARY POLICY
2013 - 2014



JUNE
2014

BANK OF GREECE
EUROSYSTEM

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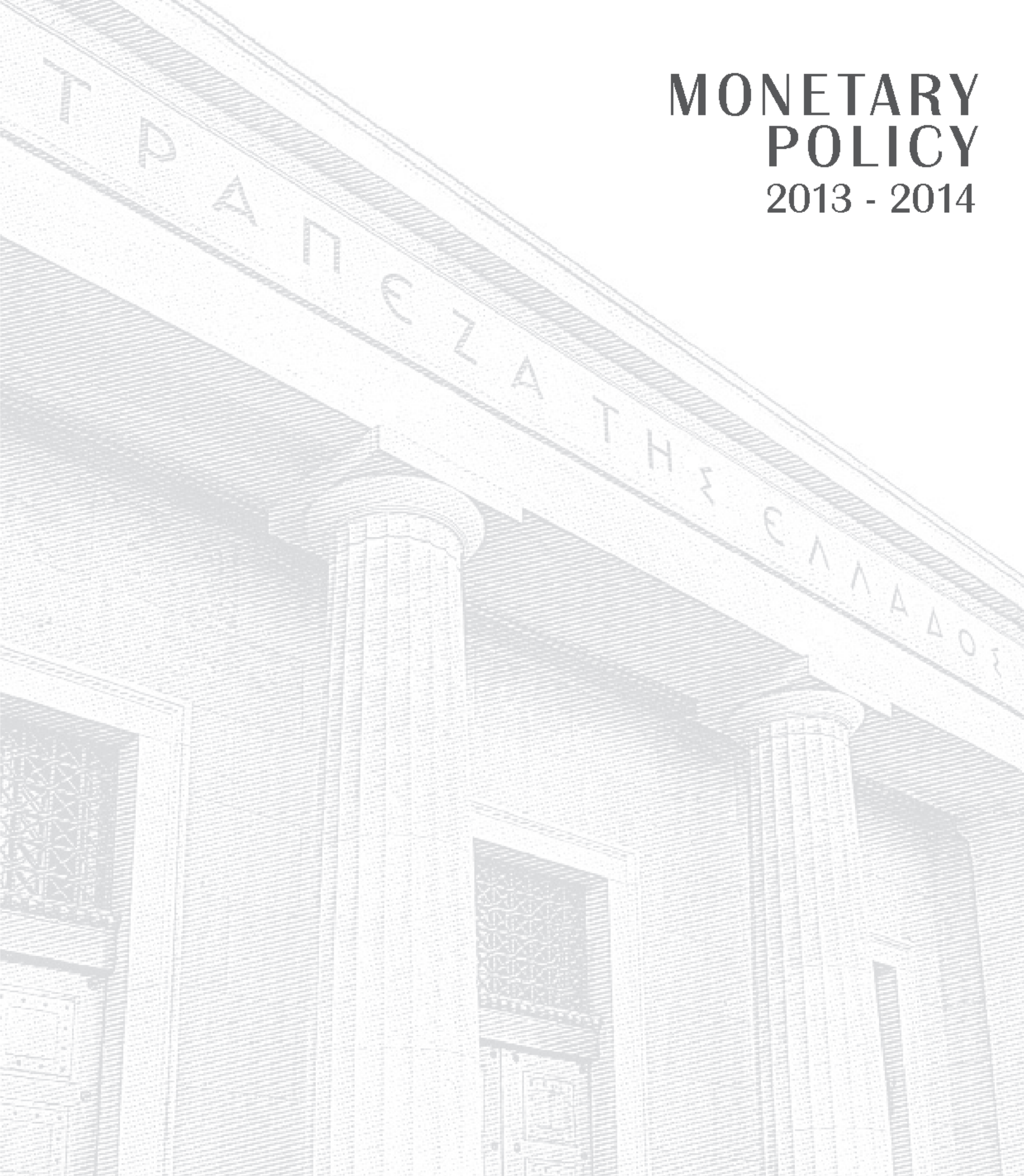

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BANK OF GREECE
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To the Greek Parliament
and the Cabinet

In its Annual Report last February, the Bank of Greece assessed that the elimination of the twin deficits and the recouping of competitiveness would gradually restore confidence and lead to further improvements in the financing of the Greek economy.

Developments in the months since then have been in line with that assessment:

– The capital increases by the core banks were very successful and a combined total of €8.3 billion was raised, with strong participation from foreign investors.

– The Greek government's return to the markets was also successful, with €3 billion raised through a five-year bond issue.

– Moreover, the issuance of corporate bonds also elicited a positive response from the markets. Between December 2012 and May 2014, large Greek corporations raised a total of €4.8 billion on foreign corporate bond markets.

All of the above support the view that confidence in the prospects of the Greek economy is being restored and markets anticipate a gradual exit from the crisis. If this momentum can be maintained and enhanced, the economy is very likely to return to positive growth. However, the forecast of positive growth is subject to downside risks, relating to developments in global markets, currently characterised by ample liquidity, as well as to possible reform fatigue and a relaxation of the reform effort on the domestic front.

The turnaround in sentiment was the result of consistent implementation of the adjustment programme. A decisive role was also played by the achievement of a primary surplus of 0.8% of GDP in 2013, which was higher than initially forecasted.

Encouraging signals are also present in certain developments in the real economy:

– The recession has eased considerably since early 2013. If this trend continues in the remainder of 2014, GDP should grow by about 0.5%.

– Consumption, the most important component of GDP, is showing signs of bottoming out.

– A positive contribution to growth is also expected from the external balance, driven by buoyant tourism receipts and upward trending shipping receipts, reflecting an upswing in world trade.

– Moreover, industrial production shows signs of a tentative recovery, and soft data (IOBE and PMI surveys) suggest a more optimistic outlook for the months ahead.

– Lastly, encouraging indications are emerging with regard to employment, which is showing signs of recovery. However, the level of unemployment remains exceptionally high and is expected to fall only gradually.

The outlook for a global recovery appears favourable, while in the EU major institutional changes geared towards strengthening economic governance are underway. Specifically, in the first half of 2014 major steps were taken towards the establishment of a Banking Union.

ECB monetary policy remained accommodative, bolstering economic activity in the euro area. The key interest rates, which had been cut twice in the course of 2013, were lowered further in June 2014, and additional non-standard monetary policy measures were adopted, aimed at supporting the flow of credit to the real economy.

As discussed in the report, recent developments in the Greek economy support the forecast of a gradual return to positive growth in 2014. However, recovery hinges upon, first, a reversal of the decline in investment and, second, a faster growth of exports.

Improvements in business and overall confidence strengthen the prospect of a recovery in investment as (i) firms are gaining access to alternative sources of financing, such as corporate bond issues; (ii) the absorption of EU funds has increased; and (iii) the creation of a Greek Investment Fund will have a positive effect on foreign capital inflows.

The second factor expected to contribute favourably to growth is a rise in exports. As discussed in the report, the normally close relationship between export performance and cost competitiveness broke down after 2009, mainly due to heightened uncertainty about the outlook for Greece and the credit squeeze faced by exporters.

Nevertheless, the significant competitiveness gains of the Greek economy, combined with the dissipation of uncertainty, the gradual improvement in financing conditions and the rise in global demand, are expected to boost Greece's exports of goods going forward. A positive outlook is emerging in the tourist sector as well as in shipping, which has begun to recover after several years of decline.

Uncertainties and risks remain, however. These could delay or even reverse the course towards recovery. Thus, the central focus of economic policy today should be to maintain and strengthen the emerging positive momentum. For this to happen, the determined effort towards the following objectives must continue:

1. An overhaul of the public sector. Progress so far has been made in downsizing and rationalising the public sector. However, there are certain areas in which there have been delays and gaps that need to be addressed promptly, if the goal of a modern state offering high-quality services without putting obstacles to business activity is to be achieved.

2. Continued fiscal adjustment over the coming years. This will secure the downward path of public debt and the country's sustainable access to global capital markets. Over the next five years, the fiscal consolidation effort will need to be based for the most part on a rationalisation of expenditures and on improving the tax administration. Moreover, the better-than-expected fiscal adjustment achieved in 2013 paves the way to the implementation of the Eurogroup decisions of November 2012 regarding possible debt sustainability measures. This commitment from our European partners was recently reiterated in the Eurogroup statement released on 5 May 2014.

3. Reorienting the production model to ensure rapid and sustainable growth in the long term. After six years of deep recession, the Greek economy is shifting to a new growth model, capable of capitalising on the country's recovered competitiveness and relying on self-sustaining and durable growth factors. In order for this shift to take place smoothly, economic policy needs to generate conditions that favour supply-side restructuring of the economy. This requires that structural reforms are stepped up to ensure the efficient and competitive functioning of product, labour and capital markets. At the same time, a recovery of investment requires a business environment with a low administrative burden for businesses, an efficient public sector and a stable tax environment that will ultimately facilitate the easing of the tax burden on businesses and individuals. A question that arises is the extent to which this growth model will be viable on the demand side. That is, will a rise in investment and net exports offset the gap in demand as a result of the squeezed private and public consumption expenditure? As detailed in the report, such an outcome is feasible in the long run, even under conservative assumptions regarding the dynamics of exports and investment.

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Important and promising developments have taken place in the banking system in recent months. At end-March 2014, the results of the stress test exercise were released, estimating the aggregate capital needs of Greek banks for the period June 2013-December 2016 at €6.4 billion under the Baseline Scenario and at €9.4 billion under the Adverse Scenario. These estimates have factored in the results of the diagnostic study as well as conservative adjustments to projections for bank profitability for the period June 2013-December 2016.

The credibility of the stress test exercise and the markets' rising confidence in the prospects of Greek banks are evidenced by the successful capital increases by the four core banks in just two months. The increases amounted to a combined total of €8.3 billion and attracted wide participation from foreign investors. Indeed, two of the core banks were able to cover not only the capital needs identified by the stress test exercise, but also secured sufficient funds to buy back the preference shares held by the Greek State. The confidence of international investors is also evidenced by Greek banks' regained access to global bond markets, with issues of €1.25 billion.

After its successful restructuring and recapitalisation, the banking sector must now optimise its troubled asset management in a manner that alleviates the burden on borrowers facing temporary difficulties in servicing their debts. In the long term, such a strategy will enable banks to unlock funds tied up in non-performing loans.

With the establishment of a Government Council for Private Debt Management and the preparation by the Bank of Greece of a framework of supervisory requirements for banks' NPL management, as well as a Code of Conduct for the management of private sector arrears, the ground has been laid for the creation of a mechanism for resolving non-performing loans of both businesses and households.

The banking system's capacity to finance economic activity has now increased, as banks have started to regain access to global markets. It is estimated that the developing economic recovery, combined with a sustained and strengthening climate of confidence, will contribute to a progressive rise in deposits, thereby enhancing banks' capacity to finance economic activity in the medium term, by relying on stable sources of funding.

Banks must now make their contribution to the restructuring of the private business sector and to help the new growth model gain traction. They must channel credit into truly viable enterprises, whether new or old, encourage business partnerships and support initiatives conducive to bold sectoral restructuring.

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The stabilisation programmes of the past years have brought about a visible improvement in fiscal aggregates, but have taken a heavy a toll on real economy. This toll would of course have been less severe if confidence in the prospects of the Greek economy had not collapsed. Today the situation has begun to turn around: confidence is being restored and the overall climate is improving. Prospects are also benefiting from the relative optimism prevailing in global markets, as reflected in renewed risk appetite, especially with regard to the euro area periphery.

If this momentum can be maintained, macroeconomic performance could exceed current forecasts and actual outcomes could improve sooner than projected. Such a path, however, is far from given and could even be interrupted. The slightest backtracking or reversal in policy could result in Greece being cut off once again from the markets and sliding back into another period of economic instability. This risk should not be underestimated. Greece's return to global markets reflects mainly the fact that markets discount that the adjustment and reform effort will continue.

In order to avert risks, the restructuring of the economy and the reforms must continue with even greater resolve across all areas. Economic policymakers must now convince that they are not complacent and will not back track, but rather stand ready to push on to the ultimate goal: the creation of a dynamic and extrovert economy.

Athens, June 2014

George Provopoulos

Governor

MONETARY POLICY COUNCIL OF THE BANK OF GREECE

CHAIRMAN

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Charalampos Stamatopoulos

Ilias Plaskovitis

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I MAINTAINING THE POSITIVE MOMENTUM WILL GRADUALLY LEAD TO OVERCOMING THE CRISIS

1 DEVELOPMENTS IN THE PAST FEW MONTHS ARE STRENGTHENING CONFIDENCE AND IMPROVING THE CLIMATE

In February 2014, the Bank of Greece assessed that the elimination of the twin deficits and the recouping of competitiveness would gradually restore confidence and would soon lead to further visible improvements in the financing of the Greek economy.

Developments in the months since then have been in line with that assessment:

- **The capital increases by the core banks** were very successful, with participation from foreign investors. In a short period of time, the four core banks carried out large capital increases for a total amount of €8.3 billion, attracting private investors.

- **The Greek government's return to the markets was also successful**, with €3 billion raised through a five-year bond issue. Following the return to the markets, the terms of short-term borrowing also improved: in May, Greek Treasury bills (€1.3 billion) were issued at a rate markedly lower than that of the previous issue.

- Moreover, the **issuance of corporate bonds** also elicited a positive response from the markets. Such issues have been made by large capitalisation companies and more are expected to follow. From December 2012 to May 2014, large Greek corporations raised a total of €4.8 billion from foreign bond markets, thereby mitigating the impact of lower bank credit to non financial corporations by €6.1 billion over that period. This development confirms the assessment made by the Bank of Greece in its *Monetary Policy – Interim Report* of December 2013 that, as confidence in the prospects of the economy rises, corporate access to market funding improves.

All of the above support the view that confidence in the prospects of the Greek economy is gradually being restored and that markets anticipate a gradual exit from the crisis. If this momentum can be maintained and enhanced, the economy is very likely to return to positive growth. However, the forecast of positive growth is subject to downside risks, relating to developments in global markets, currently characterised by ample liquidity, as well as to possible reform fatigue and a relaxation of the reform effort on the domestic front.

2 INCREASED CONFIDENCE IS THE RESULT OF THE CONSISTENT IMPLEMENTATION OF THE ADJUSTMENT PROGRAMME

The turnaround in sentiment was the result of the consistent implementation of the adjustment programme. A decisive role was also played by the **achievement of a primary surplus** of 0.8% of GDP in 2013, which was higher than initially forecasted.

Encouraging signals are also present in developments in the real economy.

- First, a considerable easing of recession can be observed: According to ELSTAT data, GDP at constant prices fell by 1.1% in the first quarter of 2014 year-on-year. The **recession has eased** considerably since early 2013 (from -6% in the first quarter of 2013 down to -1.1% currently). If this trend continues in the remainder of 2014, GDP should grow by about 0.5%.

- Consumption, the most important component of GDP, is showing signs of bottoming out.

- A more favourable forecast of the future course of consumption is also supported by leading indicators, including **retail sales** and **consumer confidence indicators**. Retail sales increased in February 2014, while the consumer confidence indicator has been improving steadily up to May 2014. But on the other hand, real disposable income of households is likely to decline further, mainly due to increased taxation. As a result, any forecast of a considerably slower decline in consumption would be risky.

- A positive **contribution to growth** is also expected from **the external balance**, driven by buoyant tourism receipts. Already in the first quarter of 2014, tourist arrivals and early bookings for tourist accommodation increased, while shipping revenue showed positive growth, reflecting an upswing in global trade.

- With regard to production, it should be noted that **industrial production shows signs of a tentative recovery**, and soft data (IOBE and PMI surveys) suggest a more optimistic outlook for the months ahead.

- Lastly, encouraging indications are emerging with regard to employment, which is showing signs of recovery. However, **the level of unemployment** —particularly of long-term and youth unemployment— **remains exceptionally high** and is expected to fall only gradually, also taking into account current levels of underemployment of the labour force.

3 THE GLOBAL ECONOMIC ENVIRONMENT IS IMPROVING

After five years of deep recession, the global economy is showing signs of recovery, particularly in the major advanced economies. In the private sector, confidence is being restored, while global trade and fixed capital formation are recovering after many years.

At the same time, major institutional changes geared towards strengthening economic governance in the EU are underway. Specifically, in the first half of 2014 major steps were taken towards the establishment of a **Banking Union**. The **Single Supervisory Mechanism** will become operational in November 2014, when the European Central Bank (ECB) will assume the supervision of credit institutions for the euro area Member States and other participating EU Member States. Moreover, in April 2014 legislation was adopted with a view to establishing the **Single Resolution Mechanism** to ensure the uniform implementation of a single set of bank resolution rules. The Single Resolution Mechanism is supported by the **Single Resolution Fund**, whose establishment is stipulated in the same legislation.

Moreover, the monetary policy of the ECB has assisted economic activity in the euro area. In mid-2013, the Governing Council of the ECB announced that it would not raise key interest rates for an extended period of time, given that euro area inflation remained at very low levels. Indeed, key interest rates, which had been cut twice in the course of 2013, were lowered further in June 2014 —resulting in a negative deposit facility rate— while the ECB Governing Council stressed that it would be prepared to proceed to further monetary policy easing. The access of banks to funding from financial markets is being gradually restored, which helps to mitigate the fragmentation of credit markets in the euro area. This development is expected to continue with the establishment of the banking union and, more specifically, the comprehensive assessment of European banks currently conducted by the ECB. Moreover, in June 2014 the Governing Council of the ECB adopted a series of measures in order to strengthen the liquidity of euro area credit institutions and support bank lending to non-financial corporations and households (excluding loans for house purchase).

4 RECOVERY IN 2014 IS FEASIBLE

Developments outlined above support the forecast of a gradual return to positive growth in 2014. However, recovery hinges upon, first, a **reversal of the decline in investment** and, second, a **faster growth of exports**.

Improvements in business expectations and overall confidence enhance the prospects of a recovery in investment, as (i) firms are gaining access to alternative sources of financing, such as corporate bond issues; (ii) the absorption of EU funds has increased; and (iii) the creation of a Greek Investment Fund is bound to have a positive effect on foreign capital inflows.

Of course, a condition for these factors to lead to a recovery in investment is that the interest currently shown by foreign investors is undiminished.

The second factor expected to contribute favourably to growth is a **rise in exports**. As discussed in the present report, the normally close relationship between export performance and cost competitiveness broke down after 2009, mainly due to heightened uncertainty about the outlook for Greece and the credit squeeze faced by exporters.[1] In particular, while cost competitiveness improved by about 30% over 2010-2013, exports of goods and services (excluding shipping) over the past three years rose at a rate only 5% faster than that of the EU-17.

Nevertheless, the significant competitiveness gains of the Greek economy, combined with the dissipation of uncertainty, the gradual improvement in financing conditions and the rise in global demand are expected to boost Greece's exports of goods going forward. A positive outlook is emerging in the tourism sector as well as in shipping, which has begun to recover after several years of decline.

5 THE POSITIVE DEVELOPMENTS LEAVE NO ROOM FOR COMPLACENCY – REFORMS MUST CONTINUE IN ORDER TO ENSURE RECOVERY

All available data suggest that the economy is on the road to recovery and growth. Although they allow optimism, there are still uncertainties and risks that could ultimately delay or even reverse the course towards recovery. Thus, the central focus of economic policy today would be to maintain and strengthen the emerging positive momentum.

For this to happen, the determined effort towards the following objectives must continue: an overhaul of the public sector, continued fiscal adjustment and reorienting the production model to ensure rapid and sustainable growth in the long term.

Overhaul of the public sector

Progress so far has been made in downsizing and rationalising the public sector. However, there are certain areas in which there have been delays and gaps that need to be addressed promptly, if the goal of a modern state offering high-quality services without putting obstacles to business activity is to be achieved.

Currently, top priorities include accelerating administrative reforms, reducing red tape and eliminating corruption.

Additional actions should be taken in order to:

- reform public procurement in order to achieve cost savings and reduce administrative burdens;
- reduce the operational costs of public administration, focusing on regional and local government;
- further rationalise the functioning of the State by assigning to the private sector operations that are not central or regulatory in nature;
- improve the quality of public services, with an emphasis on education, research and innovation;
- complete spatial planning and accelerate licensing procedures in order to facilitate large investment;
- improve the efficiency of social expenditure by targeting interventions for people in need;
- ensure the viability of social security funds;

1 See discussion in Special Feature III.3 of the present report.

- ensure the smooth functioning of justice, including the possibility of resolving cases by out-of-court settlement.

In the health sector, special attention should be placed on improving spending control and performance, as well as clearing arrears, strengthening revenues and completing the restructuring to ensure a smooth functioning of the health system.

In order to secure tighter control over spending and prevent the accumulation of State arrears to individuals, top priority should be given to immediately implementing the relevant EU Directive, which requires the repayment of debts within 30 days (or 60 days at the most, in extraordinary cases).

The implementation of new budgetary management and surveillance rules will be a catalyst in the effort to overhaul the public sector, as provided for in the draft law "Budgetary management and surveillance principles – Public accounting", which was submitted to Parliament in early May 2014. These rules will consolidate fiscal discipline and strengthen the long-term sustainability of public finances.

Enhancing tax administration

The effort to reform public revenue should rely on the following:

- enhancing tax administration by putting into operation an electronic property register and modern control techniques based on risk assessment systems;

- improving performance in collecting verified tax arrears;

- intensifying targeted tax controls on large enterprises, the self-employed, the very wealthy and offshore companies, as well as on transfers of large amounts abroad;

- ensuring a faster judicial review of tax cases, in order to address tax and contribution evasion;

- the planned reform of the legislative framework on VAT with a view to simplifying tax legislation and, in combination with increased local inspections and electronic cross-checking, improving VAT efficiency.

Progress in these areas would promote the sense of social justice and the citizens' tax compliance, thereby expanding the tax base and ultimately facilitating the achievement of future fiscal targets. Besides, combating tax evasion is a necessary condition for a future reduction of tax rates.

Continuing fiscal adjustment

Fiscal adjustment must continue in the coming years, in order to secure the downward path of public debt and the country's sustainable access to global capital markets.

Over the next five years, the fiscal consolidation effort will need to be based for the most part, as in 2013, on the expenditure side, with a special emphasis on public consumption coupled with an effort to improve the efficiency of social expenditure. Focusing on the expenditure side is dictated by three important factors: First, fiscal adjustment is more sustainable when it is primarily based on the containment and rationalisation of expenditure, as pointed out in international literature and previous Bank of Greece reports. Second, in an environment of reduced liquidity, cutting public expenditure is less detrimental to growth than imposing new taxes. Third, streamlining the public administration would release resources for the private sector, which would help strengthen the more productive and outward-looking activities and contribute to an increase in net exports.[2]

Moreover, economic recovery would expand the tax base, thus facilitating the achievement of fiscal targets.[3] This would allow the gradual reduction, as from 2015, of the top tax rates

2 See discussion in Special Feature IV.2 of the present report.
3 See discussion in Special Feature IV.1 of the present report.

applicable to enterprises, of social security contributions and personal income tax, in order to accelerate growth.

Restructuring the productive base of the economy

After four years of fiscal adjustment and deep recession, Greece managed to restore its cost competitiveness and eliminate chronic imbalances. The Greek economy is in a process of transition to a new growth model capable of taking full advantage of the country's recouped competitiveness and relying on sustainable growth factors, such as investment and exports.

As the Bank of Greece has repeatedly stressed in the past, the new growth model must shift focus from the production of non-tradables to the production of tradable goods and services and from consumption to savings and investment.

In order to ensure the transition of the economy to this new growth model and achieve high and sustainable growth of employment and income, economic policy should contribute to putting in place conditions that favour the supply-side restructuring of the economy.

In order to achieve a smooth shift of factors of production towards the most dynamic and export-oriented sectors, it is necessary to ensure the proper functioning of product, labour and capital markets. To this end, structural reforms need to progress more rapidly.

The recovery of investment requires a business environment with a low administrative burden for businesses, an efficient public sector and a stable tax environment that will ultimately facilitate the easing of the tax burden on businesses and individuals.

A question that arises is the extent to which this new growth model will be viable on the demand side. That is, whether a rise in investment and net exports will offset the gap in demand as a result of the squeezed private and public consumption expenditure. As detailed in the present report, such an outcome is feasible in the long run, even under conservative assumptions regarding the dynamics of exports and investment.[4]

Managing the high public debt

The better-than-expected fiscal adjustment paves the way to the implementation of the Eurogroup decisions of November 2012, according to which achieving a primary surplus was a prerequisite for the euro area to undertake further measures in order to ensure that Greece could reach a debt-to-GDP ratio of 124% in 2020 and a debt-to-GDP ratio substantially below 110% in 2022. This commitment from our European partners was reaffirmed in the Eurogroup statement of 5 May 2014. Negotiations on how to implement the commitments from our European partners are expected to take place in the second half of 2014. The decisions to be taken, to the extent that they will improve the manageability and sustainability of the public debt, will effectively contribute to Greece's exit from the crisis and return to sustainable growth.

6 THE BANKING SYSTEM: RECENT DEVELOPMENTS, PROSPECTS AND ITS ROLE IN ECONOMIC RESTRUCTURING

The results of the bank stress test exercise were well received by the markets

At end-March 2014, the results of the stress test exercise were released, estimating the aggregate capital needs of Greek banks for the period June 2013-December 2016 at €6.4 billion under the Baseline Scenario and at €9.4 billion under the Adverse Scenario. These estimates have factored in the results of the diagnostic study, which covered 94% of the Greek banks' loan balance on a consolidated basis, as well as a conservative adjustment of banks' profitability projections for the period June 2013-December 2016 on the basis of their

4 See discussion in Special Feature III.1 of the present report.

restructuring plans. In addition, in the framework of the conservative stance adopted, the Bank of Greece required banks to have sufficient provisions by end-2016 to cover:

- at least 95% of lifetime losses (as estimated by Blackrock) under the Baseline Scenario and 85% under the Adverse Scenario, and

- at least 52% of the Non-Performing Loans (as estimated by BlackRock) under the Baseline Scenario.

Furthermore, banks have submitted their capital plans to cover capital needs identified under the Adverse Scenario. The Bank of Greece is required to assess these plans by end-June 2014, as agreed under the Memorandum. It should be noted that some banks have already covered these needs through capital increases, while capital plans foresee several actions and measures (for example, sale of portfolios or non-banking activities).

The successful capital increases of the four core banks are indicative of the markets' confidence in the Greek banking system

The credibility of the exercise and the markets' confidence in the prospects of Greek banks are evidenced by the successful capital increases by the four core banks in just two months. The increases amounted to a combined total of €8.3 billion and attracted wide participation from private investors. Indeed, two of the core banks were able to cover not only the capital needs identified by the stress test exercise, but also secured sufficient funds to buy back the preference shares temporarily held by the Greek State as a result of its participation in the initial phase of the banks' restructuring plan. The confidence of international investors is also evidenced by Greek banks' regained access to global bond markets. In particular, two banks issued bonds, one for an amount of €500 million and the other for an amount of €750 million, with a maturity of three and five years respectively, and demand considerably outweighed the requested amount.

However, challenges related to the management of non-performing loans persist

Following its successful restructuring and recapitalisation, the banking sector must now optimise its troubled asset management in a manner that alleviates the burden on borrowers facing temporary difficulties in servicing their debts. In the long term, such a strategy will enable banks to unlock funds tied up in non-performing loans.

With the establishment of the Government Council for Private Debt Management at ministerial level and the preparation by the Bank of Greece of a framework of supervisory requirements for banks' NPL management, as well as a Code of Conduct for the management of private sector arrears, the ground has been laid for the creation of a mechanism for resolving the non-performing loans of both businesses and households. The Code of Conduct has been drafted on the basis of international best practices, relevant frameworks of other EU Member States facing similar challenges (Ireland, Cyprus, Portugal), as well as proposals put forward by stakeholders (banks, consumer associations, etc.) in a consultation carried out in April 2014.

Improving the management of troubled assets will have positive chain effects on banks' ability to finance sound entrepreneurship by providing new credit, as this is linked with the smooth and timely repayment of existing loans.

Moreover, significant progress has been made in the collection of claims of banks under liquidation, a development also due to the relatively uniform implementation of procedures. In addition, entrenched positive growth would be a catalyst in improving the recovery of arrears on NPLs, as it will increase the collection of arrears on existing NPLs and prevent the accumulation of new NPLs. A strengthened economic activity would trigger a self-sustained process that would reduce problem loans, as the capacity of households and businesses to repay their debts will improve.

Economic recovery will contribute to a gradual restoration of bank financing

The emerging economic recovery, combined with sustained and strengthening confidence, will contribute to a progressive rise in deposits, thereby enhancing banks' capacities to support economic activity in the medium term through financing. This capacity has now increased, as banks have started to regain access to global money, bond and equity markets. Up to now, this has not been combined with an effective containment of the annual weakening of bank financing to the private sector, but has enabled the repayment of a substantial part of the funds raised by credit institutions from the European Investment Bank and the Bank of Greece during the crisis.

Banks' credit activity will recover, as a stimulated economy will progressively lead to a revision of credit risk assessment (which would exert downward pressures on lending rates) and to a gradual stabilisation in the real estate market. At the same time, banks will be able to internally generate additional equity capital and reduce the stock of troubled assets, given that conditions favouring an improved management of such assets are already being put in place and will be enhanced in the future.

The European Investment Bank (EIB) and the Hellenic Fund for Entrepreneurship and Development (ETEAN) will continue to support bank credit to the real economy, while the recently established Hellenic Investment Fund can play an important role in providing financial resources to small and medium enterprises.

The banking system can contribute to a sectoral restructuring of the economy

Building on the experience gained from the restructuring of the banking sector, banks could make an important contribution to the restructuring of other sectors with excess capacity. Of course, it would be pointless or even dangerous to let chronically weak, insufficiently capitalised and over-indebted undertakings to continue to operate. The reason is that the failure of non-viable undertakings to repay funds deprives other dynamic enterprises with positive growth prospects of these resources. Banks are already working together with businesses from ailing sectors, in an effort to achieve the effective resolution and restructuring of these undertakings. Banks must now make an important contribution to the restructuring of the real economy and to help the new growth model gain traction. They must take initiatives aimed at:

- enhancing truly viable businesses, whether new or old;
- encouraging business partnerships in order to reinforce the momentum, the outwardedness and the competitiveness of domestic businesses in global markets;
- supporting initiatives conducive to bold sectoral restructuring.

The Greek banking system now has more capacity than in the recent past. Therefore, banks could spearhead the productive restructuring of the business sector having in mind the benefits for the entire economy. The Bank of Greece, as the supervisory authority of the banking system, encourages putting in place the conditions that will make this happen.

7 ECONOMIC RECOVERY REQUIRES CONTINUED REFORM EFFORT

The stabilisation programmes of the past years have brought about a visible improvement in fiscal aggregates, but have taken a heavy toll on the real economy. This toll would of course have been less severe if confidence in the prospects of the Greek economy had not collapsed. Today the situation has begun to turn around: confidence is being restored and overall prospects are improving, as global markets seem rather euphoric with regard to risk appetite and especially investment in the euro area periphery. Thus, the Greek State has regained access to bond markets, banks have been fully recapitalised with strong participation from foreign investors and businesses have raised considerable funds from foreign markets.

If this momentum can be maintained, macroeconomic performance could exceed current forecasts and actual outcomes could improve sooner than projected. Such a path, however, is far from given and could be interrupted, a development that would revive uncertainties and the general climate would turn negative again at the same speed as it improved in the previous months. This could put into question the country's growth prospects and put off recovery.

The slightest backtracking or reversal in policy could result in Greece being cut off once again from the markets and sliding back into another period of economic instability. This risk should not be underestimated, as Greece's return to global capital markets reflects mainly the fact that markets discount that the adjustment and reform effort will continue, thus helping Greece to definitely exit from the crisis and return to a sustainable growth path, as well as —secondarily— that markets are currently characterised by ample liquidity and are seeking yields.

In order to avert risks, the restructuring of the economy and the reforms must continue with even greater resolve across all areas. Economic policymakers must now convince that they are not complacent and will not back track, but rather stand ready to push on to the ultimate goal: the creation of a dynamic and extrovert economy.

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

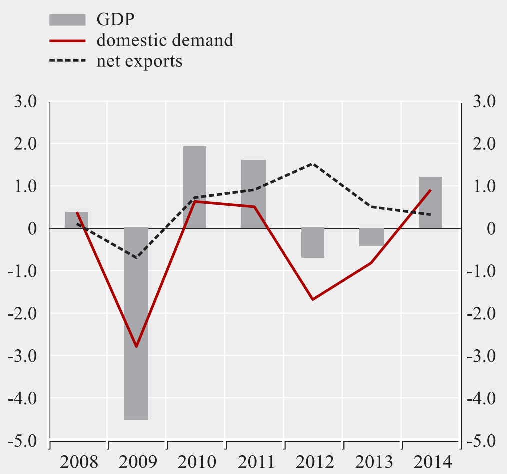
The recovery of the ***world economy*** *is under way, as global GDP is projected to grow at a rate of 3.6% in 2014 against 3.0% in 2013, in line with a pick-up in the growth rate of world trade in goods and services. Global growth dynamics in 2014 is mainly driven by advanced economies, while growth in emerging market and developing economies will remain robust, although at approximately the same level as in 2013. China is projected to maintain a growth rate of around 7.5%, while Russia is expected to experience a significant weakening in its growth rate, mostly due to the impact of the crisis in Ukraine. Inflation in advanced economies will remain at very low levels, mainly reflecting the existence of large output gaps.*

GDP growth in the ***euro area*** *is expected to be 1.2% in 2014, following negative growth (-0.4%) in 2013. Recovery appears to become broader-based across euro area countries and more self-sustaining, as the contribution of domestic demand is overall rising (see Chart II.1). The accommodative monetary policy stance of the Eurosystem and the anticipated milder fiscal consolidation are expected to boost growth. At the institutional level, further progress has been achieved towards the creation of the* ***banking union*** *with the adoption of the Single Resolution Mechanism Regulation.*

The emergence of new geopolitical risks increases uncertainty about the economic outlook, while the normalisation of the US monetary policy will increasingly pose new challenges, mainly for the emerging market economies.

Chart II.1 Euro area: GDP and composition of demand

(percentage change in real GDP)



Source: European Commission, Spring Forecasts, May 2014.
Note: For 2014, forecasts.

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

1.1 THE WORLD ECONOMY

Having suffered the impact of the great crisis for five years, the world economy is now showing signs of recovery, particularly in major advanced economies. In the private sector, confidence is being restored, while world trade and fixed capital formation are rebounding after many years of weakness. However, the unemployment rate remains alarmingly high in several advanced economies, despite some signs of stabilisation.

World GDP growth, having weakened to 2.9% in 2013 from 3.2% in 2012, has started to recover since late 2013. Moderate world GDP growth rates are due to sluggish world trade growth, as well as to subdued domestic demand in several economies as a result of the phasing-out of fiscal stimulus in advanced economies and a monetary policy tightening in emerging market economies. Growth performance varies across the major economies, reflecting the different mix of challenges faced by each of them.

World trade volume growth, although slightly stronger in 2013 (at 3.0%, against 2.8% in 2012), remained below its long-term average

1 Main data sources: European Commission, *European Economic Forecast – Spring 2014*, May 2014; International Monetary Fund, *World Economic Outlook*, April 2014; ECB, Eurosystem Staff Macroeconomic Projections, June 2014; and OECD, *Economic Outlook*, Prelim. Version, No 95, May 2014.

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)			Gross government debt (% of GDP)			Current account balance (% of GDP)		
			2012	2013	2014	2012	2013	2014	2012	2013	2014	2012	2013	2014	2012	2013	2014
World total	**189**	**100.0**	**3.2**	**3.0**	**3.6**												
1. Advanced economies	*36*	*49.6*	*1.4*	*1.3*	*2.2*	*2.0*	*1.4*	*1.5*	*-6.2*	*-4.9*	*-4.2*	*107.5*	*106.3*	*106.3*	*-0.1*	*0.4*	*0.5*
United States		19.3	2.8	1.9	2.8	2.1	1.5	1.4	-9.7	-7.3	-6.4	102.4	104.5	105.7	-2.7	-2.3	-2.2
Japan		5.4	1.4	1.5	1.4	0.0	0.4	2.8	-8.7	-8.4	-7.2	237.3	243.2	243.5	1.0	0.7	1.2
United Kingdom		2.7	0.3	1.8	2.9	2.8	2.6	1.9	-8.0	-5.8	-5.3	88.6	90.1	91.5	-3.7	-3.3	-2.7
Euro area	18	13.1	-0.7	-0.4	1.2	2.5	1.3	0.8	-3.7	-3.0	-2.5	92.7	95.0	96.0	1.8	2.6	2.9
2. Emerging and developing economies	*153*	*50.4*	*5.0*	*4.7*	*4.9*	*6.0*	*5.8*	*5.5*	*-1.6*	*-2.2*	*-2.3*	*35.6*	*34.5*	*33.3*	*1.4*	*0.7*	*0.8*
China		15.4	7.7	7.7	7.5	2.6	2.6	3.0	-2.2	-1.9	-2.0	26.1	22.4	20.2	2.3	2.1	2.2
Russia		2.9	3.4	1.3	1.3	5.1	6.8	5.8	0.4	-1.3	-0.7	12.7	13.4	13.0	3.6	1.6	2.1

Sources: IMF, *World Economic Outlook*, April 2014 and *World Economic Outlook Database*, April 2014. European Commission, *European Economic Forecast, Spring 2014*, May 2014.
Notes: 2013: estimates, 2014: forecasts.
1 Percentage share in world GDP in 2013, on the basis of purchasing power parities.
2 HICP for the euro area and the United Kingdom, CPI for the other countries. Year averages.

(5.6% over the 1980-2012 period), mainly due to subdued global demand and financing constraints faced by export firms in advanced economies. For 2014, a further strengthening to 4.3% is expected, largely driven by a rise in imports in advanced economies.

In **advanced economies** as a whole, GDP growth declined slightly in 2013 (to 1.3% from 1.4% in 2012), mainly owing to falling government consumption and a slowdown in fixed capital formation, but is expected to pick up to 2.2% in 2014, benefiting from a stronger recovery in domestic demand (1.9% from 1.0% in 2014). The enhanced implementation of fiscal consolidation programmes (in all advanced economies except Japan), compounded by the deleveraging needs of financial institutions and overindebted private sectors, weighed on recovery in 2013; at the same time, however, both these factors contributed to a gradual restoration of confidence, which had been severely impaired especially in the euro area, and bolstered expectations of financial stability and growth in 2014 and 2015 and more balanced and sustainable growth over the medium term.

The projected strengthening in output and external trade in advanced economies as a whole for 2014 masks divergent developments across countries. In the **United States**, GDP is expected to grow by 2.8%, compared with 1.9% in 2013. In **Japan**, GDP growth is projected to weaken to 1.2% from 1.5% in 2013. In the **United Kingdom**, GDP growth is expected to rise to 2.9% from 1.8% in 2013. The economy of the **euro area**, after six consecutive quarters of real GDP declines, has come out of recession in the second quarter of 2013, thereafter recording only positive quarter-on-quarter changes in GDP (see below).

Inflation in advanced economies is expected to remain at similar levels in 2014 as in 2013 (1.5%, against 1.4% in 2013) in the presence of a high —albeit lower compared with the previous year— output gap (2.4% of potential GDP, against 3.1% in 2013 in major advanced economies), the stabilisation of international crude oil prices and a projected small decline in the prices of non-oil commodities. Low inflation rates and medium-term inflation expectations will allow the continuation of expansionary monetary policies in advanced economies, with a view to supporting economic recovery and improving the financial position of both the private and the public sector.

The **unemployment rate** is estimated to have followed a downward path in 2013 for the fourth consecutive year in the United States (7.4%) and for the third year in Japan (4.0%), mainly as a result of the highly expansionary monetary and fiscal policies in the two countries, respectively, against a background of GDP growth and labour market flexibility. A further decline in unemployment is projected for 2014, namely to 6.4% in the US and to 3.8% in Japan.

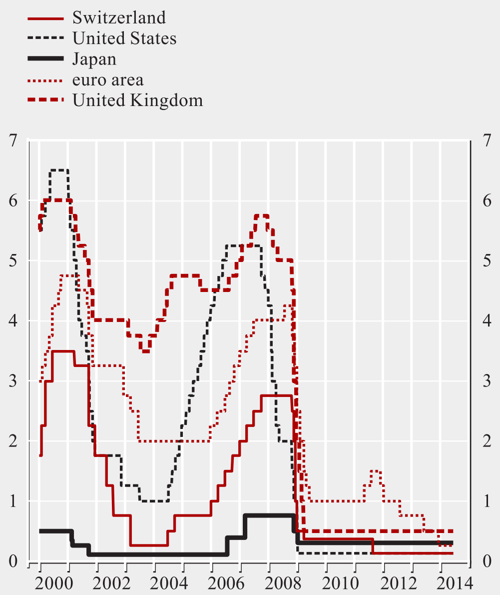
In **emerging and developing economies**, economic activity is expected to accelerate slightly, with GDP growing by 4.9% in 2014, from 4.7% in 2013, mainly due to world trade recovery. In some emerging market economies, the stabilisation of GDP growth in recent years at lower levels than in the past is due both to cyclical (following a period of overheating) and to structural factors. The projected further slight decline in GDP growth in China to 7.5% from 7.7% in 2013 reflects the country's more balanced economic growth. However, tackling the slowdown of credit expansion and the risks ensuing from the gradual reversal of monetary conditions which have been extremely accommodative over a number of years worldwide poses serious challenges for monetary authorities.

Fiscal policy in advanced economies remains a drag on growth. Structural deficits were reduced for the third consecutive year in 2013 —with the exception of Japan— with the aim to eliminate the risks entailed by the extremely high and rising public debt-to-GDP ratios in many of these countries. In the United States, the fiscal cliff was averted in early 2013 and thus the general government deficit recorded a milder narrowing, to 7.3% of GDP in 2013 from 9.7% in 2012, and is projected to decline further to 6.4% in 2014. In Japan, the decision to continue fiscal expansion has maintained the already very high general government deficit virtually unchanged at high levels: the deficit was 8.4% in 2013 and is only expected to decline to 7.2% in 2014.

Monetary policy in advanced economies, through standard and non-standard measures, continues to be highly accommodative, supporting the efforts to recover from the great recession (see Chart II.2). In several emerging market economies, monetary policy has been tightened in response to overheating or capital outflow problems. In the United States, the stronger than expected recovery and the con-

Chart II.2 Central bank policy rates (January 2000-31 May 2014)

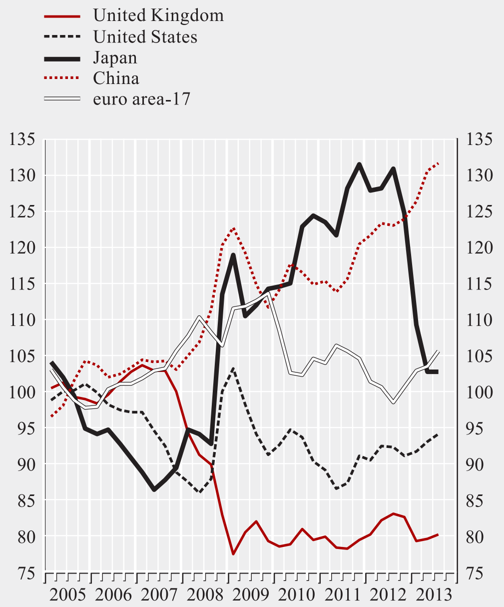
(percentages per annum, daily data)



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

Chart II.3 Nominal effective exchange rates (NEER)

(broad NEER-42, 2005=100, quarterly averages)



Source: European Commission, Price and Cost Competitiveness Report database.

tinued decline in the unemployment rate has prompted the Federal Reserve to announce that it would taper its monthly asset purchases under the third round of quantitative easing (QE3) by USD 40 billion (with four successive decisions since early January 2014) to USD 45 billion. In Japan, the adoption of a 2% inflation target by the Bank of Japan through doubling the monetary base is likely to have contributed to an improvement in economic sentiment and to a faster increase in imports than in exports in 2013, whereas the positive effect on the trade balance from the significant depreciation of the yen since August 2012 are expected to become visible with a time lag, namely from 2015 onwards.

1.2 THE EURO AREA

Economic recovery in the euro area is gaining traction and is becoming more broadly based, with an increasing number of member countries posting positive growth. At the same time, recovery is expected to become more self-sustained, on the back of a higher contribution from domestic demand (both private consumption and investment) to GDP growth in 2014. Employment is projected to rise slightly in 2014 and the unemployment rate should decline marginally, while inflation will remain at very low levels.

Euro area GDP is expected to grow by 1.2% in 2014, following a contraction (-0.4%) in 2013, reflecting positive growth rates in all member countries excluding Cyprus (where growth is expected to return to positive territory in 2015). Private consumption is projected to expand by 0.8% and investment expenditure by 2.3%, against negative rates of change (-0.7% and -2.9%, respectively) in 2013. According to Eurosystem staff projections, annual HICP inflation is expected to average 0.7%, from 1.3% in 2013.

The smaller contribution of net exports to GDP growth in the euro area as a whole in 2014 is mainly due to a projected significant increase in imports of goods and services by 3.8%, compared with just 0.2% in 2013, although exports are also expected to rise significantly, by 4.0%. The anticipated considerable rise in domestic demand in countries with large current account surpluses, such as Germany and Austria, suggests a trend towards more balanced macroeconomic developments in the euro area economy, as this will help boost the exports of peripheral countries, which in recent years have taken big steps to reduce their external deficits (see Special Feature II.1).

Despite the positive financial developments in the euro area, such as the sharp decline in the cost of borrowing for the peripheral economies and the receding financial market fragmentation, bank credit remains weak. Indeed, the economic recovery of the euro area has so far remained largely creditless, with businesses financing their investment through internal sources or relying on market-based debt financing.

Turning to fiscal developments and the outlook for 2014, a milder fiscal consolidation is expected after the significant decline in the structural fiscal deficit over the past two years. The headline fiscal deficit in the euro area as a whole is set to decrease by 0.5 percentage point, to 2½% of GDP this year, as the recovery is taking hold and additional deficit-reducing measures are being implemented by member countries. However, measured in terms of change of the structural balance, fiscal consolidation is expected to be small, around 0.2% of GDP. The government debt-to-GDP ratio is projected to reach 96.0% before embarking on a downward path in 2015, according to the European Commission's forecasts.

The most serious downside risk to the positive growth outlook of the euro area relates to a loss of confidence due to reform fatigue, while a prolonged period of very low inflation could also represent a further downside risk. Moreover, uncertainty about the external environment has risen. On the other hand, further bold structural reforms could lead to stronger than expected growth.

1.3 POLICY RESPONSES AT THE EU AND THE EURO AREA LEVEL

European Semester

The Economic and Financial Affairs Council (ECOFIN) of 18 February 2014 adopted conclusions on the European Commission's Annual Growth Survey (AGS) 2014,[2] confirming some first encouraging signs of economic recovery and setting out the policy priorities for 2014. These priorities are the same as in 2013 and focus on pursuing differentiated growth-friendly fiscal consolidation and ensuring long-term sustainability of public finances; restoring lending to the real economy; promoting sustainable and inclusive growth and jobs and competitiveness while tackling the social consequences of the crisis.

Moreover, the Council reviewed the European Commission's Alert Mechanism Report (AMR) 2014, welcomed the progress made by Member States in correcting their internal and external imbalances[3] and recognised that for the 16 Member States selected by the Commission, further analysis of in-depth reviews is required regarding the accumulation of imbalances, including countries with persistent current account surpluses, namely Germany, the Netherlands, Luxembourg and Sweden.[4]

Decisions by EU institutions on the completion of the Banking Union

In the first half of 2014, important initiatives towards the creation of the Banking Union were finalised, which had been underway after the decisions of the European Council in December 2012 and the establishment of the Single Supervisory Mechanism (SSM) in 2013. The Single Supervisory Mechanism will become operational in November 2014[5] with the European Central Bank assuming tasks relating to the supervision of credit institutions in the euro area (and in other EU Member States participating in the SSM). Moreover, in April 2014, the European Parliament voted in favour of the establishment of the Single Resolution Mechanism (SRM), ensuring the harmonised application of uniform rules for the resolution of banks in the EU (see Special Feature II.2). The Single Resolution Mechanism is supported by the Single Resolution Fund (SRF), as provided for in the relevant Regulation.

The aforementioned initiatives have set the legislative framework for the two major pillars of the Banking Union, supported by common rules, applicable to the national financial systems of all EU Member States, in accordance with the latest revisions of relevant EU legislation. In summary, 2013 saw the incorporation

2 Annual Growth Survey 2014, COM(2013) 800 final, 13.11.2013.
3 Alert Mechanism Report 2014, COM(2013) 790 final, 13.11.2013.
4 Countries under an economic adjustment programme like Greece are not subject to the Macroeconomic Imbalances Procedure under the Alert Mechanism as the assessment of their imbalances and of the measures taken to address them takes place in the context of their adjustment programmes.
5 Council Regulation (EU) No 1024/2013 of 15 October 2013 and Regulation (EU) No 1022/2013 of the European Parliament and of the Council, of 22 October 2013, L 287, 29.10.2013.

into EU law of the principles of Basel III, aimed to strengthen the capital adequacy of financial institutions, while in April 2014 the European Parliament adopted the Bank Recovery and Resolution Directive (BRRD) and a Directive on Deposit Guarantee Schemes (DGS).

Developments in the economic adjustment programmes of euro area countries

On 27 January 2014 the Eurogroup discussed the fifth and final review of the financial sector programme for Spain, officially confirming that the programme was successfully ended on 22 January. On 10 March 2014 the Eurogroup discussed the third review of the adjustment programme for Cyprus, concluding that fiscal targets for 2013 had been met with a considerable margin and that financial stability had improved.

On 1 April 2014 the Eurogroup discussed the completion of the fourth review of the second economic adjustment programme for Greece and approved the gradual disbursement of the next EFSF instalment in three tranches, with the first one amounting to €6.3 billion (disbursed on 24 April) and the remaining two tranches of €1 billion each, subject to the implementation of the required prior actions. On 5 May the Eurogroup welcomed the return of the Hellenic Republic and of Greek banks to the international capital markets, as an encouraging sign of increasing market confidence and an important step towards regaining broader market access. It also noted that the relative merits of possible debt sustainability measures, as stated by the Eurogroup on 27 November 2012, would be considered in the context of the next review. The IMF, for its part, announced on 30.5.2014 that the completion of the fifth review of Greece's performance enables the disbursement of about €3.41 billion. Moreover, on 5 May the Eurogroup announced the conclusion of the final review of the economic programme for Portugal and supported the Portuguese government's decision to exit its adjustment programme without successor arrangement.

Special Feature II.1

ADJUSTMENT IN THE EURO AREA CURRENT ACCOUNT BALANCE: CONSIDERABLE PROGRESS IN PERIPHERY COUNTRIES

The accumulation of current account deficits over 2004-2008

The run-up to the crisis was marked by an accumulation of external imbalances in most euro area periphery economies. Current account deficits in Greece, Ireland, Spain and Portugal, after shrinking in the first 4-5 years following the adoption of the euro, were widening considerably up to 2008. Widening external deficits were driven by a sharp increase in trade deficits against a backdrop of a significant appreciation of the euro and a gradual loss in international competitiveness, as well as by a deterioration in the income balance as a result of higher interest payments on public and/or private debt.

Rising trade deficits in Ireland, Spain, Portugal and Greece after 2004 came from the faster increase in imports, as strong credit expansion and external borrowing fuelled domestic demand during the reviewed period. Over the same period, the euro area periphery witnessed a continuous erosion in the competitiveness of its exported goods, coupled with a loss of its export market share in favour of —European and other— emerging markets, as a result of (i) a substantial rise in unit labour costs (ULCT), which mainly came from the non-tradables and passed through to the tradables because of the Balassa-Samuelson effect (Chen et al. 2012), and (ii) its failure to increase the quality of its exports (IMF 2013).

Chart A Exports and imports as a percentage of GDP (2004 and 2008)

Source: Eurostat, April 2014.

Adjustment in external imbalances over 2009-2013

As a result of the crisis and the subsequent deep economic recession, and with the support of the economic adjustment programmes, current account deficits in these four euro area economies started narrowing in 2009 and were gradually eliminated by 2013. By contrast, current account surpluses in core economies widened further, thus leading to an asymmetric unwinding of euro area external imbalances between core and periphery countries.

Current account deficits turned into surpluses in 2013 in Ireland, Greece, Portugal and Spain. The largest part of the improvement is attributable to import contraction, as both the duration and the intensity of the recession have considerably squeezed domestic demand in these countries. In the case of Greece, fiscal adjustment played an important role in the correction of the deficit. Nevertheless, shrinking external deficits, particularly in Ireland and in Spain, were also supported by stronger export performance through improved competitiveness. It is quite indicative that over the past five years, because of the recession and the ensuing labour market reforms, most periphery countries succeeded in recouping their lost competitiveness, in labour costs terms of the 2000-2008 period, while sizeable gains in terms of structural competitiveness were recorded. However, it should be noted that in Greece the drop in labour costs did not translate into an increase in exports relative to GDP to an equal extent as in the other countries (see Special Feature III.3 in the present report and ECB 2014, Box 5), mostly on account of the larger share of services (shipping, tourism) in total exports compared with the other countries, as services are affected mainly by international economic conditions.

In some Member States, which had been running persistent current account surpluses prior to the crisis, both rising exports and demand for imports were relatively contained (EC 2012a). However, other Member States such as Germany, the Netherlands, Luxemburg and Austria are still record-

Chart B Current account balance as a percentage of GDP

Source: Eurostat, April 2014.

ing high surpluses, which are partly attributable to cyclical factors and structural obstacles in strengthening domestic demand, or to an inability of the banking system to provide financing (EC 2013; EC 2012b). Against this background, during the latest review of Macroeconomic Imbalances (March 2014), the European Commission estimated that both Germany and the Netherlands are experiencing imbalances that need to be monitored and addressed through appropriate policy measures.[1] As a result of the substantial adjustment in the periphery countries and the persisting high surpluses in some partners, the pre-crisis balanced current account of the euro area has now turned into a surplus equal to 2.3% of GDP in 2013, according to the latest IMF estimates.

Findings of international organisations regarding the sustainability of the adjustment

A critical question is whether the correction of external imbalances achieved in the periphery economies is sustainable over the medium term or, conversely, whether deficits are likely to re-emerge as these economies exit the recession. Findings by international organisations suggest that the bulk of the correction during the 2008-2012 period is due to structural factors (ECB 2014; EC 2014; Chen et al. 2012) in three out of the four examined economies, since structural changes in the current account deficit, which are associated with a sharp drop in the potential output of these economies, are significant. In the case of Greece, by contrast, adjustment appears to be both structural and cyclical, because of the much wider output gap compared to the other periphery economies as a result of the deeper recession that hit the country.

In this light, according to the above-mentioned studies, gains recorded in recent years in terms of external balance are likely to persist to a great extent, even if the economies adjust towards

1 In the case of Luxemburg, it was determined that lasting surpluses are not due to imbalances under the Macroeconomic Imbalance Procedure but to an oversized financial sector.

full employment and domestic demand recovers. Nevertheless, the cyclical part of the adjustment might not be sustainable, a development which is likely to occur in Greece owing to the comparatively higher weight of cyclical factors in the adjustment. Boosting export performance through reforms in labour and product markets and improved structural competitiveness is a prerequisite for sustainable surpluses and for bringing down negative international investment positions to sounder levels (EC 2014).

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IMF (2013), *World Economic Outlook*, April 2013, Box 1.3.

2 THE ECONOMIES OF SOUTH-EASTERN EUROPE (SEE)

In 2013 the economies of South-Eastern Europe (SEE)[6] recorded quite high growth rates, which in many cases exceeded the initial expectations,[7] with the exception of Albania, where growth slowed down further, and Bulgaria, where growth was subdued for the second consecutive year. Among the remaining countries of the region, the economies of Western Balkans saw a remarkable recovery after negative performance in 2013, while growth rates in Romania and Turkey picked up significantly (see Table II.2).

The factors behind growth trends in the region varied across countries. Overall, however, the contribution of exports continued to be strong and domestic demand strengthened in some countries. Growth in Serbia, Bulgaria, Romania and FYROM was mainly driven by exports, while the main driver of growth in Turkey was private consumption, supported by high credit expansion.

Projections for 2014 point to a continuation of growth, with some slowdown in GDP growth for several countries, which however is likely to be followed by a slight pick-up in 2015 (see Table II.2). In most of the countries in the region, a favourable effect is anticipated not only from strong export performance but also from the partial recovery of domestic demand, mainly as a result of rising private consumption that should be supported by expansionary monetary policies,[8] as well as from a gradual improvement in labour market conditions and increased absorption of EU funds by candidate countries for EU accession. By contrast, the low level of foreign direct investment inflows and subdued credit growth in most countries are expected to dampen growth. Finally, unlike what is projected for most countries, the growth rate in Turkey is forecast to decelerate,

6 Albania, Bosnia and Herzegovina, Bulgaria, Former Yugoslav Republic of Macedonia (FYROM), Montenegro, Romania, Serbia, and Turkey.
7 Forecasts by international organisations (EU and IMF), October-November 2013.
8 The monetary authorities in Serbia, Romania, Albania and FYROM have repeatedly cut their key interest rates.

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

Country	GDP (annual percentage changes)				Inflation (averages, annual percentage changes)					Current account balance (% of GDP)				CAR (%)		Loans/ deposits (%)		NPL ratio (%)	
	2012	2013	2014	2015	2012	2013	Feb. 2014	2014	2015	2012	2013	2014	2015	2012	2013	2013	Feb. 2014	2012	2013
Albania[1]	1.3	0.4	2.1	3.3	2.0	1.9	1.9	2.7	2.8	-10.1	-10.6	-10.3	-12.4	16.2	18.0	55.3	54.4	22.5	23.5
Bosnia-Herzegovina[1]	-1.2	1.5	2.0	3.2	2.0	-0.1	-1.6	1.1	1.5	-9.3	-5.5	-7.5	-7.0	14.1	15.2	115.2	114.4	13.5	15.1
Bulgaria	0.6	0.9	1.7	2.0	2.4	0.4	-2.6	-0.8	1.2	-0.9	1.9	1.0	0.2	16.6	16.9	87.7	86.6	16.6	17.2
FYROM	-0.4	3.1	2.5	2.6	3.3	2.8	0.6	3.3	3.0	-3.0	-1.9	-2.6	-3.0	17.1	16.8	89.7	88.9	10.3	11.3
Montenegro	-2.5	3.5	2.7	3.0	4.1	2.2	-0.6	2.3	2.6	-18.7	-14.6	-15.3	-15.8	12.4	14.4	115.1	114.9	17.6	18.4
Romania	0.6	3.5	2.5	2.6	3.4	3.2	1.1	2.5	3.3	-4.4	-1.1	-1.2	-1.6	14.6	15.0	101.3	100.8	18.2	21.9
Serbia	-1.5	2.5	1.3	2.2	12.2	2.2	2.6	4.3	5.0	-10.8	-4.9	-4.7	-4.8	19.9	20.2	119.0	119.1	18.6	19.9
Turkey	2.1	4.0	2.5	3.0	8.9	7.5	7.9	8.7	7.4	-6.1	-7.9	-6.5	-4.4	17.9	15.3	110.8	112.0	2.9	2.7

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

as the monetary policy tightening should weigh on domestic demand.

Inflation in all SEE countries, with the exception of Romania, followed a downward trend in 2013, mainly on account of subdued domestic demand, lower prices of oil and non-oil commodities, as well as good agricultural harvests. Serbia achieved a remarkable correction, as inflation fell by 10 percentage points, from 12.2% in 2012 to 2.2% in 2013. By contrast, in Turkey, despite some deceleration, inflation remained the highest in the region, partly fuelled by the depreciation of the Turkish lira. In most countries, with the exception of Turkey and to a lesser extent Serbia, inflation continued its downward path in the first quarter of 2014, while Bulgaria, Montenegro, and Bosnia and Herzegovina experienced deflationary trends. Nevertheless, projections for 2014 as a whole point to a slightly upward trend in the general level of prices, reflecting to a certain extent a gradual strengthening in domestic demand in most countries. In Turkey, despite tight monetary policy, inflation is not expected to decline considerably (see Table II.2).

Current account deficits were on a downward trend throughout 2013, mainly as a result of subdued growth in domestic consumption, which squeezed down imports, as well as of a relative recovery in external demand, which boosted exports.[9] This was particularly evident in Serbia and Bosnia and Herzegovina, which both saw their deficits halve. By contrast, the current account deficit widened considerably in Turkey. According to forecasts by international organisations, no significant changes in the external sector of most countries are expected for 2014. However, a considerable improvement is anticipated in the current account deficit of Turkey (mainly in 2015) due to the depreciation of the Turkish lira (see Table II.2).

The public finances of SEE countries provided a mixed picture. In several cases, deviations from annual targets have led to a revision of annual budgets and finally to a widening of deficits. Albania is a case in point, as higher government spending combined with lower revenue (2013 was a typical election year) led to a doubling of the deficit, which came to 6.2% of GDP, from 3.3% in 2012. In Bulgaria, after three years of continuous improvements, the

9 It is worth noting that, despite the economic downturn or recession in some of their major euro area trading partners, several SEE countries have succeeded in improving their export performance considerably by turning to alternative export destinations.

fiscal deficit rose to 1.5% of GDP, from 0.5% in 2012. Conversely, in most of the other countries in the region the fiscal balances improved.

The decline in credit growth continued in 2013 in most SEE countries. In some of them, such as Serbia and Albania, credit expansion was even negative. Weak credit expansion reflected both demand- and supply-side factors. On the demand side, sluggish economic activity played an important role; on the supply side, the increase in non-performing loans (NPLs) acted as a constraint on credit expansion. It should be noted that in both countries with negative credit growth rates, NPL ratios have reached very high levels (see Table II.2). On a more general note, it is particularly important for SEE countries to effectively tackle this issue, so as to restore the normal financing of economic activity. The picture in Turkey is clearly different, as credit growth kept rising in 2013 at a high rate of about 33.4%, while the NPL ratio stood below 3% by the end of the year (see Table II.2).

The slowdown in bank lending is also due to the liquidity constraints faced by local banks, as a result of the tendency of European banking groups —evident almost from the start of the euro area crisis— to withdraw part of the funds they had channeled into the region. This trend continued throughout 2013 and is likely to intensify in 2014 following the ongoing stress tests, the results of which will be announced by the European Central Bank in the autumn of this year.

3 THE SINGLE MONETARY POLICY, THE SINGLE MONEY MARKET AND THE INTERVENTIONS OF THE EUROSYSTEM

The Eurosystem lowered its key interest rates in 2013, based on the assessment of weakening medium-term inflationary pressures in the euro area (see Table II.3). The key interest rates were again lowered in June 2014, bringing the rate on the marginal lending facility, for the first time, to a negative level. Inflation is expected to remain very low in the coming months, in the context of the slow pace of economic recovery, a remaining slack in the economy and weak monetary and credit dynamics.

As early as mid-2013, the Governing Council of the ECB indicated that it would not increase its

Table II.3 Changes in key ECB interest rates

(percentages per annum)

With effect from:[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

Source: ECB.
1 Changes in all three key ECB interest rates are effective from the first main refinancing operation following the relevant Governing Council decision, not the date of the Governing Council meeting on which this decision is made.

Table II.4 Eurosystem's open market operations in 2013 and the first quarter of 2014*

1. Main and longer-term refinancing operations:	
1.1 Main refinancing operations (MRO): provision of liquidity with a maturity of one week	**Frequency:** Once a week. **Procedure:** At least until December 2016, fixed-rate tender with full allotment.
1.2 Longer-term refinancing operations (LTRO):	
1.2.1 Provision of liquidity with a maturity of one maintenance period	**Frequency:** Once at the beginning of each maintenance period. These operations were discontinued after 10 June 2014. **Procedure:** Fixed-rate tender (at a rate equal to the MRO rate) with full allotment.
1.2.2 Provision of liquidity with a maturity of three months	**Frequency:** Once a month (usually at end-month). **Procedure:** At least until December 2016, fixed-rate tender with full allotment and an interest rate set ex post equal to the average value of the fixed rate of the MROs conducted during the life of the respective longer-term refinancing operations.
2. Fine-tuning operations:	
2.1 Liquidity absorption on a weekly basis to sterilise the effect, on the overall liquidity of the banking system, of purchases made under the Securities Markets Programme	**Frequency:** Every week, starting on 18 May 2010. The absorption of liquidity continued even after the discontinuation of the Programme (following which new purchases were no longer possible). These operations were discontinued after 10 June 2014. **Procedure:** Collection of weekly deposits from credit institutions through variable-rate tenders with a maximum bid rate equal to the MRO fixed rate.
3. US dollar liquidity-providing operations:	
3.1 Operations with a maturity of one week 3.2 Operations with a maturity of three months	**Procedure:** Fixed-rate tender with full allotment against collateral eligible for the Eurosystem's credit operations in euro. Operations with a maturity of one week will continue to be conducted at least until 31 July 2014, while operations with a maturity of three months were discontinued after April 2014.
4. Targeted longer-term refinancing operations (TLTRO):	
	They were established in June 2014 and link the supply of liquidity from the Eurosystem to credit institutions with the volume of credit (excluding loans for house purchase) that these institutions extend to households and non-financial corporations.

Source: ECB
* The table was compiled on the basis of data and information available until early June 2014.

key interest rates for a protracted period, as inflation in the euro area remained very low. According to the latest Eurosystem staff macroeconomic projections (June 2014), annual inflation is expected to average 0.7% in 2014, 1.1% in 2015 and 1.4% in 2016, while both upside and downside risks to the outlook for price developments (e.g. due to fluctuations in the exchange rate of the euro or geopolitical factors) are seen as limited and broadly balanced. The Governing Council of the ECB repeatedly stressed during 2013 and in early 2014 that the ability of banks to tap financial markets was being restored, thus helping to reduce the fragmentation of credit markets in the euro area. This trend is expected to continue, as confidence in the resilience of banks will be generally supported by the establishment of the banking union and in particular by the comprehensive assessment of systemically important banks conducted by the ECB. The Governing Council of the ECB has urged banks to improve – in the context of the comprehensive assessment – their capital base and solvency, thereby alleviating the supply-side constraints on bank lending that hamper economic recovery.

As regards developments in the single money market, interbank rates (EONIA, Euribor) started to rise slightly in the course of 2013. This upward trend continued into early 2014, when the EONIA showed high volatility, and was largely due to the decrease in the liquidity surplus of the euro area money market. Since credit institutions have secured alternative sources of funding, as a result of the considerable progress towards reducing financial fragmentation, they were able to repay early a large part of the liquidity they had obtained from the Eurosystem (see Table II.4) through the 36-month longer-term refinancing operations. In the period before the Governing Council of the ECB started to provide forward guidance on the evolution of the ECB's policy interest rates, the Euribor rates had been recording sharp fluctuations amidst unstable expectations about the monetary policy stance in both the euro area and the United States.

Finally, in June 2014 the Eurosystem announced that it would conduct additional open market operations (targeted LTROs) aimed at improving bank lending to non-financial corporations and households. It also decided to continue conducting its one-week and three-month refinancing operations as fixed rate tender procedures with full allotment (against adequate collateral) until end-2016 and to suspend the fine-tuning operations sterilising the liquidity injected under the Securities Markets Programme.

Special Feature II.2

BANKING UNION: THE SINGLE RESOLUTION MECHANISM

During the Greek presidency of the Council of the European Union, an agreement was reached between the European Council and the European Parliament, following a proposal by the European Commission, on the completion of the banking union's second pillar, which concerns the resolution of banks. Against this backdrop, the European Parliament, at the plenary sitting of 15 April 2014, adopted a Regulation establishing a Single Resolution Mechanism (SRM) for the euro area countries and other participating EU Member States. The SRM aims, *inter alia*, to break the negative feedback loops between sovereigns and banks, strengthen financial stability and integrate the framework for bank recovery and resolution in the participating EU Member States.

Under the SRM, these objectives are to be achieved, on the one hand, through a uniform implementation, at the EU level, of the Bank Recovery and Resolution Directive (BRRD)[1] and, on the other hand, through the financing of resolution costs with resources drawn from a single fund. The uniform application of resolution schemes is ensured with the establishment of a Single Resolution Board (SRB), which will be responsible for monitoring the implementation of the Regulation and for taking decisions on the resolution of failing banks including the use of the Single Resolution Fund (SRF).

In brief, according to the main points of the Regulation regarding the decision-making process, the following steps must be followed:

- The European Central Bank, within its scope of competence in the context of the Single Supervisory Mechanism (SSM) for banks, notifies the *Single Resolution Board* of any existing or likely viability issues faced by banking institutions. Furthermore, the Resolution Board may, on its own initiative, assess whether an institution is failing or is likely to fail.

- Upon receipt of the ECB's notification (or on its own initiative and after informing the ECB), the Resolution Board assesses whether the criteria for resolution are met, in order to adopt a resolution scheme or wind up the bank.

- The scheme enters into force only if, within 24 hours after its transmission, no objection has been expressed by the ECOFIN Council[2] or by the European Commission, or if the Commission endorses it.

1 The objective of the Directive is to align different bank recovery and resolution frameworks across the EU. To this end, from 2016 onwards, the participation of shareholders, holders of subordinated securities and depositors with savings exceeding €100,000 is envisaged in the banking resolution process.
2 The ECOFIN Council may object to a resolution decision only where the Commission considers that the proposed scheme is not in the public interest and the amount of the Fund provided for in the resolution scheme should be materially modified.

- The Resolution Board will take the resolution decisions in its executive session.[3]

- If the support of the Fund in a specific case is required above the €5 billion threshold, any participating member of the plenary has the right, within a strict time frame, to call for a decision of the plenary session.

- Any decisions in the plenary session of the Resolution Board, regarding cases in which the Board is competent to decide, will be adopted by simple majority representing 30% of contributions to the Single Resolution Fund.

The *Single Resolution Fund*, established by the SRM Regulation, will be financed through contributions from the financial sector collected by the national resolution authorities, which will be gradually mutualised at the European level. The procedure for this mutualisation of the funds available in the national compartments of the Single Resolution Fund is foreseen in an Intergovernmental Agreement (IGA) between the Member States participating in the SRM. The signing of an IGA was chosen for legal reasons, as the transfer of the contributions to the national compartments and the ensuing merger of funds at the EU level are not provided for in the legal framework of the European Union. This provision under the Single Resolution Mechanism ensures the orderly functioning of the Fund and is of vital importance for the effectiveness of bank resolution across the EU.

The transitional period of mutualisation of the contributions will last eight years, starting from the launch of the SRM on 1.1.2016. The target level of the amounts contributed to the SRF, by the end of this transitional period, is equal to 1% of the covered deposits of all banks operating in participating Member States. This mutualisation of funds raised through bank contributions will be frontloaded, starting with 40% in the first year, 60% in the second year, and continuously increasing by equal amounts over the subsequent six years until the SRF is fully mutualised.

During the transitional period, it is envisaged that initially the resources collected at the national level will be used, if needed. Moreover, when a cross-border group is under resolution, the estimated costs will be distributed, proportionally, between different national compartments. If additional resources are needed, the remaining financial means in the national funds and, subsequently, the common resources pooled into the Single Resolution Fund will be used. In the event that the aforementioned sources of financing have been used up, temporary transfers between national compartments will be possible, while it is foreseen that, if needed, the signatory Member States will allocate to the Fund further support either from national sources, backed by additional bank contributions, or from the European Stability Mechanism. Lastly, under the IGA, during the transitional phase a common backstop will be developed to facilitate borrowings by the SRF.

The Single Resolution Mechanism (SRM) and the Single Supervision Mechanism (SSM) are two of the three pillars of the banking union; the supervisory arm of the banking union enters into force on 4.11.2014, while the bank resolution arm becomes effective on 1.1.2016. Furthermore, the third pillar of the banking union is reinforced by a common system of deposit protection in the EU.[4] An effective functioning of the banking union's pillars is expected to support confidence in the euro area financial system, with considerable benefits for those Member States which have been severely hit by the recent crisis.

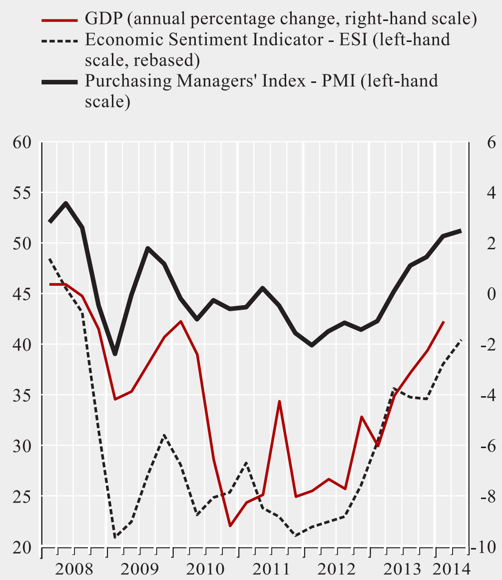
3 For this session, the Board consists of the Chair, the Vice Chair, four independent permanent members and the representatives from the ECB and the European Commission participating as permanent observers, while the representatives from the national resolution authorities can only attend its plenary session as observers.

4 The amendment of the relevant Directive was agreed by the ECOFIN Council and the Committee on Economic and Monetary Affairs of the European Parliament on 18.2.2014 and endorsed by the plenary session of the European Parliament on 15.4.2014.

III MACROECONOMIC DEVELOPMENTS AND PROSPECTS IN GREECE

The Greek economy is expected to chart a course of positive growth rates in 2014, after six consecutive years of recession, as evidenced by coincident and economic sentiment indicators so far. Exports should be the main pillar of growth, while there are positive indications of increasing investment. The improving competitiveness of the Greek economy —which is largely due to structural reforms— combined with higher world demand, is expected to boost exports. Business investment should be supported by improved competitiveness and economic sentiment, as well as the private sector's access to a wider pool of financing. Privatisations under way are also expected to enhance investment. The rate of decrease in consumption is expected to decelerate in 2014. The fall in domestic demand in the past three years and the decline in labour costs should continue to push down prices, which are expected to keep falling throughout 2014. On the employment front, recent evidence of a slower increase in unemployment this year is encouraging.

Chart III.1 GDP, Economic Sentiment Indicator (ESI) and manufacturing Purchasing Managers' Index (PMI)



Sources: ELSTAT, European Commission and Markit Economics.

- Recent data on GDP, economic activity indicators and economic sentiment indicators suggest that the economy stabilises, approaching a turning point to positive growth (see Chart III.1). In more detail: GDP data show a strong deceleration in the annual rate of decline of GDP from -7% in 2012 to -3.9% in 2013, and from -6% in the first quarter of 2013 to -2.3% in the fourth quarter of 2013 and -1.1% in the first quarter of 2014. The industrial output index increased in the past four months (December 2013-March 2014), while the Purchasing Managers' Index (PMI) in industry stood around levels that signal a recovery. The retail trade index has been stabilising, reaffirming consumers' positive expectations, which improved in the first five months of the year.

- According to Bank of Greece estimates, the Greek economy should post positive growth rates in the second half of 2014. Total GDP growth for the year is calculated at 0.5%. The recovery should be based on increased exports and investment, while the rate of decline of private consumption is expected to decelerate substantially in the following period.

- Exports are expected to continue their upward course as a result of improved competitiveness and the anticipated increase in external demand. Positive projections largely concern receipts from tourism and shipping (accounting for around 52% of exports of goods and services in the past five years). The first quarter of 2014 has already seen an increase in tourist arrivals and pre-bookings for resorts, while shipping revenue is on a positive course, reflecting the upward trend of world trade.

- Investment —excluding residential investment— is expected to rebound as a result of improved competitiveness, business expectations and structural reforms in product markets. Although bank lending should remain limited in the short run, restoring the capital adequacy of the banking system should have a gradual positive effect on credit supply. Moreover, after the Greek government made a successful return to the markets and the banks' capital increases saw demand outstrip supply, major Greek companies started to issue bonds.

- Restoring confidence in the prospects of the Greek economy should continue to expand the access of companies to capital market-based financing, as an alternative to bank lending.[1] It should be noted that in the December 2012-May 2014 period, major Greek companies raised total funds to the amount of €4.8 billion from foreign corporate bond markets, thus offsetting to a large extent the decline in bank lending to non-financial corporations by €6.1 billion in the same period.

- Business investment is expected to increase, which is partly due to co-financed schemes under the EU structural funds, and lending from the EIB to SMEs. In the current conjuncture, attention should be paid to the evaluation of funded investment projects, with the aim of gearing resources to the most dynamic sectors, which would lead the economy to a sustainable production model in the long run.

- Employment is expected to increase and unemployment should begin to decline in 2014. A stabilisation of employment is already observed in the January-February 2014 period, while the first four months of 2014 saw positive salaried employment flows in the private sector. However, the level of unemployment —particularly of long-term and youth unemployment— remains exceptionally high and is expected to decelerate only gradually, given the current labour force underutilisation rate.

- Inflation should remain negative in 2014, as a result of lower labour costs, the effects of lower domestic demand, the drop in international oil prices in euro, the impact of reforms in product markets (opening-up of closed professions), and the waning effects of indirect taxation. In the medium term, however, prices should stabilise, as economic recovery should accelerate in 2015.

1.1 ECONOMIC ACTIVITY: DEVELOPMENTS AND PROSPECTS

Developments on the demand side

In 2013, GDP fell at an annual rate of 3.9%. The decline in GDP was particularly driven by falling private consumption and, to a lesser degree, lower investment, while exports of goods and services had a positive contribution to the change in GDP (see Table III.1). Compared with 2012, the negative contribution of both private consumption and public consumption and investment stood at lower levels, while the positive contribution of the external sector fell, due to the slower decline in imports.

The decrease in public consumption continued in 2013, owing to the decline in households' disposable income, though at slower rates than in 2012 (see Table III.1). Specifically, according to quarterly non-financial accounts of institutional sectors published by ELSTAT, from January to September 2013, gross disposable income of households and non-profit institutions serving households (NPISHs) fell by 8.1% against the respective period of 2012. As a result, households continue to spend wealth accumulated in past years and their saving remains strongly negative (see Chart III.2).

Given that incomes are not expected to increase, private consumption is estimated to decline also in 2014, although at a clearly slower rate than in 2013. Encouraging signs for a further deceleration in the rate of decline of consumption are the gradual improvement in consumer confidence, the sta-

1 For an analysis of investment and alternative sources of financing see also: Bank of Greece, *Monetary Policy – Interim Report*, December 2013, p. 57-64. This analysis projected that restoring confidence in the economy should improve the access of companies to capital market-based financing (p. 63-64).

Table III.1 Demand and GDP

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

	2009	2010	2011	2012	2013
Private consumption	-1.6 (-1.2)	-6.2 (-4.4)	-7.7 (-5.6)	-9.3 (-6.7)	-6.0 (-4.2)
Public consumption	4.9 (0.9)	-8.7 (-1.7)	-5.2 (-1.0)	-6.9 (-1.3)	-4.1 (-0.8)
Gross fixed capital formation	-13.7 (-3.2)	-15.0 (-3.0)	-19.6 (-3.6)	-19.2 (-3.0)	-12.8 (-1.8)
Residential investment	*-20.7* *(-1.7)*	*-21.6* *(-1.5)*	*-18.0* *(-1.0)*	*-32.9* *(-1.6)*	*-37.8* *(-1.3)*
Final domestic demand[1]	-3.0 (-3.5)	-8.3 (-9.1)	-9.3 (-10.2)	-10.4 (-11.1)	-6.6 (-6.8)
Inventories and statistical discrepancy (% of GDP)	-1.8	-0.3	0.4	0.7	1.6
Domestic demand	-5.4 (-6.2)	-7.1 (-7.8)	-8.7 (-9.5)	-10.1 (-10.8)	-5.7 (-5.9)
Exports of goods and services	-19.4 (-4.7)	5.2 (1.0)	0.3 (0.1)	-1.7 (-0.4)	1.8 (0.4)
Imports of goods and services	-20.2 (7.7)	-6.2 (1.9)	-7.3 (2.3)	-13.8 (4.2)	-5.3 (1.6)
External demand	... (3.1)	... (2.9)	... (2.4)	... (3.8)	... (2.0)
Gross domestic product at market prices	-3.1	-4.9	-7.1	-7.0	-3.9

Source: ELSTAT, National Accounts, March 2014.
Note: Contributions (in percentage points) are given in parentheses.
1 Excluding inventories and statistical discrepancy.

bilising volume of retail sales and VAT revenue, as well as the increase in the number of new private passenger car registrations (see Table III.2). It should also be noted that private consumption stabilised in the fourth quarter of 2013 compared with the respective quarter of 2012. At the same time, while consumer credit is not expected to rise, an improvement in retail trade confidence is observed (see Chart III.3).

In 2013, gross fixed capital formation fell by 12.8% against 2012, as businesses were still hesitant to invest on new capital equipment, while bank credit also remained hard to get.[2] More pronounced was the deceleration in construction investment (-17.9%) compared with investment in machinery and equipment (-7.4%). Residential construction investment fell substantially; as a result, its contribution to total investment expenditure in the economy fell to 18.3%, from 47.1% in 2007. By contrast, investment in other construction followed an upward course (+3.2%, from -7.9% in 2012), also thanks to the preparatory phase of four major motorway projects.

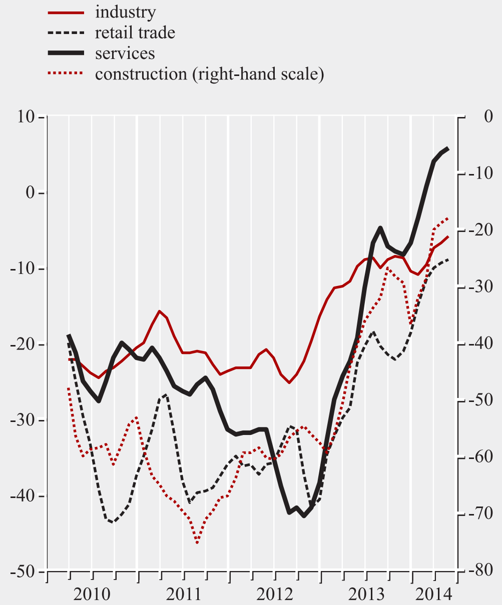
Investment demand —mostly for machinery and transport equipment— is expected to recover in 2014, as firms' planning presumes an exit from the crisis. As reflected in relevant indicators, domestic business climate[3] continued to improve in the first months of 2014, and businesses are looking to invest on new capital equipment, in order to maintain their position in the market, while at the same time seeking —if possible— alternative sources of funding through corporate bonds in international capital markets. The positive outlook is also confirmed by increased budgets for investment projects to come under the development law, in the first round for 2014 (+372% compared with the second round for 2013), the encouraging results of the 2014 European Commission-IOBE investment survey (which shows a substantial increase in positive projections against the previous survey), and the steady

2 The change in net lending flows to non-financial enterprises reached -5%, from -3.3% in 2012.
3 The economic sentiment indicator for Greece, compiled by the European Commission, improved significantly during 2013 (90.9, against 80.3 in 2012) and recorded the highest level in the past 67 months in March this year (97.5).

Chart III.2 Household and corporate saving as a percentage of GDP[1] (Q1 2001-Q3 2013)

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

Chart III.3 Confidence indicator[1] in individual sectors (March 2010 - May 2014)



Source: Foundation for Economic and Industrial Research (IOBE)/European Commission, Business and Consumer Survey Results.
1 Three-month moving average.

rise in industrial capacity utilisation, according to the relevant IOBE indicator which, however, remains well below its average during upturns. At the same time, the financial status of businesses gradually recovers, which is estimated to facilitate the financing of long-term investment plans.[4]

A critical element for supporting investment climate in Greece is the course of the privatisation programme. The completion of the tender process for the former Hellinikon international airport is already considered as a positive signal for a long-term commitment of domestic and foreign funds in the Greek economy. The plans of the Hellenic Republic Asset Development Fund (HRADF), apart from tender processes already under way (Piraeus Port Authority (OLP), a first cluster of four tourist marinas, regional airports, the train operating company (TRAINOSE S.A. – ROSCO S.A., etc.), also include initiating procedures for the next round of privatisations (Thessaloniki Port Authority, Athens International Airport, Egnatia Odos S.A., Independent Power Transmission Operator (ADMIE)), as well as the securitisation of future revenue from privatisation of public property (fourth quarter of 2014). However, it is estimated that the extensive legal and financial planning of the past few years, combined with recent changes in the operation of the HRADF, should help accelerate privatisation in the following years. The improvement in investment climate is also supported by strategies to turn Greece into a regional distribution centre from Asia to Europe (multinational companies HP, ZTE, Huawei, Sony, P&G expressed an interest in the ports of Piraeus and Thessaloniki) and to reinforce the productive and export capacity of the country (cooperation in pharmaceuticals and the tobacco industry).

Greece's investment prospects are also supported by:

4 It should be noted that a balance sheet analysis of 1,210 large firms in the ICAP sample for 2013 shows a small decline of 5.2% in losses against 2012. However, if the two largest loss-making firms are excluded, results turn positive, showing profits of €36.1 million.

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

(annual percentage changes)[1]

	2009	2010	2011	2012	2013	2014 (available period)
Volume of retail trade (total)	-11.4	-6.2	-10.2	-12.2	-8.1	-0.1 (Jan.-March)
Volume of retail trade (excluding fuel and lubricants)	-9.3	-6.9	-8.7	-11.8	-8.4	-3.0 (Jan.-March)
Food-beverages-tobacco[2]	-6.1	-5.5	-6.0	-9.0	-9.1	-0.4 (Jan.-March)
Clothing-footwear	1.4	-11.4	-18.8	-20.6	-2.2	2.5 (Jan.-March)
Furniture-electrical appliances-household equipment	-15.3	-12.7	-15.7	-16.3	-6.2	-3.3 (Jan.-March)
Books-stationery-other	-24.0	-4.3	-5.2	-12.1	-0.1	7.4 (Jan.-March)
Revenue from VAT (at constant prices)	-10.2	0.1	-5.9	-12.8	-6.6	-0.4 (Jan.-Apr.)
Retail trade confidence indicator	-21.4	-26.4	-0.5	-3.1	22.9	22.9 (Jan.-May)
Consumer confidence indicator	-46	-63	-74	-75	-69	-52.5 (May)
New private passenger car registrations	-17.4	-37.2	-29.8	-41.7	3.1	18.4 (Jan.-Apr.)
Tax revenue from mobile telephony[3]	13.2	37.1	-16.8	-7.9	-12.8	-0.9 (Jan.-Apr.)
Outstanding balance of consumer credit[4]	1.8 (Dec.)	-4.2 (Dec.)	-6.4 (Dec.)	-5.1 (Dec.)	-3.9 (Dec.)	-2.9 (Apr.)

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

Table III.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	-9.7	-16.4	-12.2	16.5 (Jan.-March)
Capacity utilisation rate in the capital goods industry	73.4	66.1	62.7	58.2	61.4	65.2 (Jan.-May)
Bank credit to domestic enterprises[2]	5.1 (Dec.)	1.1 (Dec.)	-2.0 (Dec.)	-4.4 (Dec.)	-4.9 (Dec.)	-5.3 (March)
Disbursements under the Public Investment Programme[3]	-2.8	-11.3	...	-10.5	14.5	67.3 (Jan.-Apr.)
Production index in construction (at constant prices)	-17.5	-29.2	-28.1	-26.1	-4.1	...
Volume of private construction activity (on the basis of permits issued)	-26.5	-23.3	-37.7	-30.6	-25.6	-25.8 (Jan.-Feb.)
Cement production	-21.4	-14.3	-37.8	-12.8	3.4	-2.3 (Jan-March)
Construction confidence indicator	-31.4	-27.4	-27.8	26.1	50.6	49.7 (Jan.-May)
Outstanding balance of total bank credit to housing[4]	3.7 (Dec.)	-0.3 (Dec.)	-2.9 (Dec.)	-3.4 (Dec.)	-3.3 (Dec.)	-3.3 (Apr.)

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

Table III.4 Gross value added at basic prices (2009-2013)

(annual percentage changes and sectoral contributions, at constant prices of 2005)

	2009	2010	2011	2012	2013
Agriculture, forestry and fishing	5.2 (0.2)	5.5 (0.2)	-5.4 (-0.2)	-0.8 (0.0)	0.1 (0.0)
Secondary sector	-8.5 (-1.5)	-9.9 (-1.7)	-12.6 (-2)	-8.4 (-1.3)	-6.4 (-0.9)
Industry including energy	2.0 (0.2)	0.9 (0.1)	-7.4 (-0.9)	-5.3 (-0.6)	-3.9 (-0.5)
Construction	-24.6 (-1.8)	-32.3 (-1.8)	-28.4 (-1.1)	-20.7 (-0.6)	-18.2 (-0.5)
Tertiary sector	-1.2 (-1.0)	-4.9 (-3.7)	-5.7 (-4.6)	-7.1 (-5.7)	-3.5 (-2.8)
Trade, hotels and restaurants, transport and communications	-9.2 (-2.5)	-3.8 (-0.9)	-10.9 (-2.8)	-14.2 (-3.4)	-6.8 (-1.5)
Information and communication	7.6 (0.4)	-10.3 (-0.6)	-8.1 (-0.4)	-7.2 (-0.4)	-8.9 (-0.5)
Financial and insurance activities	-2.5 (-0.1)	-1.0 (-0.1)	-8.0 (-0.5)	-8.3 (-0.5)	-6.1 (-0.3)
Real estate activities	2.3 (0.3)	-8.1 (-1.1)	2.4 (0.3)	0.6 (0.1)	0.3 (0.1)
Professional, scientific and technical activities	7.4 (0.4)	-14.1 (-0.9)	-18.1 (-1.0)	-6.5 (-0.3)	-9.0 (-0.5)
Public administration and defence	1.1 (0.2)	-1.5 (-0.3)	-0.8 (-0.2)	-3.4 (-0.7)	-0.3 (-0.1)
Arts, entertainment and recreation	8.8 (0.3)	-0.7 (0)	-0.2 (0)	-10.7 (-0.5)	-1.2 (-0.1)
Gross value added at basic prices	-2.2	-5.2	-6.6	-7.0	-3.7

Source: ELSTAT, Quarterly National Accounts, March 2014, non-seasonally adjusted data.
Note: Contributions (in percentage points) are given in parentheses.

– the creation of the Hellenic Investment Fund, with the participation of the EIB, the German investment bank KfW and other institutional investors, which is expected to have a positive effect on attracting foreign funds and supporting SMEs' liquidity;

– the reset of four major motorway projects (Olympia Odos, E65, Ionia Odos, Aegean Motorway);

– support to actions, such as 23 PPP projects under way, with a budget of €2.8 billion.

Investment activity in residential construction is expected to decline further, as developments in construction volume on the basis of permits issued remain strongly negative, and credit to housing is exceptionally low (see Table III.3). By contrast, public investment is expected to recover, given that the Public Investment Programme is projected to increase slightly against 2013 (€6.80 billion, against €6.65 billion in 2013), and disbursement until now has been quite satisfactory compared with 2013.

Lower decline in consumption and investment compared with 2012 resulted in a deceleration in the rate of decrease in **imports of goods and services** (-5.3% in 2013) on a national accounts basis. Exports of goods, after an increase of 2.0% in 2012, rose by 2.7% in 2013 (EU-17: 1.1%). Exports of services, after dropping for two consecutive years (mostly due to lower receipts from shipping), rose in 2013 (0.8%), also due to the upward course of demand for tourist services from abroad. Together, **exports of goods and services**, on a national accounts basis and at constant prices, rose by 1.8% in 2013 (EU-17: 1.3%), against a decline of 1.7% in 2012.

Developments on the supply side

In 2013, **gross value added** (at basic prices) in the domestic economy fell by 3.7% (see Table

Table III.5 Indicators of industrial activity (2009-2014)

(annual percentage changes)[1]

	2009	2010	2011	2012	2013	2014 (available period)
1. Industrial production index (overall)	**-9.4**	**-5.9**	**-7.8**	**-3.4**	**-3.6**	**0.3 (Jan.-March)**
Manufacturing	-11.2	-5.1	-8.5	-4.2	-2.0	0.9 (Jan.-March)
Mining-quarrying	-11.8	-6.5	0.6	0.7	-9.8	0.4 (Jan.-March)
Electricity	-4.2	-9.2	-8.8	-3.0	-6.9	-1.3 (Jan.-March)
Main industrial groupings						
Energy	-2.9	-4.9	-8.4	5.3	-4.0	-2.4 (Jan.-March)
Indermediate goods	-18.4	-0.9	-8.8	-10.6	-3.1	3.8 (Jan.-March)
Capital goods	-22.5	-22.1	-9.7	-16.4	-12.2	-16.5 (Jan.-March)
Consumer durables	-20.7	-13.4	-15.6	-18.4	-14.6	-9.4 (Jan.-March)
Consumer non-durables	-4.1	-7.2	-4.8	-6.0	-1.4	-0.2 (Jan.-March)
2. Industrial turnover index[2]	**-23.2**	**6.0**	**7.1**	**3.0**	**-6.4**	**-1.7 (Jan.-March)**
Domestic market	-22.2	-0.7	-2.3	-6.4	-10.7	-3.8 (Jan.-March)
External market	-25.6	29.3	21.6	20.2	-0.7	0.7 (Jan.-March)
3. Industrial confidence indicator	**-21.5**	**5.1**	**1.4**	**0.4**	**13.7**	**4.3 (Jan.-May)**
4. Capacity utilisation in industry	**70.5**	**68.5**	**67.6**	**64.4**	**65.9**	**67.1 (Jan.-May)**
5. Manufacturing Purchasing Managers' Index (PMI)[3]	**45.3**	**43.8**	**43.6**	**41.2**	**46.0**	**51.0 (May)**

Sources: ELSTAT (industrial production index. industrial turnover and new orders), IOBE (expectations, industrial capacity utilisation rate), Markit Economics and Hellenic Purchasing Institute (PMI).
1 Excluding capacity utilisation in industry and the PMI in manufacturing, which are mentioned in terms of indices.
2 The index refers to the sales of industrial goods and services in value terms.
3 Seasonally adjusted index; values above 50 indicate expansion.

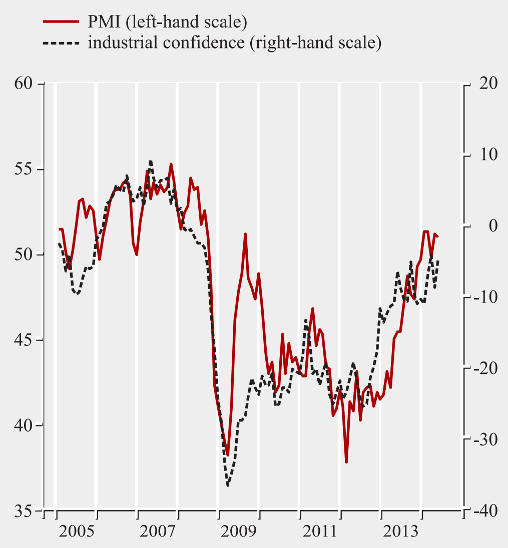
III.4). Specifically, value added decreased by 3.5% in the tertiary sector, 3.9% in industry, and 18.2% in construction, and recorded a marginal increase of 0.1% in the primary sector.

The decline in value added in industry was mostly due to lower electricity and mining/quarrying production, while the decrease in manufacturing production decelerated, as higher foreign demand partly offset the fall in domestic demand. Lower production in many sectors was partly offset by the increase in the output of pharmaceutical and oil refining companies, while other manufacturing sectors returned to positive territory, as against 2012, when one sector only had recorded growth. The gradual deceleration in the fall of manufacturing activity during 2013 was also reflected in the rising levels of the PMI (an average of 46, against 41.2 in 2012 – see Chart III.4).

In the first quarter of 2014, industrial production increased (+0.3%), despite the decline in electricity production (-1.3%) (see Chart III.5). This is mostly due to manufacturing (+0.9%), as 12 out of a total of 24 manufacturing sectors registered growth. Within the first five months of 2014, the Purchasing Managers' Index (PMI) registered four above-50-values (signalling a recovery in manufacturing) while, at the same time, showing an increase in output and new orders for seven consecutive months. The industrial confidence indicator, as recorded by the IOBE for the first five months of 2014, improved, while industrial sales in the external market followed a slightly upward course in the first quarter (+0.7%, against -0.7% for 2013 as a whole, see Chart III.4 and Table III.5).

Business expectations in **construction** in January-May 2014 are improving against 2013 (see

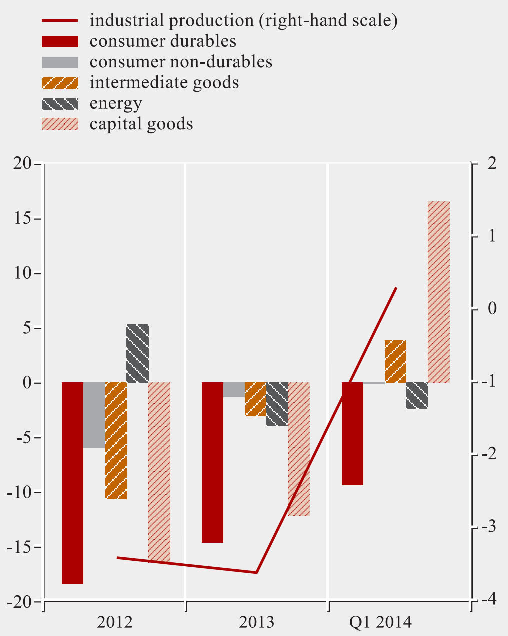
Chart III.4 Purchasing Managers' Index[1] (PMI) and industrial confidence (January 2005-May 2014)[2]



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

Chart III.5 Industrial production

(annual percentage changes of index, 2005=100)



Source: ELSTAT.

Table III.3). While the outlook for this industry is supported by the fact that infrastructure projects are under way, the continued decline in residential construction has an adverse effect on economic activity directly or indirectly associated with construction. However, the necessary liquidity to implement infrastructure projects seems to be secured, among other things through support from the European Investment Bank (EIB) and the effective utilisation of the National Strategic Reference Framework (NSRF) (it is estimated that from December 2013 until now, the four major motorway projects absorbed around €900 million).

The decline in the value added of **services** by an annual rate of 3.5% in 2013 contributed by 2.8 percentage points to the change in total gross value added in the same year (see Table III.6). The only —marginal— increase was recorded in the real estate activities sector, while declines were registered for professional, scientific and technical activities, information and communication, trade, hotel-restaurants and transport-communications, financial and insurance activities, as well as arts, entertainment and recreation.

The turnover in retail sales (including fuel) fell by 8.6% in 2013, due to weak domestic demand. However, in the first quarter of 2014 it fell by only 2.7% year-on-year, as price decreases in many categories of goods, and companies' discount policies, support retail sales. The gradual improvement in retail trade confidence, as recorded since the second half of 2013, reflects weaker negative pressures on retail trade businesses and, probably, the positive effects from structural reforms in this sector in the past few years.[5]

An exception to the downward course of services, according to data on services turnover at

5 Illustrative examples include the recent adoption of Law 4254/2014 "Measures for the support and development of the Greek economy, in the context of the implementation of Law 4046/2012 and other provisions", Government Gazette 85A/07 April 2014 (sub-paragraphs F.1-F.5) and Law 4177/2013 "Regulations on the marketing of products and the supply of services and other provisions", Government Gazette 173A/08 August 2013 (p. 2693-2711).

Table III.6 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	-12.2	-11.5	---
Retail trade	-10.2	-1.2	-7.2	-11.0	-8.6	-2.7 (Jan.-Mar.)
Motor trade	-15.7	-36.5	-26.5	-29.3	-2.8	---
2. Transport						
Land transport	-31.5	-18.1	-1.7	-3.3	-4.3	---
Sea transport	-22.8	-8.5	-2.7	-15.3	-7.4	---
Air transport	-11.7	-7.0	-0.9	-1.1	14.3	---
Storage and supporting transport activities	-32.2	-10.8	-7.9	-4.8	-7.0	---
3. Hotels and restaurants						
Accommodation and food service activities	-9.1	-8.2	-7.4	-17.2	4.8	---
4. Information and communication						
Telecommunications	-8.9	-11.3	-8.9	-5.1	-11.6	---
Film, video and TV programme production, recordings and music products	1.4	-6.6	-28.4	-4.9	-5.1	---
Programming and broadcasting activities	-6.7	-2.1	-27.1	-16.3	-7.9	---
5. Professional-scientific-technical activities						
Legal, accounting and management consulting services	-12.4	-7.3	-0.3	4.5	0.8	---
Architectural and engineering services	-18.6	-20.4	-19.6	-12.3	-13.6	---
Advertising and market research	-18.4	-23.8	-21.2	-16.7	-20.9	---
Travel agencies and related activities	-9.9	-24.5	-35.3	-26.9	13.1	---
B. Passenger traffic						
Athens International Airport	-1.5	-5.0	-6.3	-10.4	-3.2	14.3 (Jan.-Apr.)
Aegean Airlines[1]	9.9	-5.1	4.2	-5.8	44.6	12.2 (Jan.-Mar.)
Piraeus Port (OLP)	-3.8	-6.0	-0.8	-17.5	1.0	---
C. Services confidence indicator	-28.3	-9.3	-2.9	-11.2	28.4	29.0 (Jan.-May)

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

current prices (see Table III.6), were travel agencies, hotels and restaurants, and air transport, which rose by 13.1%, 4.8% and 14.3%, respectively, mostly due to a successful and prolonged tourist season.[6] By contrast, a contraction is seen in the turnover of advertising and market survey, architectural and engineering services, telecommunications and wholesale trade.

The IOBE services confidence indicator (excluding retail trade and banking) followed an upward course in January-May 2014, rising by 29.0% against 2013. Tourist enterprises appear particularly optimistic, while a signifi-

6 Due to the extension of the tourist period beyond September, turnover in these sectors was strengthened substantially in the fourth quarter of 2013, rising by 41.3% and 35.9% year-on-year.

cant increase was seen in tourist arrivals and tourist receipts in the first quarter of 2014.

Growth prospects for 2014-2015 are expected to be supported by the reform dynamics of the past four years. Recent reform initiatives include measures to improve business environment by further reducing the start-up costs for businesses and simplifying bureaucratic procedures (e.g. activity commencement by simple notification to competent authorities and replacement of audits by said authorities with corporate responsibility, abolishment of the obligation to submit document originals or certified copies), as well as lifting restrictions on licensing and operation of firms (e.g. licensing to industrial units in Attica, use of a private-use truck). Certain new arrangements aim at opening up specific professions (e.g. actuaries) and, drawing on the conclusions of the OECD toolkit on competition assessment, deregulate economic activities in the supply chain (e.g. dairy production), retail sales (e.g. bread, pharmaceuticals, fuel, books), industry (e.g. building materials), and construction and transport in tourism. It is worth noting that further actions are under way to rationalise public expenditure and improve the quality of public services, such as merging or closing down public sector entities, starting the civil servants performance evaluation process, and restricting (where necessary) joint competence of different public entities.

1.2 DEVELOPMENTS AND PROSPECTS IN THE REAL ESTATE MARKET

2013 witnessed persisting pressures on commercial values, prices and rents of both residential and commercial properties. The main characteristics of the real estate market were weak demand and excess supply, which can be attributed to high unemployment and a further contraction in households' disposable income, real estate tax hikes, as well as liquidity shortage against the backdrop of banks' tightened credit standards. However, some first signs of stabilisation in the real estate market are being observed since late 2013, while an increased interest is currently visible, particularly in income properties, as a result of improving economic climate and expectations.

In the **housing market**, the drop in prices continued at a strong, though gradually easing, pace throughout 2013. More specifically, data collected from credit institutions show an average annual rate of decline of 10.3% in apartment prices in 2013, against -11.7% in 2012, while between the last quarter of 2012, when the highest rate of decline in prices was recorded (-12.8%, year-on-year), and the first quarter of 2014 (-7.5% – latest available data), a clear and gradual moderation in the decline of prices was observed. Yet, on a cumulative basis between 2008 (average level) and the first quarter of 2014, apartment prices fell by 34.4% according to data collected from credit institutions, whereas data collected from real estate agencies point to an even sharper decline. The fall in prices was stronger in the two major urban centres (Athens: -37.6% and Thessaloniki: -37.8%), compared with other cities (-31.1%) and other areas (-29.6%), as well as larger properties in relatively higher-value areas in Greece.

The shift of households' purchasing interest towards smaller, older and more affordable properties in medium-value areas, which has been observed since the onset of the current crisis, continued into 2013 and the first months of 2014. According to data from the quarterly survey of real estate agencies and property advisors conducted by the Bank of Greece, a mere 17% of transactions was financed by banks, while the average loan-to-value ratio came to roughly 35%.[7]

7 In early 2009, 82% of transactions were financed by banks, whereas the average loan-to-value ratio stood at 70%. The time required to market more than doubled during the crisis (from about five months in early 2009 to almost a year in 2013), while the average difference between initially asked and final purchase prices rose significantly (from 12.6% to 20.7%). See the results of the quarterly survey of real estate agencies and property advisors, available at the Bank of Greece's website: http://www.bankofgreece.gr/Pages/el/Statistics/realestate/publications.aspx.

The downward trend of house prices is likely to persist in the following quarters, but at a relatively weaker pace, as the high rates of decline in prices that were registered in 2012 have eased since. The housing market is expected to recover with a relative time lag, largely depending on a steady increase in households' disposable income, a rise in employment, as well as an improvement in bank financing conditions.

The **commercial real estate market** recorded a dramatic decline over the past few years, with significant pressures to renegotiate and reduce rents, especially for secondary retail properties, warehouses and non-prime office buildings. Both rent and market prices contracted further in 2013, at an average annual rate of 16.3% and 16.9%, respectively (according to data from the survey of real estate agencies), while prime office and retail yields ranged between 8.5% and 9.0%. Taxes levied on real estate property over the past few years, which were often based on administrative, not actual market values, made the recession in the real estate market more pronounced and considerably discouraged demand.[8] Recent legislation on real estate taxation has limited the uncertainty of the tax regime on real estate property, while the significantly lowered Property Transfer Tax (down to 3%) is expected to help boost the particularly low frequency of transactions in the Greek real estate market. However, the implementation of a capital gains tax on real estate transfers (Law 4172/2013) since early 2014 has led to stagnation in the Greek real estate market, due to considerable uncertainty regarding the modalities of the capital gains tax on real estate. The latest amending provisions (Law 4254/2014) helped eliminate uncertainty and address such issues, but the delayed issuance of the relevant regulatory decisions and acts which are envisaged under the new law resulted in the continuation of stagnancy at least during the first quarter of 2014.

Despite a sharp decline in the market, a number of major transactions on prime properties were completed in the course of 2013, which are estimated to account for over a €1 billion investment in the Greek commercial real estate market. Greek Real Estate Investment Companies (REICs) have also been active, as the new institutional framework on REICs (Law 4141/2013) introduced significant improvements, provided new incentives and allowed for greater flexibility in the composition of their portfolios. The recent significant participation of foreign funds in the share capital of Ethniki Pangaea and of Eurobank Properties ensures additional sizeable liquidity in the sector, which is expected to translate into new investment in the course of 2014.

From the beginning of this year, a considerable improvement in investment climate and expectations has been observed, with investment interest mainly focusing on income properties. In terms of investment interest, the most dynamic sectors appear to be that of tourist properties-hotel units, as well as that of prime office buildings and retail properties, while an increasing shift of investment interest towards prime large warehouses is recorded.[9] Nevertheless, it should be noted that, despite the observed interest, the current stock of commercial properties fails to meet the desirable investment criteria to a great extent, while the finalisation of transactions is often hindered by legal issues and weaknesses in the existing institutional framework (land use, urban planning regulations, etc.), by red tape and multiple ownership, as well as by the unrealistic prices asked by individual owners (as a result of the very high initial acquisition prices of their properties). Red tape in the Greek real estate market, along with ambiguous urban planning regulations and multiple violations thereof, the lack of a stable and clear framework on regional planning and land use, as well

8 In fact, the distortion caused by the existence of real estate administrative values, which in certain cases (e.g. large properties in "expensive" areas, depreciated central Athens neighbourhoods, etc.) significantly exceed property market values, leads to an artificially excessive taxation of real estate property.

9 In recent months, investors' interest stems mainly from foreign funds, especially US and European funds, while increasing interest is observed from Middle East countries and China.

as of a complete and accurate cadastre, are some additional factors that discourage demand, often prevent the conclusion of investment agreements and hinder the development of public properties.

Prime commercial property prices are expected to stabilise in 2014, while prospects for high-end tourist properties are even more favourable, as a result of a projected substantial growth in tourism. Turning to non-prime commercial properties, prices are expected to drop further in the following quarters, while the real estate market as a whole is projected to start recovering gradually in 2015, provided that the present trend is not reversed by exogenous factors (political factors, international conjuncture, etc.). Over the medium term, a gradual development of a new stock of prime commercial properties is expected, as current supply fails to meet the standards of emerging demand. In any event, to the extent that uncertainty is easing further and the recovery prospects of the Greek economy are improving, while at the same time individual legal issues associated with the Greek state are effectively addressed and the economic climate ameliorates, it is estimated that —given the emerging investment interest— the sharp downward trend that was observed during the current crisis is likely to be reversed and some signs of stabilisation and gradual recovery in the Greek economy may become visible.

As regards **public real estate development**, the implementation of the relevant programme in 2013 continued at a slow pace and revenues remained low. The most prominent among property privatisations in progress concerns the recent agreement on the exploitation and development of the land in Astir Vouliagmenis, which is expected to bring high added value in the years ahead. In March 2014 the so far most important agreement was concluded, namely the development of the former Hellinikon International Airport property, covering a total area of 624 hectares, at a final bid of €915 million —settled over a ten-year period— for the acquisition of 100% of shares in Hellinikon S.A., while the level of the total investment is estimated at about €6 billion. The swift completion of individual procedures for the development of public real estate assets already in progress (regional airports and ports, securitisation of a package of public properties, etc.) is particularly important, as relevant agreements are expected to attract further foreign funds and stimulate investment in the domestic real estate market, as well as to support job creation in the Greek economy.

2 EMPLOYMENT AND UNEMPLOYMENT: DEVELOPMENTS AND PROSPECTS

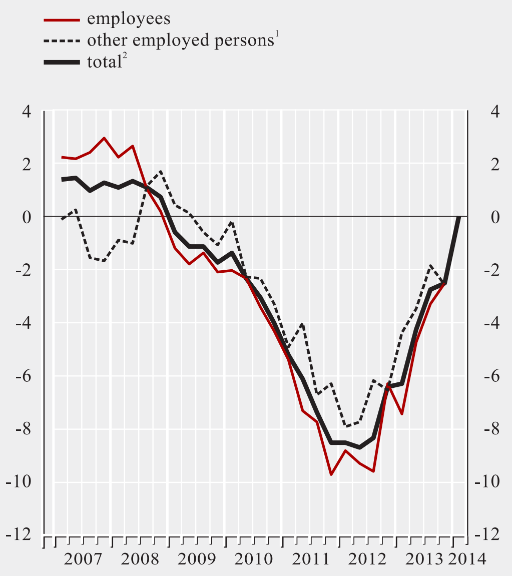
After a dramatic decline in employment in the previous two years (-8.0% in 2012 and -6.8% in 2011), 2013 saw a substantial deceleration in this rate of decline (-4%), halting the strongly negative developments in employment observed from 2009 onwards. Similar developments were seen in the employment of employees and the self-employed, mostly those with personnel (see Chart III.6).

The stabilising trend of employment was strengthened in 2013, which is reflected in the increased probability of remaining in employment for two consecutive years, particularly in the second half of 2013 (see Chart III.7). Data from the monthly labour force survey for January-February 2014 show that employment keeps improving (employment remained unchanged on an annual non-seasonally adjusted basis, against -6.7% in January-February 2013, see Chart III.6).

The decline in the rate of job losses is also reflected in employment developments by sector. In the private sector, construction, manufacturing and trade were still the industries hit the hardest by the crisis in 2013, declining by 54%, 34% and 20%, respectively, against 2009; however, the rates of decline in employment fell substantially, particularly in the last two. A significant decline was also recorded in separations from the broader public sector.

Chart III.6 Employment (2007-Q1 2014)

(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.
2 Data for Q1 2014 from the monthly LFS (January-February, not seasonally adjusted).

Chart III.7 Probability[1] of remaining in employment/unemployment for two consecutive years

Source: ELSTAT, Labour Force Surveys.
1 Probabilities calculated based on responses to questions no. 75 and 91 of the Labour Force Survey.

The gradual stabilisation of employment is considered to be associated with a substantial decline in labour costs for businesses, mostly since 2012, due to arrangements that reduced minimum wages and favoured decentralisation of wage bargaining. The accelerated restructuring of employment towards more flexible forms of employment in the past two years has had a stabilising effect, after institutional restrictions on the labour market were lifted. Specifically, the increase in part-time employment (8.4% of the total in 2013, from 6% in 2009) helped contain the decline in employment, and limited the use of fixed-term contracts. Companies continued to pursue flexible employment forms when recruiting in January-April 2014.[10]

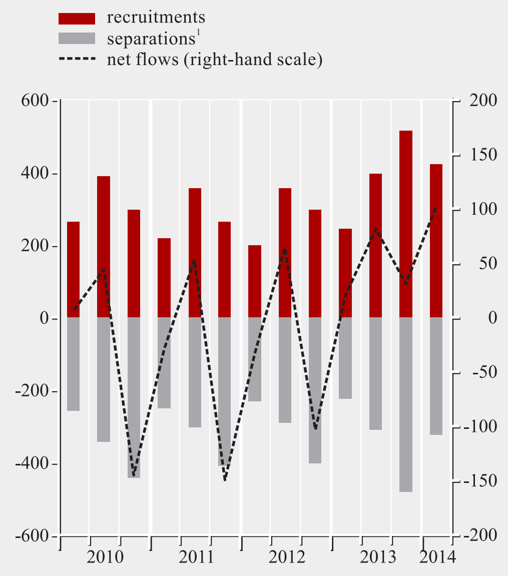
Data on salaried employment flows in the private sector supports the positive image of employment developments. It should be noted that, after a continued negative balance of hires and separations in the 2007-2012 period, in 2013 hires of employees in the private sector exceeded separations by 133 thousand. Specifically, from May-August 2013 to January-April 2014 (when the hires/separations balance stood at 101 thousand), four-month period net flows improved year-on-year (Chart III.8). The improvement mainly reflects increased hires. A recent indication (April 2014) that the recovery of hires is not solely associated with seasonal activities is the increase in employment in manufacturing, for the first time since October 2007, as reflected in the employment sub-index of the Purchasing Managers' Index (PMI, Markit).

A continuously positive balance of salaried employment flows in the private sector is also

10 45% of new hirings are under non-full time employment contracts. See Ministry of Labour monthly press releases on results from the information system ERGANI.

Chart III.8 Salaried employment flows in the private sector

(thousand persons, quarterly)



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

important for supporting the viability of the social security system. Characteristically, the recovery of hiring after the second quarter of 2013, combined with intensified controls for uninsured labour and the increase in relevant fines, led to a rise in the monthly revenue of the Social Insurance Institute (IKA) in January 2014, for the first time since 2009.

Firms' short-term prospects for employment, as reflected in IOBE/European Commission business surveys for the five-month period of January-May 2014 (seasonally adjusted data), improved substantially in all sectors compared with the respective period of 2013 (and against the 2013 average). Indeed, the January-May period registered continuously positive employment expectations in construction and retail trade, and also in the services sector after March. As expectations of a particularly favourable tourist period in 2014 are verified, it is expected that positive employment expectations will receive a boost and new hires will increase.

According to both labour force survey and Manpower Employment Organisation (OAED) data, the deceleration in the rate of decline in employment is also accompanied by a weakening in the rate of increase of the unemployed in 2013, and a marginal drop in the unemployment rate in the first two months of 2014. Despite positive developments, unemployment started dropping from a very high level, since the loss of another 150 thousand jobs in 2013 led to an equal increase in the number of the unemployed; as a result, the unemployment rate rose to 27.3%, from 24.3% in 2012, and the long-term unemployment rate increased to 18.8%, from 14.8%, of the labour force (see Chart III.9).

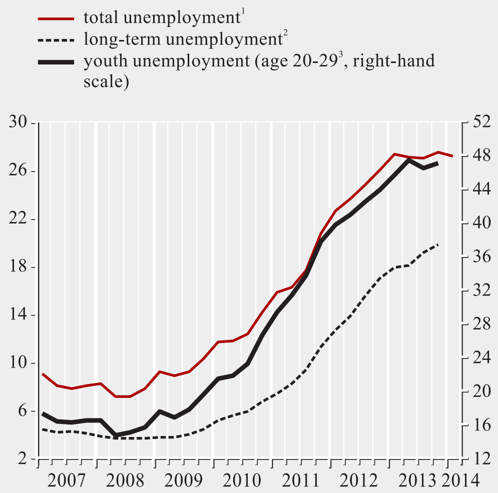
The youth unemployment rate (of persons aged 20-29 years) also fell (see Chart III.9), as did the unemployment rate of persons not in education or training (see Chart III.10). However, the level of unemployment and the percentage of youth not in employment or education remains extremely high compared with the situation before the crisis and against respective figures for other EU countries (see e.g. *EU Employment and Social Situation Quarterly Review*, March 2014). Nevertheless, it should be noted that most young persons in this age group remain economically active (labour participation of 70.5% in 2013).

As regards the geographical breakdown of unemployment, unemployment rates almost tripled in 2013 compared with 2009 both in urban and semi-urban areas and in agricultural areas, with agricultural areas being slightly less affected. A detailed presentation by region shows that in 2013 the highest unemployment rate was recorded in West Macedonia (32%), while the Ionian Islands and the Aegean Islands registered the lowest rates (18% and 21%, respectively), which however exceeded the respective averages for the 2010-2013 period.

Although production and employment are projected to return to positive rates of change in 2014 (projected annual growth rate of 0.6% for both figures, see European Commission

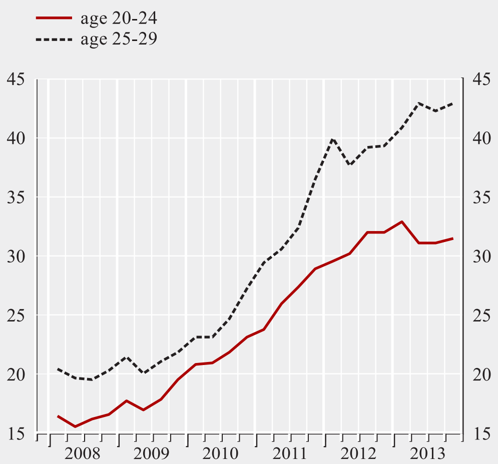
Chart III.9 Unemployment rates (2007 - Q1 2014)

(percentage of labour force)



Source: ELSTAT, Labour Force Surveys.
1 Data for Q1 2014 from the monthly LFS (January-February, not seasonally adjusted).
2 Defined as having been unemployed for over 12 months.
3 As a percentage of the labour force of the respective age group.

Chart III.10 Persons not in education, employment or training as a percentage of population of the respective age group



Source: ELSTAT, Labour Force Surveys.

forecast, Spring 2014), the absorption of the unemployed should be a slow process, given the current degree of underemployment, which according to Eurostat and ELSTAT is calculated at around 4.4%, while potential labour force reaches almost 3%.[11] The Manpower Employment Organisation (OAED) expanded active employment programmes under way for the period 2014-2015 should support faster absorption of the unemployed and should contribute to a quicker recovery in the employment rate (which fell to 53.2% in 2013 for persons aged 20-64, from 65.8% in 2009, and against a national target of 70% for 2020). Additional support to these programmes could come from expanding activities and revising the operational framework of temporary employment agencies under recent legislative interventions (Law 4254/2014). These interventions also include: (i) reducing employers' social security contributions (and, thus, the non-wage labour costs) as from 1st July this year, which could contribute to job creation on a longer-term basis; and (ii) reducing seniority benefits on minimum wages for the long-term unemployed, which motivates companies to hire from this category of unemployed, thus helping to prevent labour force skill depreciation.

3 DEVELOPMENTS AND OUTLOOK OF INFLATION, LABOUR COSTS AND COMPETITIVENESS

3.1 INFLATION

The aggregate decline in domestic demand and the labour cost in the past three years pushed the average price level downwards and, since March 2013, into negative inflation rates. The average annual rate of change in the Harmonised Index of Consumer Prices (HICP) fell for the first time into negative territory to -0.9% in 2013, from 1.0% in 2012, while the average rate in January-April 2014 was even

11 See *EU Employment and Social Situation Quarterly Review*, March 2014. Specifically, according to Eurostat data (press release no. 56/2014, 10 April 2014) and ELSTAT data (press release, 5 December 2013), underemployed part-time workers (i.e. part-time workers who are available and want to work more) reached 217 thousand persons in 2013, that is 6.0% of total employment or 4.4% of the labour force. Moreover, potential additional labour force, i.e. persons looking for work but not readily available to start working plus persons available to work but not seeking, reached 141 thousand persons or 2.9% of the labour force in 2013.

Table III.7 Contributions to the inflation differential between Greece and the euro area (2009-2014)

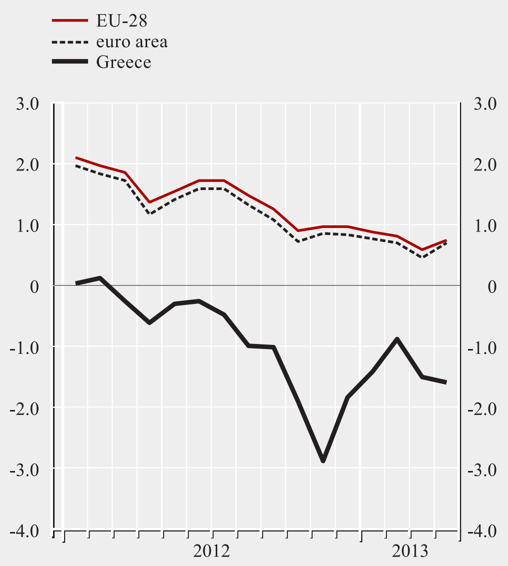
(percentage points)

	2009	2010	2011	2012	2013	2014 (Jan.-Apr.)
Average annual HICP inflation differentials	**1.1**	**3.1**	**0.4**	**-1.5**	**-2.2**	**-2.0**
Contributions:						
Core inflation	0.91	1.60	-0.04	-1.64	-2.58	-1.90
of which						
Services	0.64	0.71	0.01	-0.86	-1.81	-1.61
Processed food	0.14	0.52	0.21	-0.29	-0.21	-0.16
Non-energy industrial goods	0.13	0.37	-0.26	-0.49	-0.56	-0.13
Unprocessed food	0.39	-0.12	0.08	-0.16	-0.18	-0.25
Energy	-0.25	1.66	0.40	0.35	0.55	0.11

Source: Calculations based on Eurostat and ELSTAT data.

Chart III.11 Harmonised index of consumer prices

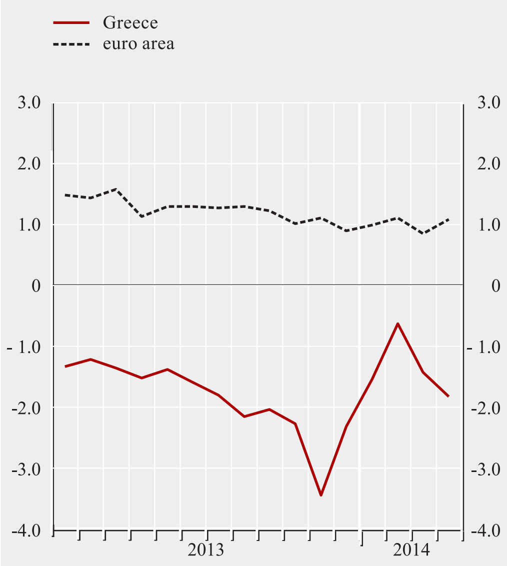
(year-on-year percentage changes)



Sources: Eurostat and ELSTAT.

Chart III.12 HICP core inflation (excluding energy and unprocessed food)

(year-on-year percentage changes)



Sources: Eurostat and calculations based on ELSTAT data.

more strongly negative (-1.3%) (see Chart III.11 and Table III.7). Core inflation (HICP excluding energy and unprocessed food) followed a similar downward course and fell from -0.1% in 2012 to -1.9% in 2013, while the average annual rate in January-April 2014 stood at -1.4% (see Chart III.12).

The factors behind negative annual inflation rates of change in 2013 were the cumulative impact from lower domestic demand, the decline in international oil prices in euro, the drop in labour costs, the contracting effects of indirect taxes, and the reforms in product markets. These factors are expected to remain rel-

Table III.8 Earnings and labour costs (2009-2015)

(annual percentage changes, unless otherwise indicated)

	2009	2010	2011	2012	2013	2014 (estimate)	2015 (forecast)
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**	**-0.6**	**...**
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	6.4	-2.1	-1.1	-7.5	-7.3	-2.4	-2.5
– business sector[2]	4.4	-1.1	-3.5	-11.7	-8.1	-2.8	-2.4

Sources: Bank of Greece estimates/forecasts.
1 Average compensation per employee.
2 The business sector includes private and public enterprises and banks.
3 Average annual change in 2012 and carryover effect for 2013, based on the cut in minimum earnings by a percentage between 22% (for persons aged 25+) and 32% (for persons under 25), as of 15 February 2012.

evant throughout 2014, excluding indirect taxes, which are expected to decline, thus their effect on services should be eliminated as from August. Against this background, in 2014 both headline inflation and core inflation are expected to stand at around -1.0%. In the medium term, high unemployment and low disposable income should be conducive to excess supply conditions, thereby maintaining negative inflation levels for the second consecutive year.

Negative inflation, which persisted for over a year, although posing risks if it continues for a long period of time, contributes to the price competitiveness of the economy (particularly tourist services) and supports consumers' real income. Although mild deflation is not expected to compensate for the decline in disposable income in nominal terms in the past four years, it should contribute to stabilising private consumption in the medium term.

3.2 LABOUR COSTS

2013, same as 2012, recorded the strongest rates of decrease in earnings in the 2010-2013 period. According to revised estimates of the Bank of Greece, average earnings in total economy fell by 6.5% in 2013[12] (2012: -6.6%), while unit labour cost decreased by 7.3% in total economy and 8.1% in the business sector (see Tables III.8 and III.9).

In 2014, it is estimated that the average decline in earnings should be much smaller than in 2012-2013, while for some categories of employees the level of wages should remain

12 According to ELSTAT, on a national accounts basis, compensation of employees fell by 10.8% and compensation per employee by 6.6% in 2013, while on the basis of non-financial accounts of institutional sectors, compensation of employees in the general government dropped by 9.0%. According to the same accounts, in January-September 2013 compensation of employees in the business sector fell at an annual rate of 14.8%. Moreover, the index of wages for the whole economy (excluding the primary sector and household activities – non-seasonally adjusted data) declined in 2013 by an average annual rate of 6.9%.

Table III.9 Average earnings and unit labour costs in total economy: Greece and the euro area (2001-2015)

(annual percentage changes)

	Average earnings		Unit labour costs	
Year	Greece	Euro area	Greece	Euro area
2001	4.7	2.8	3.9	2.4
2002	6.6	2.7	5.5	2.5
2003	5.6	2.9	2.3	2.2
2004	7.2	2.6	4.3	1.0
2005	4.4	2.2	3.4	1.3
2006	5.7	2.5	2.2	1.1
2007	5.2	2.5	4.5	1.4
2008	6.2	3.4	8.7	3.8
2009	4.6	1.8	6.4	4.3
2010	-4.6	2.0	-2.1	-0.6
2011	-1.7	2.2	-1.1	0.7
2012	-6.6	2.0	-7.5	1.8
2013	-6.5	1.7	-7.3	1.1
2014 (estimate)	-1.5	1.6	-2.4	0.7
2015 (forecast)	0.1	1.9	-2.5	0.8

Sources: For Greece, Bank of Greece estimates; for the euro area: European Commission, *European Economic Forecast, Spring 2014.*

stable, or the average working hours should show a small increase (in the private sector), with a positive effect on weakly and monthly earnings. Specifically, average gross earnings are expected to fall by 1.5% in total economy and by 2.0% in the business sector.[13] However, the average labour costs per employee in the business sector should drop by 3.0% (i.e. even more), due to the decline in employers' social security contributions by 2.9 percentage points as from 1st July 2014 (as provided for in Law 4254/2014). At the same time, average (pre-tax) *net* earnings of employees in the business sector should only drop by 1.4% in 2014, i.e. less than gross earnings, due to lower employees' social security contributions by one percentage point as from 1st July (also provided for in Law 4254/2014). The unit labour cost is projected to decline by 2.4% in total economy and by 2.8% in the business sector in 2014, reflecting on the one hand the rise in productivity (which should be slightly faster than in 2013, as the economy starts to rebound) and on the other hand the aforementioned reduction in employers' social security contributions. The above estimates imply that the target set in the 2nd Economic Adjustment Programme (February 2012) as regards cutting back unit labour costs by 15% in the period 2012-2014 will be overshot by a wide margin, since the cumulative reduction over these years is now estimated to reach 21.1%.

Additionally, the year 2015 is expected to see a stabilisation of average gross earnings in total economy and the business sector (+0.1%), a decline of 0.8% in average labour costs per employee in the business sector, and a small increase (+0.6%) in average net earnings in the business sector (owing to the carry-over

13 According to data from the Labour Inspectorate (SEPE) and the information system ERGANI of the Ministry of Labour, during the 16-month period from January 2013 to April 2014, the business sector signed 402 firm-level contracts (354 in 2013 and 48 in the first four months of 2014), covering 91,394 employees and providing for an average wage reduction of 6.9%. Furthermore, 570 firm-level collective agreements were uploaded on the website of the Ministry of Labour during the same 17-month period from January 2013 to May 2014 (409 in 2013 and 161 in the January-May 2014 period).

effect from the reduction in employers' and employees' social security contributions in mid-2014). Unit labour costs are expected to continue falling in 2015, by 2.5% in total economy and by 2.4% in the business sector, reflecting (i) the marked rise in the growth rate of productivity, as the GDP should recover faster than employment; and (ii) the carry-over effect from the reduction in employees' social security contributions as from mid-2014.

3.3 BUSINESS PROFITS

In the January-December 2013 period, gross and net profit margins of non-financial corporations listed on the Athens Exchange (Athex) (i.e. the profits-to-turnover ratio) continued narrowing. According to the published financial statements of 161 Athex-listed non-financial corporations,[14] sales dropped by 4.7%, gross profits fell by 15.3%, and net losses before tax rose by 79.2%. Thus, the gross profit margin fell by 1.4 percentage point (to 11.8%, from 13.2% in 2012), while a negative net profit margin (-2,5%) was recorded, i.e. 1.1 percentage point worse than in 2012 (-1.4%). Return on equity (ROE) and return on assets (ROA) was negative and deteriorated against 2012 (to -2.9% from -1.5%, and to -1.2% from -0.7%, respectively).

The non-financial accounts of institutional sectors published by ELSTAT also indicate a considerable decline in the profits of non-financial corporations, showing that, in the January-September 2013 period, the net operating surplus of non-financial corporations decreased at an annual rate of 21.8%. Nevertheless, a different picture of the evolution of profit margins in the economy can be obtained when the change in unit labour costs in the total economy (-7.3%) is compared with the change in the GDP deflator (-2.1% in 2013, according to ELSTAT), which at first glance suggests an increase in the profit margin for the economy as a whole. However, this comparison ignores other input costs (raw materials and intermediate products, energy consumption), financial costs, and the tax burden on businesses.

3.4 INTERNATIONAL COMPETITIVENESS

The loss of international competitiveness Greece suffered on the basis of labour cost in 2000-2009 was restored in the 2010-2013 period, mostly due to labour market reforms, as well as the deep and protracted downturn. According to the real effective exchange rate index based on the unit labour cost of the Bank of Greece, the cumulative loss of competitiveness against Greece's major trading partners, after reaching 31.9% in 2000-2009, narrowed from then on, and was eliminated in 2013, improving by 7.5 percentage points. In 2014, despite the projected small further appreciation of the euro, international competitiveness based on labour cost is projected to improve further, by 2.0% against the 28 trading partners, and 3.1% against the euro area (see Table III.10). According to respective ECB indicators, Greece now shows the second best performance following Germany as regards developments in labour cost competitiveness after the year 2000, among the euro area countries (see Special Feature III.3, Chart E). By contrast, the loss in competitiveness on the basis of consumer price indices, after rising to 18.5% in the 2000-2009 period, declined, though to a lesser extent (to 13.3% in 2013), due to rigidities in general price levels and in product markets, the increase in indirect taxation and higher energy and financing costs for enterprises. However, price competitiveness strengthened from the fourth quarter of 2012, since inflation in Greece is negative.

A more significant improvement in —and recovery of— labour cost competitiveness since end-2012 is implied in Greece by the respective ECB and European Commission competitiveness indicators. Specifically, until 2013 (in annual average terms) Greece had increased its competitiveness against 2000, by 4.1% according to the ECB Harmonised Competitiveness

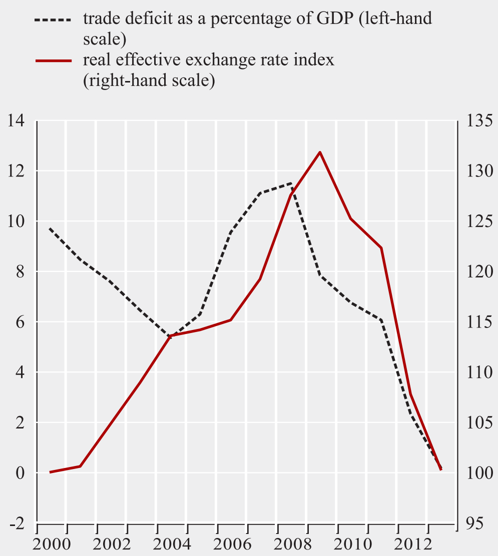
14 These 161 corporations do not include the two refineries and Folie-Folie (development of the company aggregates is not indicative of its current situation, due to the sale of the group's stake in the travel retail sector, i.e. the Hellenic Duty Free Shops , to the Swiss group Dufry AG).

Table III.10 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	CPI-deflated	ULCT-deflated
2000	100.0	100.0	100.0	100.0	100.0
2009	115.5	118.5	131.9	109.2	121.6
2010	112.2	118.0	125.2	112.6	119.7
2011	112.7	118.4	122.4	113.0	117.3
2012	110.5	114.2	107.7	111.3	106.4
2013	112.7	113.3	100.2	108.7	97.1
2014**	114.4	112.5	98.2	107.0	94.1

Sources: For Greece, Bank of Greece (unit labour costs in the total economy); for competitor countries, ECB (exchange rates, CPI, unit labour costs).
* 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 rest of the euro area (EER-euro area). Weights are calculated on the basis of imports and exports of manufacturing goods (SITC 5-8).

Chart III.13 Balance of goods and services and international labour cost competitiveness[1]



Sources: Bank of Greece and ELSTAT.
1 Based on unit labour costs in the total economy (ULCT), 2000=100.

Indicators, and by 4% on the basis of the respective European Commission indicator.

On the basis of most of the composite global competitiveness indices (of the World Economic Forum, World Bank, etc.), the structural competitiveness of the Greek economy, after deteriorating for a number of years, has been showing signs of improvement since 2013. Although Greece received the highest score on responsiveness to OECD recommendations for structural reforms, it continues to occupy one of the lowest positions – on the basis of most of the above indices – among both the EU-27 economies and all advanced economies. According to these composite indices, the most important constraints to improving the international competitiveness of Greek enterprises are now access to financing, ineffective bureaucracy, and the continuously changing tax framework.

4 DEVELOPMENTS AND PROSPECTS IN THE BALANCE OF PAYMENTS

The significant improvement in the balance of payments and the 0.8% surplus (€1.4 billion) in GDP in 2013 are attributable to positive developments in the total trade balance (of goods and services) and the current transfers balance. Specifically, the decline in the net oil import bill, the increase in receipts from travel services and the rise in general government net

Table III.11 Key components of the balance of payments

(million euro)

	January-December			January-March		
	2011	2012	2013	2012	2013	2014
I CURRENT ACCOUNT BALANCE	**-20,633.5**	**-4,615.0**	**1,396.7**	**-4,431.8**	**-2,238.9**	**-1,048.7**
Trade balance	-27,229.1	-19,619.0	-17,229.4	-5,872.2	-4,522.4	-4,558.9
Oil trade balance	-11,126.9	-10,220.0	-7,697.5	-3,142.9	-2,299.1	-2,187.3
Non-oil trade balance	-16,102.1	-9,399.1	-9,531.9	-2,729.3	-2,223.4	-2,371.6
Services balance	14,629.6	15,138.9	16,978.9	1,521.0	1,477.0	1,940.8
Travel	8,238.2	8,598.6	10,317.0	-1.8	42.9	73.1
Transport	6,862.2	6,959.4	6,536.9	1,727.9	1,477.2	1,797.6
Other services	-470.8	-419.0	125.0	-205.1	-43.1	70.1
Income balance	-8,594.8	-1,566.4	-2,819.0	-1,459.6	-884.4	-640.0
Current transfers balance	560.8	1,431.5	4,466.2	1,379.0	1,691.0	2,209.3
II CAPITAL TRANSFERS BALANCE	**2,671.8**	**2,327.6**	**3,040.8**	**1,053.4**	**1,092.5**	**1,461.2**
III CURRENT ACCOUNT AND CAPITAL TRANSFERS BALANCE (I+II)	**-17,961.7**	**-2,287.5**	**4,437.4**	**-3,378.4**	**-1,146.4**	**412.5**
IV FINANCIAL ACCOUNT BALANCE	**17,838.1**	**2,658.2**	**-3,607.7**	**4,584.3**	**361.9**	**-1,219.3**
Direct investment[1]	-452.6	827.1	2,405.5	-892.2	-29.6	93.4
Portfolio investment[1]	-19,778.3	-99,903.9	-6,583.1	-37,033.7	2,470.8	309.9
Other investment[1]	38,050.0	101,744.1	677.0	42,530.1	-2,087.3	-583.6
RESERVE ASSETS	5,332.0	5,500.0	4,172.0	5,434.0	5,461.0	5,457.0

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

receipts, mostly due to profit transfers of euro area national central banks from holdings of Greek government bonds, were the key drivers of the surplus.

In the first quarter of 2014, the current account balance posted a deficit of €1.05 billion, i.e. almost half the deficit of the respective period in 2013 (see Table III.11). This is mostly attributable to the increase in the services and current transfers balances and the decrease in the income account deficit, while the trade balance did not change substantially.

The current account balance is estimated to register a surplus of over 1% of GDP also in 2014. The improved services balance is expected to play the key role in the above developments, due to favourable projections for receipts in both tourism and shipping, given the enhanced international economic environment and the upward trend registered by world trade volume.

As regards the trade balance of goods, strengthened external demand owing to the accelerated growth rate of developed economies, which are among the typical export destinations for Greek products, and the continuous improvement in the competitiveness of the Greek economy, are expected to have a positive effect on exports. At the same time, imports are not expected to change substantially, as upward pressures on the imports of capital and other goods, due to the estimated increase in economic activity, are expected to be offset by the continued decline in private consumption (see Special Feature III.1). The positive contribution from the current transfers balance is expected to continue, though it should be smaller in 2014.

The decline in trade deficit in 2013 was mainly due to the decrease in the net oil import bill, which is attributable to the rise in exports and the drop in imports. As regards exports of other goods, weak foreign demand and liquidity constraints faced by Greek businesses dampened the growth of receipts from exports. However, in real terms, the deceleration was smaller, given that export prices started to decline in 2013, compared with 2012, when they had risen substantially. Moreover, the import bill for all categories of goods continued to drop in 2013, due to a further decline in disposable income and production activity, albeit at a significantly slower rate than in the previous year (4.5% in 2013, against 12.3% in 2012).

In the first quarter of 2014, the trade deficit remained at around the level of the first quarter of 2013, without substantial fluctuations in individual items, excluding increased payments for the purchase of ships. Thus, in real terms, exports increased, due to lower prices. It should be noted that fuel exports also increased, as did exports in foods and beverages, textiles, chemicals and plastics, metallurgy, machinery and electrical equipment. Regarding the geographical breakdown of Greek exports, increased exports are registered mainly to non-euro area markets, such as the United Kingdom, SE Europe, the Middle East and Northern Africa, as well as to certain euro area markets such as Germany, France, the Netherlands and Cyprus.

During the same period, the import bill remained almost unchanged, as payments for purchases of ships were substantially higher, offsetting the decline in other payments. Moreover, payments for the import of consumer non-durables also increased.

The rise in the services surplus in 2013 is mostly attributable to the substantial increase in receipts from tourism, after a modest performance in the previous years, owing to heightened uncertainty and the negative image of the country abroad. In the first quarter of 2014, the services surplus was strengthened mainly due to the increase in net receipts from transport, mostly from shipping, and the surplus in other services, and to a lesser degree by the rise in net receipts from travel services.

Specifically, in the first quarter of 2014, the travel services surplus rose, given that receipts increased by 21.7%, i.e. faster than respective payments, which rose by 15.9%. During the same period, tourist arrivals, according to the Bank of Greece Border Survey, rose by 16%. Estimates of the Association of Greek Tourist Enterprises (SETE) for 2014 as a whole suggest that total arrivals, excluding cruise visitors, should reach 19 million, as an increase of 10%-20% in pre-bookings is recorded.[15] A positive effect on tourist traffic stems from the protracted instability in Egypt and the Eastern Mediterranean, which however has a negative impact on the cruising industry, as expected arrivals so far recorded a decline year-on-year. Nevertheless, cruise passenger traffic in 2014 is expected to remain unchanged at last year's levels.

In the transport industry, receipts, mostly from shipping, shrunk in 2013 (for a third consecutive year) by 9.0%, reflecting lower freight rates in international markets in January-September 2013. Although in the fourth quarter of 2013 freight rates mainly in the dry cargo ships registered an increase, respective receipts partly offset the already recorded decline. The continuous improvement in international freight rate markets in the first months of 2014 contributed to the increase in receipts from transport services by 8.4% in the first quarter of 2014. Projections on transport receipts for 2014 are positive, owing to the expected increase in international trade volume and the drop in excess supply of maritime services (see Special Feature III.2).

15 According to provisional data on international tourist arrivals at the country's main airports, an increase of 30.1% was recorded in the first four months of the year. Increased bookings are also registered from Germany, the United Kingdom, the USA and the Scandinavian countries. Increases are recorded so far in bookings from Russia, year-on-year, but this market is characterised by a high degree of uncertainty, associated with recent developments in Ukraine (source: SETE).

The income account deficit rose in 2013, owing to the increase in net payments for interest, dividends and profits against 2012. This was the result of the sale of loss-making banks by non-residents and the fact that these banks did not register any more losses. In the first quarter of 2014, the income account deficit fell, mostly due to the decline in net interest payments.

In 2013, the current transfers surplus rose by €3 billion against 2012, mainly due to the increase in current transfer receipts of the general government (mostly by the EU), and the capital transfers surplus rose by €713 million, mainly owing to the accelerating absorption rate of EU structural funds. In the first quarter of 2014, the current transfers balance showed a surplus of €2.2 billion, i.e. €518 million above the level of the first quarter of 2012, and the capital transfers balance showed a surplus of €1.5 billion, against €1.1 billion in the respective period of 2013. In 2014, according to provisional estimates of Bank of Greece, net current transfers from the EU should reach €3.3 billion, and net capital transfers from the EU are estimated at €4.2 billion.

The financial account showed a net outflow of €3.6 billion during 2013, which is mostly due to the net outflow in portfolio investment (due to the decrease in non-residents' holdings of Greek bonds and Treasury bills), while net inflows were registered in other investment and direct investment.

In the first quarter of 2014, a net outflow of €1.2 billion was registered in the financial account. As regards portfolio investment, the net inflow recorded is mostly attributable to inflows from the decline in residents' holdings of foreign bonds, and the rise in non-residents' purchases of Greek shares. These offset the outflows from residents' investment on foreign Treasury bills and the decline in non-residents' holdings of Greek bonds and Treasury bills. Furthermore, a net outflow was recorded in "other investment", which is mostly attributable to the decline in the outstanding debt of the public and the private sector to non-residents (of which €1.3 billion for the payment of arrears arising from an IMF loan under the support mechanism).

In the past five years, inflows of foreign direct investment (FDI) in Greece dropped, due to increased uncertainty caused by the economic crisis. FDI in the first quarter of 2014 related in most cases to acquisitions of Greek public enterprises, under privatisation schemes. For the rest of 2014 and for 2015, FDI inflows are expected to increase, given that Greece has achieved a substantial improvement in fiscal sustainability and competitiveness, and economic indicators inspire optimism that economic activity will stabilise and gradually grow. Improved economic climate, combined with institutional reforms, are expected to lead to an increase in FDI inflows, mostly in services, i.e. the financial industry, shipyards, energy, and tourism.

Special Feature III.1

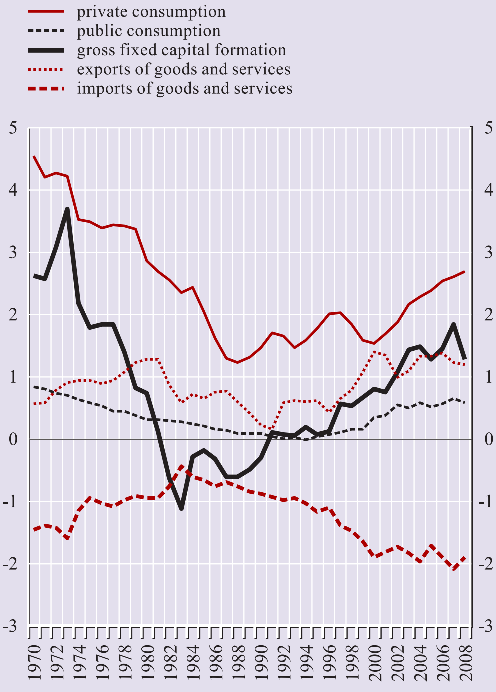
RESTRUCTURING THE GREEK ECONOMY TOWARDS AN INVESTMENT- AND EXPORT-LED MODEL

After four years of fiscal consolidation and deep recession, Greece has managed to recoup its cost competitiveness and eliminate long-standing internal and external imbalances. The economy is in transition to a new growth model, capable of taking full advantage of the country's regained competitiveness and of relying on self-sustaining factors of growth, such as investment and exports of goods and services.

This new growth model must be based on a shift from the production of non-tradables to the production of tradables, from consumption to saving and investment.

Chart A Contribution of demand components to real GDP change[1]

(change in each component as percentage of GDP of preceding year, at constant 2005 prices)



Source: European Commission (AMECO).
1 10-year moving average.

A key question that arises is the extent to which such a growth model is viable from the demand side. That is, could a rise in investment and net exports offset the gap in demand resulting from the reduced growth contribution of private and public consumption expenditure? Chart A summarises the growth model of the previous years by presenting the contributions of demand components to real GDP growth in the period 1960-2008.[1] Over that period, private consumption was the single most important demand component, with annual contributions to GDP growth ranging between 1 and 4 percentage points. From the late 1970s onwards, exports of goods and services were the second most important driver of GDP, after private consumption, and their contribution to growth was stable over time. By contrast, the contribution of investment to GDP showed wide fluctuations (from 3 percentage points in the 1960s to -1 percentage point in the early 1980s). However, from the early 1990s, it followed a steady upward trend, before stabilising at 1-1.5 percentage points in the 2000s (partly on account of projects associated with the Olympic Games). It is worth noting that the increase in the negative contribution of imports after the mid 1990s is highly correlated with the increase of all individual components of domestic demand during the same period.

Table A shows the average annual rates of change in real GDP and its components for selected periods from 1960 to 2008. In an attempt to answer the original question as to the viability of an investment- and export-led growth model, Table B presents indicatively three growth scenarios —a baseline scenario, a pessimistic and an optimistic one— for the 2015-2030 period. The growth scenarios are the results of simulations based on alternative assumptions regarding the evolution of individual demand components.[2]

All three growth scenarios for the 2015-2030 period assume that in real terms public consumption remains unchanged and private consumption increases by 1% per annum, which is less than half the growth of private consumption over the 1980-2000 period.[3]

The scenarios differ only as to the assumptions regarding the dynamics of exports and investment. In the baseline scenario, exports are expected to rise at an annual rate of 5%. This rate is con-

1 The 2009-2013 crisis period is excluded, as it is connected to negative GDP rates of change.
2 These scenarios do not constitute projections or forecasts of the Bank of Greece. The aim of this analysis is to examine whether the economy's transition to a new growth model is possible on the demand side under plausible, albeit conservative, assumptions. In this sense, the baseline scenario presented in Table B is a conservative scenario.
3 The 1980-2000 period is quite representative, since it does not include the boom years of the 1960s, the highly volatile 1970s or the 2001-2008 period of strong growth.

Table A Average rates of change in GDP and its components: 1960-2008

(annual percentage changes, at constant 2005 prices)

	1960-1979	1980-1989	1990-1999	2000-2008
Private consumption	6.5	2.0	2.3	3.9
Public consumption	6.6	1.4	1.1	3.8
Gross fixed capital formation	6.3	-1.7	3.7	5.7
Domestic demand	7.2	1.2	2.6	4.6
Exports of goods and services	11.6	3.3	6.5	4.6
Imports of goods and services	10.0	5.2	7.2	5.4
Gross domestic product	6.9	0.8	1.9	3.7
Net exports (contribution to GDP)[1]	-0.3	-0.4	-0.7	-0.8

Source: European Commission (AMECO).
1 Percentage points.

sidered to be realistic on the basis of Greek export performance in the past and the projected international economic outlook. It should be noted that global trade was increasing at an average annual rate of 6% in the period 1980-2008 and Greek exports at a rate of 4.8%.[4] The assumption on the increase in imports in all three scenarios is based on their historical elasticity to final demand (see Chart B). Specifically, imports of goods and services are expected to increase by up to 1.5 percentage points for every percentage point of increase in final demand.

Investment is expected to increase at an annual rate of 5% under the baseline scenario. This rate is considered to be feasible, on the basis of the size and scope of the structural changes that have taken place over the past four years in labour and product markets, as well as of the improvement in the business environment. Combined with the stabilisation of the Greek economy and a decline

4 According to forecasts by international organisations, world trade should increase at an average rate of 5.6% over the 2015-2019 period (see IMF, *World Economic Outlook*, April 2014).

Table B Alternative scenarios: 2015-2030*

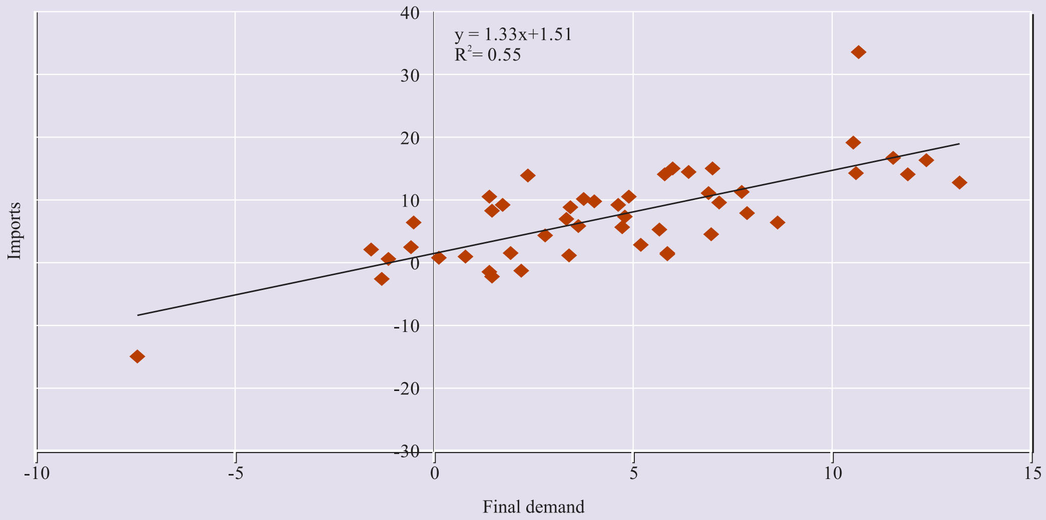
(annual percentage changes, at constant 2005 prices)

	Pessimistic	Baseline	Optimistic
Private consumption	1.0	1.0	1.0
Public consumption	0.0	0.0	0.0
Gross fixed capital formation	3.0	5.0	5.0
Domestic demand	1.2	1.6	1.6
Exports of goods and services	3.0	5.0	8.0
Imports of goods and services[1]	2.4	3.8	5.2
Gross domestic product	1.4	2.1	2.9
Net exports (contribution to GDP)[2]	0.2	0.5	1.4

Source: Bank of Greece estimates.
* Average annual rates of change for the period 2015-2030. Alternative scenarios' assumptions refer to the average rates of change in consumption (private and public), investment and exports, while the other components result from the national accounts identity.
1 The average annual rate of change in imports is calculated on the basis of their historic elasticity in terms of final demand.
2 Percentage points.

Chart B Imports and final demand[1]: 1960-2008

(annual percentage changes, at constant 2005 prices)



Source: European Commission (AMECO).
1 Final demand=consumption+investment+exports.

in uncertainty, reforms in the regulatory framework create new investment opportunities (e.g. by opening up activities to competition, privatisations, reducing the cost of starting a business). Besides, the baseline scenario rate of investment growth is in line with the historical experience of the previous decades (see Table A).

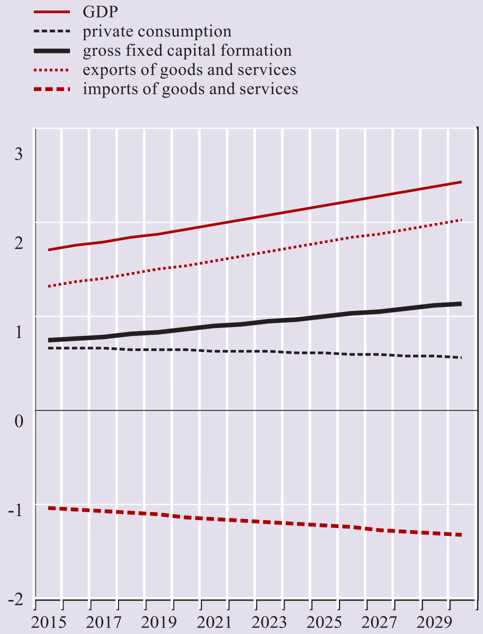
Moreover, the shift in the composition of investment away from residential investment towards productive capital investment (in machinery, non-residential construction and public works) would bring about long-term gains in terms of aggregate productivity and competitiveness, by unlocking resources from the non-tradable construction sector that can be absorbed by tradable goods and services sectors. Besides, investment in productive capital has historically exhibited strong dynamics.[5]

Finally, it should be noted that the shift in the composition of investment from residential construction to productive capital investment is part of a secular trend that takes place in the context of the Greek economy's catching-up with more advanced economies. In particular, Greece started out from a low base, with a 44% share of productive investment in total investment over the period 1980-2000, compared with 63.3% for the euro area. The crisis accelerated the catching-up process, as two thirds of the collapse of private investment after 2007 concerned the housing market and, as a result, the share of residential investment in total investment dropped from 47% in 2007 to 18.4% in 2013. Besides, the current conjuncture does not favour a return to residential construction growth rates similar to those of the past decade, given the high stock of houses available for sale, the increased tax burden on real estate, the tighter financing conditions and the high owner occupancy rate in Greece (76% compared with 68% in the euro area).

5 Specifically, in the 1960-2008 period, fixed capital formation increased at an average annual rate of 5.7% (8.3% for machinery), against 3.7% for residential construction investment. The shift in the composition of investment is even more marked in the period 1980-2008, when non-residential fixed capital formation rose at an average annual rate of 9.5% (and its annual contribution to GDP was 1 percentage point), while residential construction investment remained unchanged with zero contribution to GDP.

Chart C Contribution of demand components to real GDP change (baseline scenario)

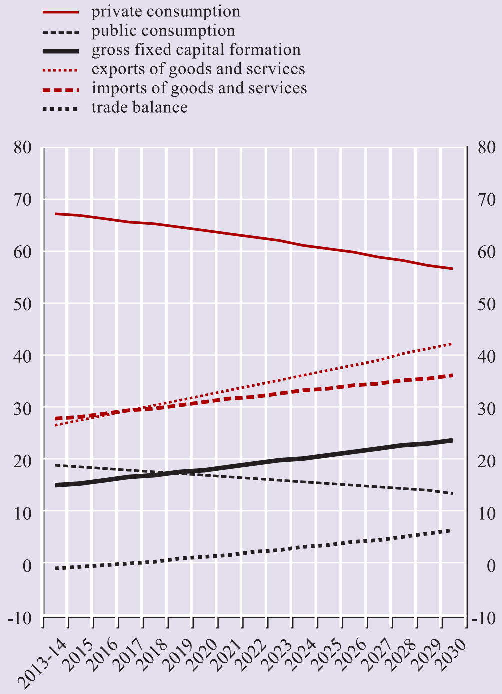
(change in each component as percentage of GDP of preceding year, at constant 2005 prices)



Source: Bank of Greece estimates.

Chart D Restructuring of the Greek economy on the demand side (baseline scenario)

(as percentage of GDP, at constant 2005 prices)



Source: Bank of Greece estimates.

Chart C shows the contribution of demand components to real GDP change for the 2015-2030 period under the baseline scenario.[6] In this scenario, the economy is expected to grow at an average annual rate of 2.1% over the 2015-2030 period. The main contributors to growth are exports and investment, while the contribution of consumption decreases and the negative contribution of imports increases, though not to an extent capable of offsetting the positive contribution of exports. It should be noted that the GDP growth rate is set to accelerate as the economy becomes more extrovert and a larger proportion of the national product is used for investment rather than consumption.

The transition to a new growth model is depicted in Chart D, which shows that the restructuring of the economy from consumption to exports and investment is feasible, under plausible assumptions. Consumption as a percentage of GDP is expected to fall from 67% (at 2005 prices) in 2013 to 56% in 2030, coming closer to the EU average. At the same time, exports as a percentage of GDP increase from 27% to 42% (slightly above the EU average), while investment as a percentage of GDP gradually approaches its historical average of 24% of GDP.

Under the pessimistic scenario, investment rises at an annual rate of 3% (see Table B), as it is assumed that increased uncertainty diminishes the positive effect on investment of the structural reforms that took place over the past four years. The conservative assumption regarding exports implies an annual increase of 3%, i.e. lower than the projected rise in world trade and without tak-

6 As to the starting point, the initial level of individual demand components is set equal to their 2013 level (constant 2005 prices).

ing into account the benefits from the economy's recouped cost competitiveness. Under the pessimistic scenario, it is estimated that the economy will grow at an average annual rate of 1.4% for the 2015-2030 period. The restructuring of the economy in this scenario takes place at a slower pace.[7]

The optimistic scenario holds the same assumptions as the baseline scenario regarding the dynamics of investment, implying an unchanged rate of change in domestic demand. The higher annual GDP growth rate (by 0.8 percentage point) compared to the baseline scenario is exclusively due to the increase in exports at an annual rate of 8%. In particular, the optimistic scenario incorporates the impact of the Greek economy's competitiveness gains over the past four years, which is estimated to lead, in the long run, to an annual increase in exports by up to 2% above their historical performance (see also Special Feature III.3). At the same time, under this assumption the performance of Greek exports is similar to that of other South-European countries.[8] In the context of the optimistic scenario, almost half of the GDP increase stems from the contribution of net exports.

Policies that will speed-up the restructuring of the economy

In order to achieve the transition of the economy to a new growth model and ensure fast growth rates through investment and exports, economic policy needs to contribute to the development of the conditions that will favour the restructuring of the economy on the output side.

As regards the reallocation of resources to the more productive and outward-oriented sectors, a prerequisite is the smooth functioning of product, labour and capital markets. In order to ensure this, structural reforms in the product and services markets and privatisations have to be implemented at a faster pace. The reforms will contribute to the reallocation of resources not only across but also within sectors, towards high-productivity and high-added value innovative businesses. This restructuring will help create a virtuous circle of investment and exports of a higher technology content that will deliver additional long-term gains in terms of competitiveness and employment.

The recovery of investment necessitates the creation of a business environment in line with best international practices, with a low administrative burden for businesses, an efficient public sector and a stable tax framework with a stable commitment to reduce the tax burden on businesses and natural persons. In the context of improving public sector efficiency, it is necessary to reorient public expenditure towards education, the social safety net (a more effective targeting of social transfers, ensuring the provision of healthcare services to vulnerable social groups), as well as towards enhancing the auditing and regulatory functions (upgrading tax administration and the tax collection mechanism, speeding-up the resolution of tax cases pending before the courts, improving the effectiveness of public administration through the development of electronic governance).

The main challenge is to maximize the financial resources available to support the recovery process. Therefore, actions are needed to relax businesses' liquidity constraints by enhancing the role of capital markets in their financing, by attracting foreign investment, as well as by making better use of the European resources. Furthermore, the banking system should encourage the transition to the new growth model that the country needs by reorienting bank credit towards viable businesses.

7 Investment as a percentage of GDP increases from 15% in 2013 to 20% in 2030, while exports as a percentage of GDP rise from 27% to 35%.

8 Specifically, in 1980-2000, the exports of Spain and Portugal increased at annual rates of 7.4% and 8.7%, respectively (compared with 7.2% in the EU). Moreover, it is worth noting that in the 2000s Greek exports followed closely the rates of change of exports of these countries (4.6% for Greece, compared with 4.4% for Spain and 4.5% for Portugal). However, this performance was interrupted since the onset of the crisis in 2009 for reasons specific to the Greek crisis.

Special Feature III.2

THE OUTLOOK FOR GREEK OCEANGOING SHIPPING

Over the 2004-2008 period, receipts from sea transport services in the balance of payments increased sharply at an average annual rate of 15% and came to about €18.0 billion in 2008, reaching their highest level in recent years. This rise has played a decisive role in bringing down the continuously widening current account deficit. However, as a result of the global economic crisis, receipts declined by 30% in 2009, year-on-year, and have recovered only partly ever since. In more detail, receipts from sea transport services over the 2009-2013 period accounted for 5.9% of Greek GDP, down from the high level of 6.9% observed in the five-years period prior to the crisis. At the same time, their share in total receipts from services exports shrank by about 5 percentage points to 44% between the two periods under review.

The present Special Feature provides an overview of recent developments in the structure of the Greek shipping industry and in international freight markets. The contribution of Greek-owned shipping to the Greek economy relative to other European countries is discussed, while the prospects of an increase in sea transport earnings are explored.

Balance of payments: Receipts from sea transport services

Receipts from sea transport services are almost entirely determined by receipts from transport of goods (cross-trade), which reflect business activity in the shipping industry. Key determinants in sea transport receipts are also the evolution of rates in international freight markets as well as the size of the Greek-controlled fleet.[1]

Recent developments and prospects in international freight markets

The pick-up in world trade, coupled with a slowdown in the delivery of new vessels, contributed to a recovery in freight markets in 2013. Although in the first nine months of 2013 freight rates —as captured by the ClarkSea Index[2]— declined slightly by 3.0%, the surge in rates that was observed in the fourth quarter of 2013, primarily for dry bulk carriers and secondarily for oil tankers, brought about a turnaround in the then prevailing adverse situation.

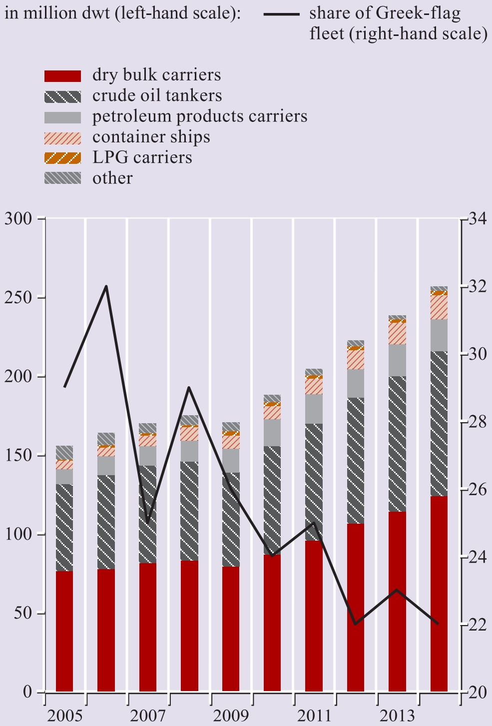
An estimated further increase of about 4.2% in the volume of seaborne trade in 2014 and a moderation in the growth rate of world fleet to below 4.0% create the appropriate conditions for a rebound in freight rates. This trend is also corroborated by the fact that in the first quarter of 2014 the shipping industry confidence index returned to its pre-crisis levels, while expectations point to higher rates across all sectors of the shipping industry (dry bulk, tanker and container ship sectors).[3] To the extent that the growth rate of world fleet remains at its present levels, freight rates are expected to continue rising over the next two years. However, a sharp increase in orders for new vessels since mid-2013 with estimated delivery mostly after 2015 is expected to raise the supply of cargo capacity, pushing rates downwards, in the event of unresponsive demand. This development is likely to hamper a further recovery in shipping after 2015.

Breakdown of Greek-controlled fleet

Greek-controlled fleet accounts for 43% of the EU fleet and about 15% of world fleet. It exhibits high concentration in the oil tanker sector (25% of world fleet) and the dry bulk sector (18%),

1 Bragoudakis et al. (2013).
2 The ClarkSea Index is a measure of average earnings for the main vessel types of the world merchant fleet, expressed in US dollars per day.
3 Moore Stephens (2014).

Chart A Composition of the Greek-owned fleet



Source: Calculations based on Lloyd's Register-Fairplay data.

while its shares in the sectors of LNG tankers and container ships are significantly lower (6% and 7%, respectively) (see Chart A).

High liquidity in international money and capital markets, coupled with the profitability of shipping companies over the 2004-2008 period, contributed to an increase in Greek firms' orders for new vessels and a rise in the cargo capacity of Greek-controlled fleet at annual rates of over 5% over the past decade. Nevertheless, Greek-flagged fleet grew at a weaker average annual rate of about 3.5% and thus, only 22% of Greek-controlled fleet flies the Greek flag (in terms of deadweight tonnage – dwt), down by about 10 percentage points during the last decade.

The renewal of Greek-owned fleet contributed to its qualitative upgrading and, as a result, its average (dwt-weighted) age is currently 7.7 years, i.e. down by about 4 years relative to 2005, thereby making the Greek-controlled fleet younger than the world fleet.

A comparative presentation of sea transport receipts and of shares of shipping in GDP

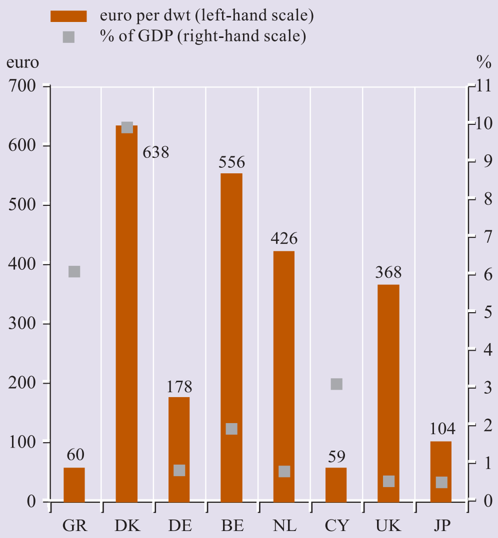
Receipts from sea transport of goods, an activity which is inextricably linked to oceangoing shipping, amount to high levels for Greece, compared with the remaining EU Member States. Over the 2010-2012 period, Denmark recorded the highest receipts (€23.8 billion on an annual basis), followed by Germany (€21.0 billion) and Greece (€12.6 billion). However, as a percentage of GDP, receipts came to 9.9% for Denmark and 6.1% for Greece, while for Germany and the EU-27 they stood at 0.8% and below 1.0%, respectively.

However, the calculation of receipts as a percentage of GDP does not take into account the size of each country's fleet. To address this issue, receipts per dwt of fleet were calculated over the 2010-2012 period for the largest shipping countries. Receipts per dwt of Greek-controlled fleet averaged approximately €60, while for Japan, which has a similar-sized fleet, receipts averaged €100, for Germany €178 and for the EU-27 €200 (see Chart B). Although these divergences may be due to the different structure of each country's fleet, they point to the Greek economy's potential to increase its sea transport earnings. In more detail, Greek-controlled fleet specialises in the tanker and dry bulk sectors and is mainly engaged under short-term charter contracts. Conversely, German-controlled fleet exhibits high concentration in the sector of container ships, which are engaged under long-term charter contracts and are usually operated by Germany-based shipping companies.[4]

4 A large part of the container ship fleet is financed through Kommanditgesellschaft (KG) closed-end funds, which entail important tax relief measures on private investors. One of the prerequisites for this favourable tax treatment is that the management of the vessel that is financed by KG is based in Germany. However, the recession in the shipping industry over the past few years also weighed on the German KG model.

Similar results were also drawn from a recent study on the economic value of the EU shipping industry.[5] Although Greek-controlled fleet accounts for 43% of the EU fleet, Greece contributes a mere 13% of the EU shipping industry's gross value added to the EU economy, while German-controlled fleet, which accounts for 19% of the EU fleet, makes a 20% contribution. Furthermore, the Norwegian or UK shipping industries, which are oriented towards higher value added activities, such as service and offshore support activities in the energy sector, have a much higher contribution to EU gross value added compared with their respective tonnage. According to the same study, the total direct contribution of the EU shipping industry's gross value added to EU GDP was estimated at about €56 billion in 2012, of which freight transport accounted for 59% (or €33 billion).

Chart B Receipts from sea transport of goods (2010-2012)



Source: Calculations based on Eurostat, UNCTAD and Bank of Greece data.

The above analysis shows that the shipping industry's contribution to the Greek economy is smaller than expected on the basis of the Greek fleet's size. This fact is also associated with the structure of the industry, as Greek shipping companies tend to operate in international maritime hubs. If the contribution of the Greek shipping industry to the domestic economy were in line with the size of its fleet, as in the case of the German fleet, an increase in gross value added by about 3 percentage points of GDP could possibly be observed. According to an IOBE study,[6] attracting Greek-controlled shipping companies on the one hand and strengthening the country's shipping cluster on the other are likely to contribute to a further increase in the shipping industry's contribution to the Greek economy. To this end, the appropriate policies for attracting shipping companies to the country and bolstering the shipping cluster should be explored. More specifically:

1. A stable institutional and tax environment: Greece was among the first EU countries to introduce a tonnage tax on vessels —a regime which has remained broadly unchanged since 1975— with a view to attracting shipping companies to the country and addressing competition from open registries, where similar tax systems are applied. In the early 2000s Greece's example was followed by other EU countries (e.g. Germany, Denmark, United Kingdom). This stable institutional and tax regime is key to the maintenance of the existing shipping cluster.[7]

2. Development of a national strategy towards attracting shipping companies to the country. In the context of the government's proposed growth model for the country (Greece 2012 – The new growth model), shipping and its related activities (financial services, insur-

5 Oxford Economics (2014).
6 IOBE (2013).
7 It is estimated that the absence of the tonnage tax regime would reduce the EU shipping industry's direct value added to the EU economy by about 50% (Oxford Economics 2014).

ance, training of seafarers, ship building and repairs) are one of the sectoral growth pillars. This plan could lay the foundations for the development of a national strategy aimed at turning Greece into a major maritime hub.

3. Bolstering the domestic shipping cluster: Furthermore, providing incentives to bolster the shipping cluster through the development of shipping-related activities, such as banking, insurance, arbitration and intermediation (e.g. shipbroking), will strengthen consumption of relevant products and services by domestic firms and help attract shipping companies.

4. Development of human capital: Attracting adequate numbers of new manpower and strengthening human capital in the shipping industry are vital to the development and sustainability of the shipping cluster.

Conclusions

Over the next two years, sea transport receipts are projected to rise moderately and return to the average levels of the past decade, as the expected decline in excess supply of cargo capacity will improve conditions in international freight markets. However, the considerable rise observed in orders for new vessels since mid-2013 with estimated delivery after 2015 is likely to hamper a further improvement in rates. A further rise in earnings may also stem from attracting Greek-controlled shipping firms to the country, as well as from bolstering the domestic shipping cluster.

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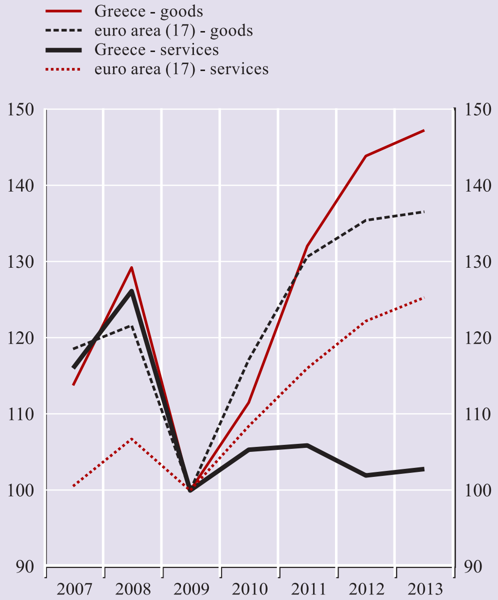
GREEK EXPORTS: CHARACTERISTICS AND PROSPECTS

The past five years have seen important developments in the external sector of the Greek economy. The current account deficit, which had peaked at about 15% of GDP in 2008, turned into a small surplus of 0.8% of GDP in 2013. Many view this improvement as conjunctural, i.e. as a result of a temporary depression in domestic demand that limited imports, a trend which is expected to reverse as recession weakens. This interpretation overlooks the significant improvement in the country's export performance, which is mainly observed in the goods sector and largely reflects competitiveness gains.[1] It should be noted that the recovery in Greek exports of goods since 2009 has been remarkable, as Greek firms, facing pressure due to a slump in domestic demand, turned to foreign markets and took advantage of lower wage costs. By contrast, exports of services stagnated, reflecting high uncertainty and the country's negative image abroad that adversely affected tourism, as well as the ongoing crisis in global shipping.

Chart A Exports of goods and services at current prices

(index 2009=100)



Sources: For Greece, Bank of Greece. For the euro area, Eurostat, Ameco.

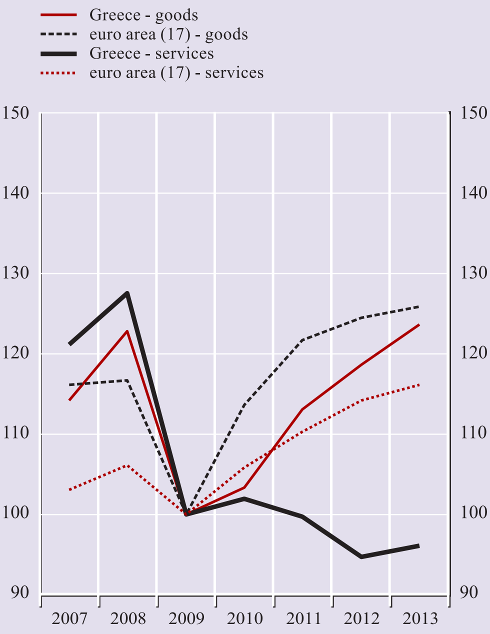
The share of goods and services exports in total GDP rose from 19% in 2009 to 29% in 2013. In the past four years exports of goods, in nominal terms, increased overall by 47%, compared with an increase of 36.5% for the euro area as a whole (see Chart A). At constant prices, exports of goods increased by 23.5% between 2009 and 2013, compared with 25.5% for the euro area (see Chart B), while their share in global trade has grown by 30% since 2010 (see Chart C). Meanwhile, there has been a significant shift of Greek exports, in addition to traditional markets (EU and SE Europe), towards other geographical destinations, such as Northern African and Middle East countries, Russia and China. On the other hand, the sectoral breakdown of exports has not changed significantly. With the exception of fuels, which doubled their share in total exports largely as a result of higher prices, the sectors that showed a strong export performance, such as "food and beverages", "chemicals and plastics", "metallurgy", "machinery and electrical equipment", were already the most extrovert ones.

Unlike the remarkable performance of exports of goods, exports of services at constant prices declined by 4% in 2009-2013, compared with a 16% increase in euro area services exports. The factors that acted as a drag to the growth of Greek services exports mainly relate to developments

1 The recent drop in the growth rate of Greek exports (from 6.7% in the first half of 2013 to -1.2% in the second half of 2013 and to nil in Q1 2014 in nominal terms, according to Bank of Greece data) reflects a more general slowdown in the euro area's foreign trade (possibly partly due to the appreciation of the euro in that period). In particular, euro area exports of goods (according to ECB balance of payment data) stagnated in the second half of 2013, after growing by 1.2% in the first half of 2013 and 7.3% in 2012. Euro area imports declined strongly in the same period (-2.6% on average in January 2013-March 2014), negatively affecting Greek exports as well.

Chart B Exports of goods and services at constant prices*

(index 2009=100)



Sources: For Greece, Bank of Greece. For the euro area, Eurostat, Ameco.
* Data on Greek exports were deflated using the national accounts' deflators with 2005 as the base year.

Chart C Greece's world export market share for goods by geographical destination

(index 2000=100)

Source: IMF, Direction of trade statistics.

in tourism and shipping. In more detail, uncertainty about whether Greece would remain in the euro area and, more generally, the country's overall negative image abroad dampened tourism growth until mid-2012. Moreover, the decline in the international freight market, on the back of the global economic downturn from 2008 onwards, had an adverse impact on shipping receipts, which in 2013 were 39% lower than their 2008 peak. It should be recalled that shipping receipts account for about 50% of Greek exports of services.

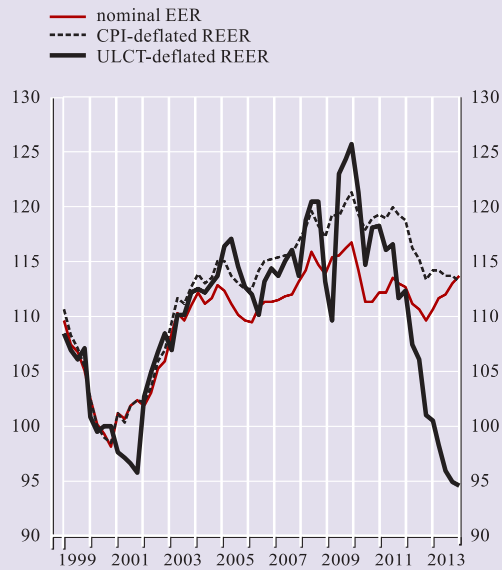
Greek exports rely much more on services than what is the case with the other euro area countries. Specifically, exports of services account for 65% of total Greek exports (2000-2010 average), while the corresponding share of the euro area excluding Greece is just 22%. This is a crucial difference that is often disregarded in comparisons between Greek exports and those of other euro area countries.

Underlying the drastic improvement in the current account balance and a reversal from a deficit to a small surplus were both cyclical and structural factors.[2] Lower domestic demand and the resulting decline in imports was the most important among cyclical factors. The anticipated recovery of the Greek economy should bring about a pick-up in imports —of raw materials, capital equipment, as well as consumer goods— thus partly reversing the improvement in the current account balance, provided that the effect of cyclical factors prevails. It should be noted however that the

2 One year ago, the IMF estimated that 50% of the total adjustment in the current account balance was driven by cyclical factors (IMF, Euro Area Policies, 2013 Article IV Consultation, July 2013).

Chart D Competitiveness indicators based on labour cost and prices

(index 2000=100, quarterly average)



Source: ECB, harmonised competitiveness indicators for Greece.

Chart E Change in competitiveness based on labour cost

(cumulative percentage change between 1998 and 2013)

Source: ECB, harmonised competitiveness indicators based on unit labour costs in total economy.

deep recession of the past five years was accompanied by important structural changes to the economy. In this light, the improvement in the current account balance in the past four years is to a large extent sustainable.

The structural factors that affect the current account balance include: (i) recouped labour cost competitiveness, which will lead to a rise in exports and import substitution in the long run; (ii) higher prices of tradables versus non-tradables, implying improved profit margins for the former, which creates favourable growth prospects for the sector and enhances the extroversion of the economy;[3] (iii) structural reforms in the labour and product markets and measures to reduce the time and costs required for starting a business, all of which encourage labour and capital mobility across economic sectors and reinforce export dynamics.[4]

In the past few years the Greek economy has taken important steps towards improving its international competitiveness, primarily in terms of labour costs and, to a lesser extent, prices; as a result, a large part of the losses in competitiveness recorded in almost two decades has been recouped since 2010 (see Chart D).

The substantial decline in unit labour costs has more than offset total cost competitiveness losses of 2001-2009. It is worth noting that, among euro area countries, Greece has made the second largest adjustment in cost competitiveness after Germany in 1998-2013 (see Chart E).

3 See Bank of Greece, *Annual Report 2013*, February 2014, Box V.1: "The crisis favours a shift to tradables".
4 See IMF, Euro Area Policies. 2013 Article IV Consultation, July 2013, p. 33.

Chart F Competitiveness on the basis of unit labour costs and Greek export performance vis-à-vis the euro area

(indices 2000=100)

Sources: For the relative export performance, Bank of Greece and Eurostat, Ameco. For competitiveness, ECB.
1 Ratio of Greece's exports of goods and services (except for shipping) to exports of goods and services of the euro area, at 2005 constant prices.
2 The inverse of the REER index based on unit labour costs in total economy vis-à-vis 37 countries.

The improvement in cost competitiveness achieved in the past four years has not translated in a commensurate rise in exports, as exporters continued to face difficulties in their access to financing and tourism was negatively affected by heightened uncertainty until 2013. As shown in Chart F, in 2000-2008 Greece's cost competitiveness and relative export performance (goods and services excluding shipping) vis-à-vis the euro area (EU-17) were strongly correlated. In more detail, for every unit of decrease in cost competitiveness, the growth rate of exports was one unit lower than the EU-17 figure. Thus, as Greece's real effective exchange rate index vis-à-vis its trading partners, measured on the basis of unit labour costs in total economy (ULCT-based EER), rose by a total of 26% in 2000-2009, implying a commensurate decrease in competitiveness, exports of goods and services (excluding shipping) declined by 27% compared with EU-17 exports.[5] However, this strong correlation between export performance and competitiveness has been abruptly broken since 2009, as wage competitiveness increased by about 30% in 2010-2013, while exports grew only 5% faster than EU-17 exports, mainly due to high uncertainty about the country's prospects and to financing constraints.

The gradual restoration of normal liquidity conditions and confidence in the outlook of the economy is expected to lead to a significant increase of up to 30% in exports in the future. A rebound in investment and higher productivity would also boost exports, by expanding the productive base of the economy and increasing cost and quality competitiveness. As suggested by projections from international organisations, the growth rate of exports of goods and services should accelerate compared with 2013 (for 2014 and 2015, respectively, to 4.1% and 5.2% according to the European Commission and to 4.5% and 7.7% according to the OECD).

The international environment is expected to be favourable for Greek exports, with foreign demand supported by stronger growth in developed economies that are among the traditional destinations of Greek exports. In the past, Greek firms managed to take advantage of global demand developments to dynamically expand to foreign markets;[6] now this can be repeated, in fact steps have been made towards penetrating new markets. However, the establishment of Greek products in foreign markets cannot rely on low cost only, but also on non-price aspects. The development of research and technology would create the necessary conditions for a more efficient allocation of resources in the Greek economy, favouring a shift in the composition of exports

5 The 27% decline in the exports index in 2000-2010 means that Greece's exports grew 27% less than EU-17 exports.
6 As was the case in the mid-1990s with penetration and expansion to SE European markets, the second destination of Greek products after euro area countries.

that has so far been hampered by the existing constraints on financing and investment in the context of the crisis.

From 2013 onwards, there has been a visible recovery in tourism, which is expected to continue. It should be noted that the Association of Greek Tourism Enterprises (SETE) expects arrivals to increase by 6% in 2014 to 19 million visitors. At the same time, given the weight of shipping receipts in total receipts from services and, as already mentioned, their low level relative to 2008, the recovery of sea transport will have a significant positive contribution to Greece's overall export performance. This development is highly likely to occur in the coming years, as global trade picks up and excess capacity in shipping is absorbed by rising demand (see Special Feature III.2).

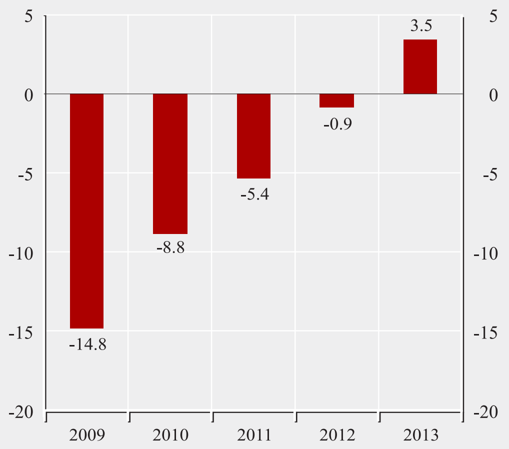
Finally, the current account balance should benefit in the long run from a stabilisation of private consumption, as developments in wages and disposable incomes are expected to be moderate. Economic recovery should thus lead to an increase in imports, however not so strong as to reverse the positive impact of greater extroversion and improved export performance.

IV FISCAL DEVELOPMENTS AND PROSPECTS

The achievement of a general government primary surplus of 0.8% of GDP in 2013, one year earlier than what was required under the Economic Adjustment Programme (EAP), and Greece's successful return to international bond markets after four years are clear signs of improvement in the country's economic outlook. In the years ahead, Greece will have to pursue its fiscal consolidation effort, which, along with the return to positive growth, will secure continued access to international capital markets and a definitive exit from the protracted crisis. The fulfilment of the Eurogroup commitments of November-December 2012 to guarantee public debt sustainability will also contribute in this direction.

Chart IV.1 Structural primary balance of general government

(percentage of potential GDP)



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

1 OVERVIEW OF DEVELOPMENTS AND PROSPECTS[1]

In the context of fiscal consolidation, which is still underway, the structural primary balance of general government[2] improved by 18.3 percentage points of potential GDP in 2010-2013 (see Chart IV.1). Moreover, general government achieved a primary surplus of 0.8% of GDP (EAP methodology) in 2013, one year earlier than what was required under the EAP; this has bolstered market confidence in the Greek economy and contributed to Greece's return to international capital markets four years after the last successful bond issue and two years after the PSI. Specifically, on 10 April 2014, the Greek government tendered a five-year bond issue governed by English law, with an issue amount of €3 billion, a yield of 4.95% and an annual coupon of 4.75%, in which total bids from international investors exceeded €20 billion.

Tentative signs of an improving outlook for the Greek economy had already been visible since the beginning of the year, as the yield spread of the Greek 10-year government bonds over the corresponding German bonds fell back to the level observed before the activation of the financial support mechanism for Greece in May 2010. Specifically, in late April 2014 the spread stood at around 450 basis points, down from 683 basis points in the fourth quarter of 2013 and 2,500 basis points in June 2012. These positive developments also contributed to a significant decline in yields on Treasury bills with a maturity of 13 and 26 weeks.

This first successful comeback to the international capital markets is fostering a climate of optimism about the prospects of the Greek economy. Restored market confidence would be conducive to a normalisation at the longer end of the domestic yield curve, thereby further reducing the rollover cost for shorter maturities. The improved economic outlook will contribute to the absorption of a sizeable amount of such Treasury bill issues not only by domestic banks but also by foreign investors, thus enhancing liquidity in the domestic economy (see Chapter V). Moreover, the return to markets has already improved the prospects for Greek banks and large domestic firms to obtain financing from abroad.

1 Based on data and information available up to 23 May 2014.
2 The structural balance represents the permanent component of the cyclically adjusted balance, net of temporary factors, such as one-off outlays for the recapitalisation of the banking sector. It is a theoretical concept, therefore its estimation may differ depending on the quantification method used.

Table IV.1 General government and state budget balances

(percentages of GDP)

	2009	2010	2011	2012	2013*
General government balance[1] *(national accounts data - convergence criterion)*	**-15.7**	**-10.9**	**-9.6**	**-8.9**	**-12.7**
– Central government	-15.4	-12.0	-9.0	-8.1	-15.7
– Social security funds, local government, legal entities in public law	-0.3	1.1	-0.5	-0.9	3.0
General government balance adjusted for net state support to financial institutions[1]	-15.8	-11.3	-9.9	-6.2	-2.1
General government primary balance adjusted for net state support to financial institutions[1]	-10.7	-5.5	-2.7	-1.2	1.9
General government primary balance (Hellenic Economic Policy Programme)[2]				-1.3	0.8
State budget balance					
Administrative data[2]	**-14.6**	**-10.0**	**-10.9**	**-8.1**	**-3.0**
Cash data[3]	**-14.1**	**-10.5**	**-11.1**	**-5.5[4]**	**-7.0[5]**

Sources: Bank of Greece, Ministry of Finance and ELSTAT.
* Provisional data.
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).
3 Bank of Greece data for the state budget balance (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 the transfers of earnings on Greek government bond holdings of Eurosystem central banks (Securities Markets Programme - SMP). Including expenditure of around €6,155 million for the payment of arrears.

According to national accounts data, as announced by the Hellenic Statistical Authority (ELSTAT) and Eurostat on 14 and 23 April 2014, respectively, the general government deficit rose to 12.7% of GDP in 2013, from 8.9% of GDP in 2012 (see Table IV.1). However, adjusted for net state support to financial institutions, the general government deficit shrank to 2.1% of GDP in 2013, from 6.2% of GDP in 2012.[3] The primary balance of general government (calculated according to the EAP methodology)[4] was in surplus, at 0.8% of GDP (or €1.5 billion) in 2013, against an estimated surplus of 0.4% of GDP in the 2014 Budget and an EAP target for a primary balance of 0%.

The stronger-than-expected fiscal performance in 2013 largely reflected the better outturn of the state budget and, to a lesser extent, the improved results of social security organisations, as a consequence of the significant containment of operational and social expenditure. A positive contribution also came from revenue, on the back of a very strong tourist season and robust collection of direct taxes, most notably property taxes, and higher-than-projected non-tax and one-off revenue. The fiscal outcome benefited from the frontloaded absorption of EU funds in the context of reactivation of the large motorway construction projects. These positive developments allowed for a social dividend of around €525 million, or one third of the primary surplus, to be distributed to vulnerable social groups.

3 Excluding net state support to financial institutions of 2.7% of GDP in 2012 and of 10.6% of GDP in 2013.
4 The EAP methodology differs from the ESA 95 methodology as, specifically for 2013, it does not include in the general government balance: (i) the impact of state support to financial institutions; (ii) ANFA revenue, i.e. the transfer to the Greek state of profits accruing to Eurosystem national central banks from holdings of Greek government bonds (which did not participate in the PSI); (iii) SMP revenue, i.e. the transfer to the Greek state of income accruing to Eurosystem central banks from the SMP portfolio; (iv) the retroactive lowering of the interest rates of the Greek loan facility (GLF); (v) proceeds from privatisation not originally included in the privatisation programme; and (vi) tax refund arrears dating before September 2012. By contrast, it includes part of the revenue from the special property tax paid through electricity bills (EETHDE) which was collected in the second quarter of 2013 and is counted towards the fiscal targets for 2013, although it has been taken into consideration in the national accounts balance for 2012.

In the current year, Greece continues its fiscal consolidation efforts and the implementation of its reform agenda, the success of which was acknowledged in the Eurogroup statement of 5 May 2014. This positive assessment was accompanied by the disbursement of a €6.3 billion tranche on 28 April by the EFSF, while another €3.4 billion is expected from the IMF in June. Also, following the achievement of agreed milestones,[5] an additional amount of €2 billion is to be disbursed by the EFSF in two tranches, one in June and one in July.

The better-than-expected fiscal consolidation paves the way to the implementation of the Eurogroup decisions of November-December 2012, which determined the achievement of a primary surplus as a prerequisite for further euro area measures, aimed at ensuring that Greece's debt-to-GDP ratio comes to 124% by 2020 and significantly below 110% by 2022. This commitment by our European partners was reiterated in the Eurogroup statement of 5 May 2014. Negotiations on the specific form of such measures should be finalised within the second half of 2014. Any decisions should be clear enough to remove uncertainty and secure the manageability and long-term sustainability of public debt. This is essential for ensuring Greece's definitive exit from the crisis and return to sustainable growth.

The progress towards restoring sound public finances becomes more evident when measured net of cyclical effects on revenue and expenditure. The structural primary balance of general government (calculated according to a Eurosystem methodology) is estimated to have improved by 18.3 percentage points of potential GDP in the 2010-2013 period, turning into a surplus of 3.5% of potential GDP in 2013. Also, according to an IMF report,[6] the cyclically adjusted primary surplus is estimated at 5.8% of potential GDP in 2013, having shown a cumulative improvement of about 19.6 percentage points of potential GDP between 2010 and 2013. Moreover, on the basis of IMF data, in 2010-2013, Greece was ranked first among advanced economies in terms of both the size of its cyclically adjusted primary surplus (as a percentage of potential GDP) and the improvement in its fiscal balance. To provide a basis for comparison, during the same period, Ireland's cyclically adjusted balance improved by 7.5 percentage points of potential GDP, while the improvement for Portugal and Spain was 8.1 and 6.8 percentage points of potential GDP. The cyclically adjusted primary balances of Ireland, Portugal and Spain for 2013 are estimated by the IMF at -1.0%, 1.3% and -1.9% of potential GDP, respectively.

The continuation of fiscal consolidation in the coming years is essential if Greece is to sustainably achieve a reduction of its public debt-to-GDP ratio and a return to markets. The Medium-Term Fiscal Strategy Framework (MTFS) 2015-2018 targets a primary surplus of 2.3% of GDP for 2014 (calculated according to the EAP methodology), significantly above the initial target of 1.6% of GDP in the 2014 Budget and the EAP target of 1.5% of GDP. As noted in the April 2014 European Commission report[7] and confirmed by fiscal data available so far, Greece is on track to meet the EAP targets for 2014 on the back of the better-than-expected results in 2013 and of the measures that are already underway or planned for 2014. These include a higher- than-expected yield of the new Income Tax Code, structural measures to strengthen collection of social security contributions, stronger-than-expected revenue from direct and indirect taxes as a result of already adopted and implemented reforms in tax administration, measures to

5 On the fiscal front, key milestones include: (i) adoption of a joint ministerial decision for the integration of social security contributions debt collection to tax administration; (ii) adoption of the necessary legislation to merge under ETEA all the supplementary pension funds and to apply the non-deficit clause and sustainability factor formulas to all the funds not currently in ETEA from 1 January 2015; (iii) abolishing all charges that finance supplementary pensions from 1 January 2015; (iv) reducing the overall profit margins of pharmacies; (v) combating corruption through the adoption of a code of conduct for members of government and the adoption of legislation on funding of political parties; (vi) simplifying procedures and reducing administrative burdens in the public sector; (vii) adoption of Small PPC law and clearance of all general government arrears with the Public Power Company.

6 IMF (2014), *Fiscal Monitor*, April (Statistical Table 2).

7 European Commission (2014), "The Second Economic Adjustment Programme for Greece, Fourth Review", *European Economy*, *Occasional Papers* 192, April.

combat smuggling, an increase in court fees, a more efficient collection of personal tax arrears, a hike in the excise tax on tobacco, the taxation of firms' extraordinary reserves and the automatic offsetting of VAT and income tax refunds against social security contribution arrears. Further positive effects are expected from the scaling-back of outlays for defence procurement and cost-cutting in general government entities, the rationalisation of OAED (Manpower Employment Organisation) activities and the reform of OAEE (the Self-Employed Workers' Insurance Organisation), and the containment of public investment budget expenditure. Revenue gains from these measures are expected to more than offset losses arising from a 3.9% cut in social security contribution rates effective from July 2014.

However, as suggested by the European Commission's Fourth Review and the MTFS 2015-2018, on the basis of the current macroeconomic projections, the EAP targets are likely to be missed for 2015-2016, by a margin that is estimated by the MTFS at 0.5% and 1.0% of GDP in 2015 and 2016, respectively. Attaining EAP targets for a general government primary surplus of 3.0% of GDP in 2015 and of 4.5% of GDP in 2016 will necessitate commitment to budgetary discipline, with fulfilment of the required prior actions, stronger tax compliance and a faster return to growth.

The projected improvement in the macroeconomic environment, the gradual easing of liquidity conditions in the economy and the country's return to positive growth rates from 2014 onwards are expected to boost tax revenue (tax buoyancy effects), particularly with regard to VAT revenue. Specifically, a narrowing of the output gap and a reversal of the increase in the share of necessity goods in total household consumption expenditure could lead to a rise in VAT revenue in 2014-2016 over and above what would be implied by a 1:1 ratio between VAT revenue and consumption changes (see Special Feature IV.1).

Special Feature IV.1

THE IMPACT OF ECONOMIC ACTIVITY ON VAT TAX EFFICIENCY

The fiscal adjustment that has been achieved in Greece in the past few years has considerably contributed to an improvement in the country's fiscal position. This can also be partly attributed to the hikes in indirect taxes, and particularly in the Value-Added Tax (VAT), that had been introduced mainly in the early years of the fiscal consolidation effort (2010-2011). Nevertheless, despite successive increases in VAT rates from March 2010 onwards, the VAT tax efficiency ratio has been following a downward trend.[1] As pointed out in the European Commission report of April 2014, the ratio has been declining, as it dropped from 50% over the 2007-2008 period to about 40% in the 2011-2012 period, i.e. among the lowest in the EU, while it shows signs of marginal recovery in 2013.

As stressed in several international studies[2] as well as by the Bank of Greece,[3] VAT tax efficiency exhibits high cyclicality. In line with the above, the economic downturn observed in Greece in recent years has squeezed down VAT tax efficiency, but the waning recession and the anticipated economic recovery are expected to help boost its performance.

1 According to the European Commission (2014), "the overall VAT tax-efficiency ratio is the ratio between VAT tax revenue collected against what would be collected if all consumption was taxed at the standard VAT rate". See European Commission (2014), "The Second Economic Adjustment Programme for Greece, Fourth Review – April 2014", Box 6. p. 31, *Occasional Papers*, No 192, and European Commission (TAXUD), "Study to quantify and analyze the VAT Gap in the EU-27 Member States", July 2013.
2 Sancak, C., R. Velloso and J. Xing (2010). "Tax revenue response to the business cycle", IMF Working Paper 10/71, Washington; Poghosyan, T. (2011), "Assessing the variability of tax elasticities in Lithuania", IMF WP 11/270.
3 See *Monetary Policy 2012-2013*, May 2013.

Taking into account the aforementioned studies and using quarterly national accounts data on VAT revenue, private consumption, real GDP, and VAT rates, and proxies of the output gap between the first quarter of 2000 and the fourth quarter of 2013, the relationship between VAT tax efficiency and economic activity[4] was econometrically examined.

The results show that 1% increase in real GDP raises VAT tax efficiency from 0.20 to 0.43 percentage points approximately. At the same time, an output gap narrowing by 1 percentage point of potential GDP contributes to an increase in VAT tax efficiency of about 0.29-0.55 percentage point. On the basis of current projections for a rebound in economic activity and a decline in the output gap, and if VAT rates remain unchanged during the 2014-2016 period, it is estimated that a cumulative increase in VAT revenue (tax buoyancy effects) of about €1.4 billion (or 0.8% of the 2013 GDP) may arise, which could be even higher to the extent that the recovery of economic activity is achieved more rapidly. This increase does not include additional revenue that could stem from the improved efficiency of the tax collection mechanism.

Furthermore, there are indications that the shifts in consumer patterns towards necessity goods and services (which are usually taxed at a lower VAT rate) observed during the crisis has so far negatively affected VAT revenue.[5] On the other hand, taking into account data from the Tax Administration Monitor and in particular the audits on VAT non-compliance over the January 2012-December 2013 period,[6] there is a strongly positive correlation between VAT tax efficiency and intensified tax audits. Therefore, an intensification of tax audits is expected to have a positive effect on VAT tax efficiency in the years ahead.

Conclusions

The projected improvement in economic conditions in the three-year period of 2014-2016, the decreasing share of necessity goods' consumption (as a result of higher incomes) and more effective efforts to combating tax evasion, through an intensification of tax audits, could contribute to improving VAT tax efficiency and subsequently further boosting VAT revenue collection. In sum, all of the above can lead to better than expected fiscal results and a faster attainment of fiscal targets.[7]

4 On the basis of the abovementioned studies and the November 2013 OECD report, VAT tax efficiency is defined as follows: [VAT tax revenue/private consumption)/standard VAT rate] x 100. Tax efficiency would reach 100% if all goods were taxed with the standard VAT rate with no exceptions and if there were no distortions in the collection of tax revenue. See OECD (2013), *Economic Surveys*, Greece, November.
5 Eurostat data were used for the share of consumption expenditure on foods and non-alcoholic beverages, as well as on housing, water supply, electricity, natural gas and other fuel.
6 These data are published by the General Secretariat of Information Systems (GSIS).
7 Taking into account the impact from an annual increase of 10% in tax audits on VAT non-compliance and the anticipated gradual drop in the share of necessity goods' consumption to its pre-crisis levels (e.g. to the 2007 levels) by 2016, then an additional cumulative increase in VAT revenue by a minimum of 0.2% of the 2013 GDP could arise over the 2014-2016 period.

The key pillars of the reform effort should be: (i) strengthening tax administration; (ii) intensifying tax audits on large enterprises, self-employed persons, high wealth individuals and offshore companies; (iii) speeding up the resolution of tax cases pending in courts with a view to effectively combatting tax and contribution evasion; (iv) improving the collectability rate of tax and social security contribution arrears; and (v) pressing ahead with the envisaged VAT reform. Progress in these areas would reinforce a sense of social justice and tax compliance among citizens, leading to a broadening of the tax base and facilitating the achievement of future fiscal targets. This, in turn, would enable, from 2015 onwards, a gradual reduction in the high statutory tax rates on corporate profits and personal income, as well as in social security contribution rates, so as to accelerate the growth process.

Over the next five years, the fiscal consolidation effort will need to be based for the most part on the expenditure side, as was also the case in 2013. Priority must be given to reducing operational costs; further rationalising public administration; improving the quality of public services with emphasis on education, research and innovation; enhancing the efficiency of social spending through measures targeting those in need; securing the viability of social security funds; speeding up the public administration reform, cutting red tape; and swiftly eliminating corruption. This effort will be underpinned by the implementation of the new rules on fiscal management and supervision introduced by the draft law on "Principles for Fiscal Management and Supervision – Public Finance Accounting System", tabled at Parliament in early May 2014, with a view to ensuring budgetary discipline and improving long-term fiscal sustainability.

After a substantial reduction in broader public sector employment (of more than 25%, or over 200,000 employees) in 2010-2013, the next step must now be to secure a more efficient use and objective assessment of available human resources (as well as, where necessary, the recruitment of new staff – the MTFS 2015-2018 provides for 66 thousand new recruitments in 2014-2018) so that the downsizing of public administration can go in hand with the provision of high-quality public services to citizens. Emphasis should also be placed on the health sector through tighter control on expenditures, clearance of arrears, an increase in revenue, completion of the restructuring of the National Organisation for Health Care (EOPYY), and promotion of the smooth functioning of the Primary National Healthcare Network (PEDY). Furthermore, pharmaceutical and hospital spending must be constantly controlled and further reduced. Prompt implementation of the Late Payments Directive (Directive 2011/7/EU), which requires payment of dues within 30 days (or 60 days in exceptional cases), is a key priority in order to reduce the stock of government arrears to the private sector and avert their further accumulation.

The next steps of the fiscal consolidation effort should focus on continued curtailment of public expenditure, for three reasons. First, fiscal consolidations that rely primarily on the expenditure side have been found to be more sustainable, as suggested by international literature and as highlighted in previous Bank of Greece reports. Second, in circumstances of limited liquidity, public spending cuts are less of a drag on growth than the imposition of new taxes. Third, downsizing the government sector frees up resources that can be channelled into more productive and export-oriented activities in the private sector. In other words, it increases the share of tradable goods and services in the economy, while supporting net exports (see Special Feature IV.2).

Special Feature IV.2

THE IMPACT OF FISCAL ADJUSTMENT ON THE PRODUCTIVE RESTRUCTURING OF THE GREEK ECONOMY

As already stressed by the Bank of Greece,[1] the crisis has led to a productive restructuring of the Greek economy, which —albeit still weak— is related to a gradual shift of resources from the production of non-tradable goods and services (non-tradables sector) to the production of internationally tradable goods (tradables sector), where productivity is considerably higher.

1 See Monetary Policy – Interim Report 2013 (December 2013) and Annual Report 2013 (February 2014).

According to international studies, fiscal consolidation through public sector downsizing and freeing resources for the private sector can contribute to a productive shift of the economy towards tradable goods and subsequently strengthen the export-orientedness of the economy.

On the basis of the structural econometric model (SVAR) by Blanchard and Perotti (2002) and the analyses by Bénétrix and Lane (2010), Beetsma et al. (2008), Monacelli and Perotti (2008), and Tagkalakis (2014),[2] the effect of public spending cuts[3] on real GDP, the gross value added of tradable and non-tradable goods and services as well as on net exports is reviewed for the period from the first quarter of 2000 to the first quarter of 2013.[4]

The main results of the study are the following:

- The curtailment in public spending has a negative effect on real GDP over a horizon of at least two years. At the same time, it increases the relative share of the tradables sector in the economy (even if from the non-tradables sector the part of gross value added associated with public administration is deducted – which constitutes the direct effect of fiscal adjustment on total gross value added).

- The above is explained by the fact that the gross value added of non-tradable goods responds negatively to fiscal adjustment for at least two years, as the bulk of public spending is channeled into non-tradable goods.

- Furthermore, the gross value added of the tradables sector responds positively (over a time horizon of at least five years) to the downsizing of the public sector, given that fiscal adjustment (which also signals future tax reductions) results in freeing more resources for the (more productive) private sector of the economy.

- Subsequently, a higher share of the tradables sector contributes to an increase in exports, which, coupled with the decline in imports due to weaker demand (as a result of fiscal adjustment), improves the external balance of goods and services.[5]

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2 Blanchard, O. and R. Perotti (2002), "An empirical characterization of the dynamic effects of changes in government spending and taxes on output", *Quarterly Journal of Economics*, 117, 1329-68. Bénétrix, A. and P. Lane (2010), "Fiscal shocks and the sectoral composition of output", *Open Economics Review*, vol. 21(3), 335-350. Gibson, H. and J. Malley (2008), "The contribution of sectoral productivity differentials to inflation in Greece", *Open Economies Review*, vol. 19(5), 629-650. Beetsma, R., M. Giuliodori and F. Klaassen (2008), "The effects of public spending shocks on trade balances and budget deficits in the European Union", *Journal of the European Economic Association*, 6(2-3), 414-423. Tagkalakis, A. (2014), "Credit and the transmission of fiscal policy shocks: Recent evidence from Greece", *Economic Letters*, vol. 122, 263-267. Monacelli, T. and R. Perotti (2008), "Openness and the sectoral effects of fiscal policy", *Journal of the European Economic Association*, 6, 395-403.

3 A cut of 1 percentage point of GDP in the sum of public consumption and investment spending (minus transfers) is examined. This model takes into account the evolution of net taxes, which are calculated as current taxes less current transfers (see Blanchard and Perotti 2002).

4 The main definition of real output of tradable goods and services includes the sum of gross value added (in line with the NACE Rev 2 classification) in the agricultural sector, manufacturing, and wholesale and retail trade. Alternative definitions of tradable and non-tradable goods and services were estimated on the basis of the papers by Bénétrix and Lane (2011) and Gibson and Malley (2008). The key qualitative features of the analysis are not affected by the alternative definitions under examination. See Tagkalakis, A. "Fiscal policy, net exports and the sectoral composition of output in Greece", *International Economics and Economic Policy* (forthcoming).

5 The positive effect of public spending cuts on the external balance was captured by other previous empirical studies of the Bank of Greece. See, for instance, Brissimis, S.N., G. Hondroyiannis, C. Papazoglou, N.T. Tsaveas and M.A. Vasardani (2012), "Current account determinants and external sustainability in periods of structural change", *Economic Change and Restructuring*, Springer, 45(1), 71-95, as well as Chronis, P. and G. Palaiodimos (2013), "Optimal fiscal policy mix and current account imbalances: The case of Greek economy", a paper presented in a conference of the Banca d' Italia (Perugia, 4-6 April 2013) entitled "Fiscal policy and macroeconomic imbalances".

Conclusions

- Fiscal consolidation, through the downsizing of the public sector (despite the direct negative effect on GDP) can contribute to the strengthening of the most dynamic and productive branches of the private sector and thereby enhance the export orientation of the economy, so long as the resources freed are used efficiently.

- Coupled with the endogenous productive restructuring of the economy, induced by the crisis, as well as the speeding-up of structural changes in product and services markets, fiscal consolidation will help to improve the productivity of the Greek economy and raise living standards over the medium to longer term.

It should also be underscored that the anticipated improvement in macroeconomic conditions and the narrowing of the output gap in the years ahead will significantly influence the reduction of the public debt-to-GDP ratio, as such a development would reverse the adverse "snowball effect" stemming from the interest rate/growth differential, which added about 60 percentage points to the debt-to-GDP ratio in 2010-2013. At the same time, improving macroeconomic conditions should help to attract foreign investment and speed up the privatisation programme.

Furthermore, the country's fiscal policy stance is likely to ease gradually in the coming years in line with the business cycle, implying that its strong and direct counter-cyclical impact of the 2010-2013 period will weaken. According to IMF projections, Greece's cyclically adjusted primary surplus will fall by 1.2 percentage points of potential GDP between 2013 and 2018.

In conclusion, the continuation of the fiscal consolidation effort in line with the MTFS 2015-2018, the implementation of the reform agenda, along with the stepping-up of privatisations and an effective and sustainable solution to the problem of public debt, are expected to further bolster the confidence of international markets in the Greek economy. This, in turn, would help Greece's reintegration into international capital markets, marking a definitive exit from the debt crisis and a shift towards a sustainable growth model.

2 CURRENT FISCAL DEVELOPMENTS (JANUARY-APRIL 2014)

General government (General Accounting Office data)

According to general government data compiled by the General Accounting Office, the general government balance shifted to a surplus of 0.3% of GDP in January-March 2014, from a deficit of 0.6% of GDP one year earlier. In the same period, the primary balance of general government was in surplus, at 1.4% of GDP, compared with 0.4% of GDP in the corresponding quarter of 2013. This improvement relative to 2013 was largely due to the better execution of the state budget and the improved results of public enterprises and organisations and legal entities in public law within general government.

Despite the implementation of an arrears clearance plan, the accumulation of general government arrears continued into the first quarter of 2014, largely on account of the EOPYY, the Civil Servants' Welfare Fund (because of delays in awarding pensions and the payment of lump-sum post-retirement benefits), hospitals and local government. As a result, the total stock of arrears rose to about €5.2 billion, from €4.7 billion in December 2013, of which €0.5 billion concerns tax refund arrears). The MTFS 2015-2018 expects the repayment of general government entities' arrears to reach approximately €2.5 billion in 2014 (compared with an

Table IV.2 State budget balance

(million euro)

	January-April			Percentage changes		Annual data				Percentage changes		
	2012	2013	2014*	2013/12	2014*/13	2012	2013*	2014		2013*/12	2014/13*	
								Budget/ Forecasts	MTFS Update Estimates 2015-2018			
	(1)	(2)	(3)	(4=2:1)	(5=3:2)	(6)	(7)	(8)	(9)	(10=7:6)	(11=8:7)	(12=9:7)
I. Revenue	**16,144**	**15,743**	**16,136**	**-2.5**	**2.5**	**51,926**	**53,018**	**54,695**	**55,935**	**2.1**	**3.2**	**5.5**
1. Ordinary budget (net)	14,653	14,028	13,842	-4.3	-1.3	48,325	48,423	49,693	50,783	0.2	2.6	4.9
Revenue before tax refunds	*15,586*	*14,291*	*14,748*	*-8.3*	*3.2*	*51,482*	*51,442*	*52,252*	*53,689*	*-0.1*	*1.6*	*4.4*
Special revenue from licensing and concession fees	*0*	*62*	*0*			*15*	*86*	*230*	*230*			
Tax refunds	*933*	*325*	*906*	*-65.2*	*178.8*	*3,172*	*3,105*	*2,789*	*3,136*	*-2.1*	*-10.2*	*1.0*
2. Public investment budget	1,491	1,715	2,295	15.0	33.8	3,601	4,595	5,002	5,152	27.6	8.9	12.1
– Own revenue	81	44	24	-45.7	-45.5	166	76	200	200	-54.2	163.2	163.2
– Receipts from the EU	1,410	1,672	2,271	18.6	35.8	3,434	4,520	4,802	4,952	31.6	6.2	9.6
II. Expenditure	**25,291**	**18,168**	**17,282**	**-28.2**	**-4.9**	**67,614**	**58,459**	**56,248**	**56,542**	**-13.5**	**-3.8**	**-3.3**
(State budget primary expenditure)	17,872	16,048	15,090	-10.2	-6.0	55,391	52,415	50,098	50,642	-5.4	-4.4	-3.4
1. Ordinary budget[1]	24,336	17,332	15,884	-28.8	-8.4	61,499	51,809	49,448	49,742	-15.8	-4.6	-4.0
– Interest payments	7,419	2,120	2,192	-71.4	3.4	12,223	6,044	6,150	5,900	-50.6	1.8	-2.4
– Ordinary budget primary expenditure	16,710	14,651	13,238	-12.3	-9.6	47,529	44,230	41,946	42,612	-6.9	-5.2	-3.7
– Procurement of defence equipment	53	14	25			410	529	583	533	29.0	10.2	0.8
– Call-in of guarantees for entities *of which*	154	523	398	239.6	-23.9	796	879	699	642	10.4	-20.5	-27.0
from within the general government	116	420	382			679	514	466	439	-24.3	-9.3	-14.6
from outside the general government	38	103	15			117	365	233	203	212.0	-36.2	-44.4
– Fee for disbursement of EFSF loans	0	24	32			541	127	70	55			
2. Public investment budget	956	836	1,398	-12.6	67.2	6,114	6,650	6,800	6,800	8.8	2.3	2.3
III. State budget balance	**-9,148**	**-2,426**	**-1,146**			**-15,688**	**-5,441**	**-1,553**	**-607**			
% of GDP	**-4.7**	**-1.3**	**-0.6**			**-8.1**	**-3.0**	**-0.8**	**-0.3**			
1. Ordinary budget	-9,683	-3,304	-2,042			-13,174	-3,386	245	1,041			
2. Public investment budget	535	879	897			-2,513	-2,055	-1,798	-1,648			
IV. State budget primary balance	**-1,729**	**-306**	**1,046**			**-3,465**	**603**	**4,597**	**5,293**			
% of GDP	**-0.9**	**-0.2**	**0.6**			**-1.8**	**0.3**	**2.5**	**2.9**			
Amortisation payments	5,623	856	3,223	-84.8	276.5	23,905	12,755	24,930		-46.6	95.5	
GDP (at current prices)	193,347	182,054	181,872	-5.8	-0.1	193,347	182,054	183,089	182,231	-5.8	0.6	0.1

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

initial forecast of €1.5 billion included in the 2014 Budget), whereas, according to the European Commission estimates, a similar amount should be repaid in 2015.

State budget (administrative data)

Over the January-April 2014 period, the state budget recorded a deficit of 0.6% of GDP, compared with a deficit of 1.3% of GDP one year earlier (see Table IV.2). The primary balance of the state budget turned out at a surplus of 0.6% of GDP (against a targeted primary surplus of 0.4% of GDP[8]), having improved by 0.8% of GDP relative to 2013.

The higher-than-expected primary surplus came as a result of a 9.6% decrease in ordinary budget primary expenditure relative to the January-April 2013 period. This sizeable decline largely reflected a significant reduction in grants to social security funds, as well as a curtailment in operational costs.

By contrast, net ordinary budget revenue turned out to be €1,053 million lower than budgeted. This was attributable to higher tax refunds (exceeding by €431 million the period target and expected to even surpass the annual target), delays in combined ANFA and SMP returns of €500 million, and shortfalls in revenue from corporate income tax, direct and indirect tax arrears, VAT on oil products, the special consumption tax on energy products and road duties. The main categories of revenue which performed better than expected were personal income tax, property tax, other direct tax (due to receipts from tax on luxury living) and capital accumulation tax.

Regarding the Public Investment Budget (PIB), both revenue and expenditure surpassed the period targets by €788 and €398 million, respectively.

State budget (cash data)

Between January and April 2014, the cash deficit[9] (borrowing requirements) of the State budget fell to 0.7%, from 2.9% one year earlier (see Table IV.3). The primary balance on a cash basis turned into a surplus of 0.5% of GDP, from a deficit of 1.7% of GDP one year earlier.

The balance includes expenditure of €120 million for the payment of arrears, as well as revenue of €940 million received from Alpha Bank for the buyback of its preference shares from the Greek State, but excludes ANFA revenue amounting to €62 million.

3 PUBLIC DEBT

In 2013 the general government debt rose to €318,703 million or 175.1% of GDP, from €303.9 billion or 157.2% of GDP in 2012. The rise in public debt in 2013 is attributable to borrowing for increasing the capital buffer of the Hellenic Financial Stability Fund (HFSF) to enable it to finance any further capital needs of domestic banks, as well as to additional borrowing for the payment of arrears; despite the very low level of interest rates charged under the financial support mechanism, the interest rate-growth differential had a strong upward effect on public debt. The primary deficit (on an ESA 95 basis) had also an upward effect on debt, whereas the deficit-debt adjustment was debt-reducing.[10]

On the positive side, the average residual maturity of debt was lengthened to approximately 16 years as at end-2013, from about 7 years as at end-2010, while debt servicing costs (on a cash basis) fell considerably to around 3.3% of GDP in 2013-2018, on the back of the favourable Eurogroup decisions of 27 November 2012.

8 See State Budget Execution, Monthly Bulletin, April 2014, General Accounting Office.
9 Excluding movements in the OPEKEPE (Payment and Control Agency for Guidance and Guarantee Community Aid) account.
10 While in 2013 the deficit-debt adjustment grew on account of the increase in the HFSF capital buffer and the payment of arrears, it declined (a) by the negative impact of government support to the financial sector on the general government deficit (on an ESA 95 basis) in 2013, as recorded in the debt of previous years; and (b) on account of privatisation proceeds.

Table IV.3 State budget balance on a cash basis[1,2]

(million euro)

	Annual data		January-April	
	2012	2013	2013	2014*
State budget	**-10,697**	**-12,794**	**-5,268**	**-1,271**
% of GDP	-5.5	-7.0	-2.9	-0.7
– Ordinary budget[3]	-8,503[4]	-10,785[5]	-6,152[6]	-2,169[7]
– Public investment budget	-2,194	-2,009	884	898

Source: Bank of Greece.
* Provisional data.
1 As shown by the respective accounts with the Bank of Greece and other credit institutions.
2 Excluding movements in the OPEKEPE (Payment and Control Agency for Guidance and Guarantee Community Aid) account.
3 Including movements in public debt management accounts.
4 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 interest paid on PSI bonds, as well as interest payments to the amount of €519 million due to debt buy-back in the form of EFSF short-term securities; 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: a) €901.3 million relating to Greece's participation in the European Stability Mechanism (ESM).
5 Including revenue of: a) €682 million relating to ANFA returns; and b) €998 million from privatisation proceeds (sale of IBC premises, etc.), but excluding revenue of €2.0 billion from transfers of earnings on Greek government bond holdings by the Eurosystem central banks (Securities Markets Programme - SMP). Not including €37.6 million for the participation of the Greek State in capital increases (Hellenic Defence Systems SA, etc.). Including expenditure of about €6,155 million for the payment of arrears, and €901.3 million relating to Greece's participation in the European Stability Mechanism (ESM).
6 Including revenue of: a) €317 million relating to ANFA returns; and b) €62 million from privatisation proceeds. Not including €25.9 million for the participation of the Greek State in capital increases (Hellenic Defence Systems SA, etc.). Including expenditure of about €2,687 million for the payment of arrears.
7 Including revenue of: a) €276 million relating to ANFA returns; b) €480 million from the profits of the Bank of Greece; c) €940 million from Alpha Bank for the sale of preference shares; and d) €6 million from privatisation proceeds, but excluding revenue of €62 million from transfers of earnings on Greek government bond holdings by the Eurosystem central banks (Securities Markets Programme – SMP). Not including €11 million for the participation of the Greek State in capital increases (Public Corporation for Urban Development and Housing (DEPOS SA) and Hellenic Aerospace Industry (EAB SA)). Including expenditure of about €120 million for the payment of arrears.

In 2014, the expected achievement of a primary surplus should contribute to a reduction of public debt, while the relationship between the economic growth rate and the weighted average interest rate on outstanding government debt should continue to have an adverse effect, albeit to a lesser extent. As a result, the MTFS 2015-2018 expects the public debt to reach approximately €317.0 billion or 173.9% of GDP in 2014, before declining to €301.7 billion or 139.1% of GDP in 2018.

In its recent estimates, the European Commission expects the public debt-to-GDP ratio to be slightly higher (by 1 to 2 percentage points of GDP) in 2020-2022 relative to its July 2013 estimates, standing at 125.0% in 2020 and 112.0% in 2022. This reflects higher-than-expected deflation, a slight decline in privatisation proceeds and the build-up of new government arrears (including delays in the payment of tax refunds). However, these estimates are surrounded by considerable uncertainty and do not factor in the growth-enhancing effect of the structural reforms already implemented. For example, an additional percentage point of annual GDP growth from 2014 onwards would bring debt-to-GDP ratio down to about 100% by 2022.

As noted in the European Commission's Fourth Review and the MTFS 2015-2018, the government borrowing requirements are fully covered for the next twelve months. This view takes into account: (a) pending disbursements under the loan agreement; (b) the use of idle resources of general government entities; (c) funds available from the Common Fund of Legal Persons in Public Law and Social Security Funds, managed by the Bank of Greece, through repo operations of about €6 billion; (d) banks' buyback of preference shares which the Greek State acquired in 2009-2011 through the issuance of bonds worth about €5.1 billion;

and (e) the issuance of a 5-year government bond amounting to €3 billion. Also, according to the MTFS 2015-2018, Greece is already planning to re-tap international markets with a new issue of government bonds worth €3-6 billion. In any event, the Eurogroup statement of 5 May 2014 reaffirmed the commitment of euro area Member States to provide adequate support until Greece regains full market access.

4 FISCAL POLICY MEASURES AND INSTITUTIONAL FISCAL REFORMS – THE MTFS 2015-2018

Based on an upward revision of the outlook for fiscal revenue, the MTFS 2015-2018 projects that a primary surplus of 2.3% of GDP will be achieved in 2014 (in EAP terms), against an initial estimate of a surplus of 1.6% of GDP in the 2014 Budget. The primary surplus is expected to rise to 2.5% of GDP by 2015 and 3.5% of GDP by 2016, before climbing to 4.6% in 2017 and 5.3% of GDP in 2018, respectively, assuming no new fiscal measures are taken. Under these projections, the EAP targets will be overshot by 0.8%, 0.1% and 1.1% of GDP, respectively, in 2014, 2017 and 2018, while a fiscal gap of 0.5% and 0.1% of GDP is projected for the years 2015 and 2016, respectively. These projections, in particular those for more distant years, are surrounded by high uncertainty. The implementation of structural fiscal reforms and a strengthening of growth would contribute to eliminating any fiscal gap currently projected for 2015 and 2016.

Locking in the 2014 level of primary spending for the next five years (as a result of already implemented measures) would lead to a considerable decline in general government primary expenditure-to-GDP ratio, from 39.8% of GDP in 2014 to 33.8% of GDP by 2018. This would be largely due to: (i) a reduction in public sector staff costs as a percentage of GDP on account of the expected further decline in broader public sector employment and the curtailment of bonuses and other benefits, as well as (ii) savings in operational and social expenditure through measures to promote the viability of social security funds and contain healthcare expenditure. By contrast, interest payments, on a national accounts basis as opposed to those on a cash basis, are expected to rise to 5.0% of GDP in 2018, from 4.4% of GDP in 2014.

Moreover, the MTFS expects revenue to increase in nominal terms from a broadening of the tax base, as tax compliance improves and tax evasion is more effectively tackled, and from the more favourable macroeconomic environment. Positive effects on revenue are also expected from Law 4254/2014, which rationalises the existing tax framework; the offsetting of VAT refunds against debts of the broader public sector and private individuals; the reform of VAT and the enhanced collectability rate of tax and social security contribution arrears. Meanwhile, an effort to gradually reduce the tax burden on businesses and households, by lowering their respective tax rates, is envisaged. As a result of these measures, general government revenue is projected to improve in nominal terms, but decline as a percentage of GDP, from 43.8% in 2013 to around 40.0% in 2018. The two main categories of revenue that are expected to decrease as a percentage of GDP refer to direct tax and social security contribution, whereas indirect tax revenue should remain close to its 2014 level.

Turning to the privatisation programme, the MTFS 2015-2018 expects privatisation proceeds to reach €1.5 billion in 2014 (up from €1.0 billion in 2013), against an initial target of €3.56 billion in the 2014 Budget) and a cumulative total of €4.1 billion in 2011-2014. According to the MTFS 2015-2018, cumulative privatisation proceeds are expected to reach €15.45 billion over the 2011-2018 period and to further increase to €22.3 billion by 2020, slightly lower than the European Commission's July 2013 forecast[11] of €24.2 billion, because of delays in the programme implementation. In 2014, the main priorities under the programme

11 See footnote 7.

will be the privatisations of the Piraeus Port Authority (OLP), the Thessaloniki Port Authority (OLTH), the Athens International Airport, the Greek rail operator (TRAINOSE SA), the Hellenic Company for Rolling Stock Maintenance SA (EESSTY SA) and the Athens Water Supply and Sewerage Company (EYDAP).

Although the development of public assets is proceeding rather slowly, significant progress has been made with regard to the site of the former international airport in Hellinikon, as Lamda Development was selected by the Hellenic Republic Asset Development Fund (HRDAF) as the preferred investor for the acquisition of 100% of the shares of Hellinikon SA, with a bid of €915 million. This investment is expected to generate multiple benefits, both in terms of growth and on the fiscal front, in the years ahead. Also, there has been keen investor interest in a number of small ports and marinas, and regional airports. Meanwhile, efforts are underway to empower the supervisory and regulatory authorities that will oversee privatisation projects, in order to safeguard competition and the public interest. Moreover, public consultations have been launched on three draft laws dealing with issues related to public property: (1) reform of the institutional framework governing coastal zones; (2) removing obstacles to the acquisition of public real estate by private investors; and (3) out-of court settlement of ownership disputes between the State and private parties. Work is still underway to develop a scheme for the securitisation of future cash flows that will accrue to the public sector in the context of the development of state-owned real estate.

In March 2014, the Greek Parliament enacted Law 4254/2014 "Measures to support and develop the Greek economy in the context of implementation of Law 4046/2012, and other provisions". The omnibus law envisages the distribution of a "social dividend" to socially vulnerable groups, programmes targeted at those disproportionately hit by the crisis, such as the homeless, and a one-off bonus to low-earning Armed Forces and Law Enforcement personnel. Moreover, the new law brings about significant changes in the existing tax legislation, such as: (1) increase of the monthly amounts that are exempt from seizure, from €1,000 to €1,500 for wages and pensions; (2) non-seizure of assets for outstanding debts to the State of up to €500; (3) reduction of up to 80% in fines applicable on non-issuance of retail receipts; (4) exemption of property acquired before 1995 from the capital gains tax; (5) exemption of small shareholders from the capital gains tax on shares; (6) elimination of quasi-fiscal charges; and (7) offsetting of VAT refunds against VAT debts of the broader public sector and the private sector.

Under a legislative provision enacted in late April, VAT taxable persons with an annual turnover of up to €500,000 in the previous VAT reference period will have the option (from 2015 onwards) to defer VAT payment until the time of the cash payment of the underlying transaction instead of the accrual tax basis of VAT.

As discussed in Special Feature IV.1, the gradual recovery of the economy and intensified tax audits should have a positive effect on VAT collection in the medium to longer term. However, as also pointed out in the European Commission's Fourth Review, there are additional factors other than recession and poor auditing, which contribute to a low VAT efficiency ratio, such as VAT exemptions or reduced rates across various product categories and regions. The total VAT revenue lost as a result of these factors is estimated at about €10 billion. The forthcoming adoption of new measures to address this problem is expected to facilitate the task of tax authorities and enhance the efficiency of VAT collection. Such measures include de-registration of inactive companies from the VAT register, introduction of a VAT turnover threshold below which the obligation to file a VAT return will not apply, strengthening of VAT anti-fraud units and streamlining of VAT rates, possibly combined with an abolition of exemptions and the introduction of a uniform rate lower than the current 23%.

The collection rates of past and new taxpayer arrears rose sharply in 2013 (by 38% and 23%, respectively) compared with 2012, but still fell short of the annual targets (€1,518 million against €1,900 million). However, new tax arrears continue to accumulate, remaining a source of concern. Specifically, to the end-2013 arrears of €62.1 billion, new arrears of around €3 billion were added in the January-March 2014 period, bringing the total stock of arrears to €65.5 billion, of which around 70%-75% is uncollectable. Moreover, the arrangement for the collection of tax and social security contribution arrears through the "basic" (or regular) instalment scheme and the newly introduced "fresh start" scheme does not seem to have yielded as expected.

The draft law "Principles for Fiscal Management and Supervision – Public Finance Accounting System" introduces significant changes in the existing legal framework governing fiscal management and supervision, with a view to completing the transposition of Directive 2011/85/EU on requirements for budgetary frameworks of the Member States into Greek law. Specifically, two rules are established at the general government level: a "balanced budget rule" and a "debt brake rule". Under the balanced budget rule, the general government structural deficit must not exceed 0.5% of GDP (or 1% of GDP if general government debt is below 60% and risks to the longer-term sustainability of public finances are low). Under the debt brake rule, when general government debt is above the reference value of 60% of GDP, the excessive deficit must be reduced by an average rate of at least one twentieth per year. In the event of significant deviations from the above, an "adjustment path rule" is applied allowing for the triggering of an automatic correction mechanism, although a limited number of exceptional circumstances are defined which may activate certain escape clauses.

Under the same draft law, the monitoring, analysis and supervision of fiscal rules and policies is entrusted to the Hellenic Fiscal Council, a body currently under establishment which will enjoy operational independence.[12] Furthermore, all necessary changes are introduced to ensure that the preparation and publication of the Budget and the MTFS is in line with the timetable of the European Semester. The draft law also lays down the necessary statutory framework for the closer monitoring of general government sub-sectors, envisaging internal audit of all general government entities by competent Internal Control Functions. Moreover, it foresees the creation of a contingency reserve, equal to 1%-2% of annual budget appropriations.

12 The Bank of Greece has repeatedly stressed the importance of an independent fiscal council or another similar body. See Bank of Greece, *Annual Report 2006, Monetary Policy 2009-2010, Annual Report 2013.*

V MONEY, CREDIT, FINANCIAL MARKETS AND BANKS

The gradual restoration of confidence came from the stable, consistent and effective economic policy pursued and the considerable improvement of both macroeconomic and microeconomic conditions. In turn, this directly led to (i) a strengthening of banks' ability to raise funds in the international money market and, coupled with the favourable effect from the results of the new round of the stress testing exercise, (ii) the return of banks to world bond and equity markets. Moreover, as a result of renewed confidence, (iii) the Greek government raised funds from the international market in April, having been cut off for four years, while (iv) Greek bond yields in the secondary market declined sharply. Building a climate of confidence in Greece also created the necessary conditions for (v) the ongoing issues of corporate bonds in the international market by large Greek corporations, (vi) an inflow of foreign investors' funds into the Athens Exchange, which contributed to a rise in share prices, (vii) a redeposit of hoarded banknotes with Greek banks and (viii) a repatriation of funds into the domestic banking system. Nevertheless, credit growth remained in negative territory: apart from weak demand for bank loans, this is largely due to the dampening effect on banks' lending ability from accumulated troubled assets. With the establishment of a Government Council for Private Debt Management and the preparation by the Bank of Greece of a framework of supervisory requirements for banks' NPL management, as well as a Code of Conduct for the management of private sector arrears, the ground has been laid for addressing these issues.

Although a repatriation of funds and a redeposit of hoarded banknotes with the Greek banking system were observed in 2013 and early 2014, as a result of a gradual restoration of confidence, deposits with domestic credit institutions kept decreasing almost relentlessly up until February 2014.

Economic recovery will contribute to a progressive further rise in deposits, despite the expected continuous downward path of interest rates, thereby enhancing banks' ability to finance economic activity in the medium term. This ability is now greater, as banks have started to gradually regain access to global financial markets. For the time being, however, this is not accompanied by a notable moderation in the annual rate of decline in bank credit to non-financial corporations and households, but has enabled the repayment of a sizeable part of the funding that credit institutions had received by the central bank during the crisis.

Banks' lending activity is expected to gather pace over the medium term, because Greece's gradual recovery will allow for the implementation of business plans that banks would be able to back without incurring any losses. Greece's gradual exit from the crisis will also lead to a progressive downward revision of the perceived credit risk (squeezing, in turn, lending rates) and halt the downturn in the housing market. At the same time, increasing internal capital generation and reducing the accumulation of troubled assets will be made possible for banks given that, as discussed below, the groundwork has been laid for better NPL management.

Furthermore, the pick-up in economic activity will boost demand for bank credit, thereby contributing to upward pressures on bank lending rates *ceteris paribus*. The effect of these developments could weaken if the trend observed in 2013 and early 2014 of large corporations to resort to debt issues in the international market (where favourable conditions prevail) intensifies and if the domestic corporate bond market grows further. Raising funds through bond issues on the global market has already helped mitigate the consequences of limited bank credit to non-financial corporations.

The European Investment Bank (EIB) and the National Hellenic Fund for Entrepreneurship and Development (ETEAN) will continue to support bank financing of the real economy, while the newly founded Greek Investment Fund is expected to play an important role in channeling financial resources towards small and medium-sized enterprises.

In March 2014 the results of the stress testing exercise conducted by the Bank of Greece were released, estimating the aggregate capital needs of Greek banks up to December 2016.

The banking sector must now optimise its troubled asset management in a manner that alleviates the burden on cooperating borrowers facing temporary difficulties in servicing their debts. *In the long term*, such a strategy will enable banks to unlock funds that are currently tied up in non-performing loans.

With the establishment of a Government Council for Private Debt Management at ministerial level and the preparation by the Bank of Greece of a framework of supervisory requirements for banks' NPL management, as well as a Code of Conduct for the management of private sector arrears, the ground has been laid for the creation of a mechanism for resolving non-performing loans. Considerable headway has been made in the realisation of assets of banks under liquidation, which on an initiative of the Bank of Greece are being managed in a relatively uniform manner. Besides, credit institutions (relying on the experience they have acquired from the restructuring of the banking sector) should support enterprises active in distressed economic sectors, showing them the way to bold sectoral restructuring.

Improved confidence of international investors in Greek securities, coupled with the positive response of the markets to the release of the stress test results, has facilitated the recent capital increases by the four core banks, with the participation of private investors only, while for the first time since the onset of the crisis banks have moved to the issuance of senior debt. Inextricably linked with the above developments and an important milestone was also the issuance of a five-year bond. This came after a long decline in Greek government bond yields and demand was strong after the four-year period in which Greece was shut out of the international market for medium- to long-term bonds. The Athex composite share price index has been following an upward path for several months, also supported by foreign capital inflows. In addition to an increase in transactions on the secondary market, a rise in new issues of shares from non-financial corporations was recorded.

1 BANK DEPOSITS AND M3

In 2013 and the first months of 2014, declining uncertainty contributed to a repatriation of funds placed in deposits and debt securities abroad, as well as to the redeposit of banknotes, which had been hoarded at the height of the crisis.

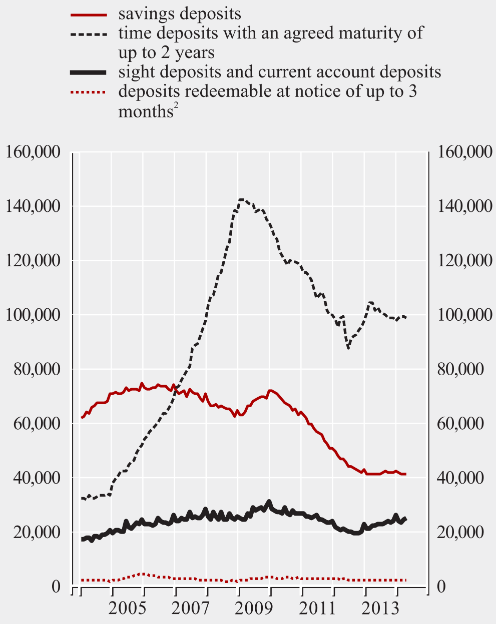
However, deposits with domestic credit institutions decreased (see Chart V.1), in line with the downward course of GDP, the price level and the average nominal deposit rate, all of which have a positive effect on demand for deposits, albeit with a time lag.[1] From a different perspective (on the money supply side), it can be argued that the decline in deposits was also driven by the fact that, as a result of shrinking bank lending, the number of new accounts, which are typically opened to borrowers to be credited with the loan proceeds, also fell.

Between end-2012 and April 2014, overnight deposits[2] by households declined (by -2.4%). Conversely, time deposits of the household sector rose (by 0.9%) due to limited preference for liquidity amid eased uncertainty and despite the narrowing of the (positive) differential between interest rates on time deposits and overnight deposits. Deposits by non-financial corporations decreased (by -1.2%). The

1 HICP deflated outstanding deposits by non-financial corporations and households (which, according to the traditional definition of demand for money, should be positively correlated with real GDP and deposit rates) remained virtually unchanged, on average, between 2013 and the first four months of 2014, hovering very close to the average level of the first half of 2012.
2 Overnight deposits comprise savings and sight deposits as well as current accounts.

Chart V.1 M3 deposits in Greece[1]
(January 2004-April 2014)

(end-of-period balances; million euro)



Source: Bank of Greece.
1 These aggregates are included in M3 together with repurchase agreements (repos), money market fund shares/units, and debt securities with a maturity of up to two years issued by domestic MFIs (minus domestic MFI holdings of debt securities issued by MFIs of other euro area countries) according to the ECB definition.
2 Including savings deposits in currencies other than the euro.

annual rate of change in M3 (excluding currency in circulation), 90% of which consists of the abovementioned categories of deposits, was positive during the largest part of the period (April 2014: 0.8%).

However, the most important changes concerned deposits by non-residents (-27.7%) and by general government (+26.9%).[3] The decline in non-residents' deposits reflects to a certain extent technical factors (e.g. banks' intra-group transactions), while the rise in general government deposits mainly reflects the inflow of borrowed funds from the EU and the IMF to the Greek government.

The recovery in economic activity will bring along a rise in household savings and demand for deposits; at the same time, more new loans will gradually be granted, which will also contribute to an increase in the volume of new deposits. Besides, the return of hoarded banknotes or deposits from abroad into the Greek banking system, as well as capital inflows in general, which all contribute to money creation in Greece, will gather pace so long as there is mounting evidence that Greece is overcoming the crisis.

2 BANK DEPOSIT RATES

Interest rates on new deposits, especially time deposits, declined (see Table V.1). This is associated with lower uncertainty, the fact that banks looked for alternative sources of financing, other than retail deposits, and the lower cost of drawing liquidity from the central bank.

The projected economic growth may push bank interest rates upwards (see Section V.4). Upward pressures, especially on deposit rates, are expected to subside, as the interest rate on Greek Treasury bills and Greek government bond yields continue to decline and confidence in credit institutions is enhanced with the functioning of the Banking Union. Furthermore, the single monetary policy will continue to be accommodative (see Chapter II.3), which among other things implies that bank deposit rates in the other euro area countries will remain at low levels. To the extent that, for the household sector, these deposits compete deposits with Greek banks, low interest rates in other member countries will squeeze Greek deposit rates, without a concurrent capital outflow.

3 BANK LENDING RATES

Interest rates in most categories of new bank loans kept decreasing during most of the period under review. However, in the first four

3 As regards deposits by non-residents, M3 comprises only deposits by non-Greek euro area residents. Turning to general government deposits, M3 comprises deposits by local government entities and social security and welfare organisations (which recorded the largest increase among all general government deposits with MFIs excluding the Bank of Greece over the examined period).

Table V.1 Bank interest rates on new deposits and loans in Greece

(percentages per annum)

	April 2014	Change Dec. 2012-April 2014 (percentage points)
Deposits with an agreed maturity of up to one year (i.e. time deposits[1])[2]		
by households	2.71	-1.99
by non-financial corporations	2.55	-1.60
Loans to households and non-financial corporations[2]		
with a floating rate or an initial rate fixation of up to one year:		
– housing loans	3.03	-0.01
– consumer loans	7.69	0.10
– loans of up to €1 million to non-financial corporations	6.19	-0.27
– loans of more than €1 million to non-financial corporations	6.64	0.57
loans without a defined maturity to non-financial corporations	7.22	-0.30

Source: Bank of Greece.
1 However, about 1% of deposits with an agreed maturity consists of deposits other than time deposits.
2 Monthly averages.

months of 2014 interest rates in several loan categories rose (see Table V.1). In real terms,[4] interest rates on new loans continued to rise over the period under review as a result of a stronger decline in the general level of prices and came close to 7.5% in April 2014.

The decline in nominal interest rates was supported by credit institutions' lower average cost of refinancing (through retail deposits or funding from the Bank of Greece), which in a number of cases helped banks facilitate borrowers' debt servicing by offering more favourable terms in existing loans. For corporate loans, the lower cost of bank lending is associated with credit co-financed or guaranteed by the EIB and the Hellenic Fund for Entrepreneurship and Development (ETEAN), which implies lower interest rates. The further enhancement in Greek banks' liquidity and the decline in credit risk coupled with the recovery of economic activity, as well as reduced operating costs as a result of the banking system's restructuring that is currently under way will help squeeze down the interest rate margin and lending rates. By contrast, upward pressures are expected on interest rates and their margin from a pick-up in demand for loans and credit institutions' need for sufficient loan-loss provisioning. In fact, interest rate hikes in the first quarter of 2014 could possibly reflect, apart from technical factors (e.g. the fact that loans are typically rescheduled month-on-month), a weaker decline or an emerging pick-up in demand for bank loans.

4 BANK CREDIT

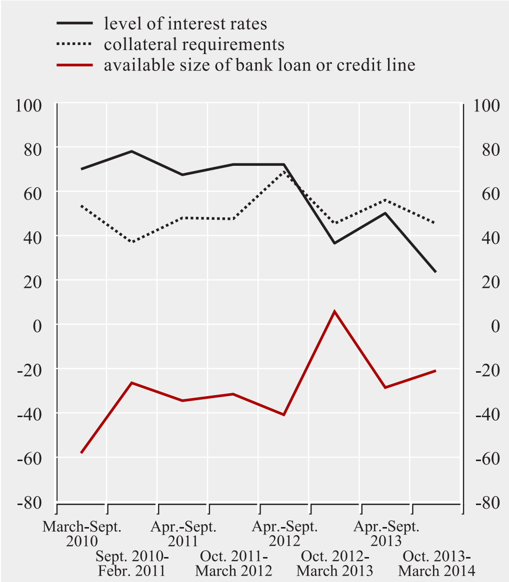
The annual rate of change in bank credit to the general government remained negative (December 2012: -7.9%; April 2014: -4.6%). This is due to the fact that general government borrowing requirements were to a large extent met by the country's international creditors, while from 2013 onwards credit institutions' bond portfolios appear to have significantly weakened[5] mainly as a result of the public debt restructuring and the debt buyback operation in 2012. The annual rate of decline in credit to

4 The real interest rate in a given month is that month's nominal rate minus the year-on-year inflation rate of the same month.
5 MFI credit to the general government does not include only loans; in the past it mainly concerned the purchase of government debt securities by credit institutions. Consequently, credit to the general government may be limited if the outstanding amount of government securities held in banks' portfolios is reduced.

households moderated slightly (2012 average: -4.2%; Jan.-Apr. 2014: -3.3%), while the respective rate for non-financial corporations accelerated (December 2012: -3.3%; April 2014: -4.6%).

Chart V.2 Bank lending terms in Greece

(over the preceding six months, net percentage of small and medium-sized enterprises)



Source: EC/ECB, Survey on the access to finance of SMEs (SAFE).
Base: All SMEs in the sample that had applied for bank loans. Figures refer to round three (March-September 2010) and up to round ten (October 2013-March 2014) of the Survey.
Note: The net percentage is the difference between the percentage of firms reporting an increase in the level of interest rates, the collateral requirements, or the available size of bank loan or credit line and those reporting a decrease.

The recapitalisation of the banking system and the easing of uncertainty, which helped credit institutions gradually regain access to international money[6] and capital markets, are estimated to have had a positive effect on the supply of bank credit to the economy, as corroborated by the Eurosystems' Bank Lending Survey. Furthermore, the Survey on the access to finance of enterprises in the euro area (SAFE) conducted by the Eurosystem and the European Commission[7] points to a decrease in the percentages of small and medium-sized enterprises which reported (i) an increase in bank lending rates, (ii) a tightening in banks' collateral requirements and (iii) a decrease in the size of loans (see Chart V.2). Although the percentage of enterprises in the sample which applied for a bank loan (15%) declined further, the share of rejected applications (27%) also shrank.

On the other hand, the accumulation of non-performing loans has a negative effect on the supply of credit. This provides, among other things, indications —albeit not leading— of heightened credit risk, reduces banks' liquidity, as it deprives them of income from interest payments that could otherwise have been recycled into new credit, and hampers banks' ability to raise funds on financial markets. Besides, the contraction in nominal GDP and particularly in private fixed capital formation is likely to have adversely affected demand for loans.

Over the period under review, banks used a large part of their resources to gradually repay the funding they had received by the central bank during the period they were more or less shut out of the interbank market and had to face a sizeable outflow of retail deposits. Thus, the amount of such funding was almost halved between December 2012 and April 2014 (to €62 billion, reaching levels similar to early 2010). As a consequence, the funds that credit institutions will have to allocate to further reduce their reliance on central bank financing are respectively lower.

The path of the annual rate of change in MFI financing of non-financial corporations is consistent with weakening demand for bank credit in 2013 and early 2014. A concurrent increase in the supply of credit may have also been recorded but, as implied by decelerating credit growth over most of the period, it must have had a weaker expansionary effect on the volume of new loans than the dampening effect from the decline in demand for loans. On the other hand, the evolution of the annual rate of

6 Access to money markets was facilitated by the enhancement of credit institutions' portfolios with EFSF notes, see Bank of Greece *Annual Report 2013.*
7 Referring to the six-month period from October 2013 to March 2014.

change in MFI financing to households also reflects a technical factor: the high NPL ratio, mainly in consumer credit, leads to relatively low interest payments by households and therefore to a respective artificial moderation in the annual rate of decline in new loans (which is calculated on a net basis, i.e. minus interest payments) to the household sector. Of course, it should not be overlooked that if banks actually collected interest payments, the subsequent short-term technical strengthening of the annual rate of decline in new loans to households would lead to an increase in credit growth over the medium term, as banks would obtain additional liquidity that could be channeled into new loans.

The recovery of the Greek economy is expected to help stimulate both loan demand and supply over the medium term. Loan supply will be positively influenced by reduced credit risk, renewed capital increases and restored bank profitability, as well as by a progressive decrease in accumulated troubled assets (lower new NPLs) *inter alia* as a result of improved management by banks. Similarly, a positive effect is expected from banks' increasing access to international capital markets and the continued return of both hoarded and expatriated banknotes and deposits to the domestic banking system, as confidence takes hold. Confidence in the prospects of Greek banks in particular, which has recently been supported by the results of the stress test conducted by the Bank of Greece (see Section 7 of this chapter), will be bolstered further with the completion of the EU-wide stress testing exercise under the auspices of the ECB in the coming autumn.

At the same time, increased demand for bank loans and a subsequent upward pressure on bank rates could ease, to the extent that the necessary expansion of the domestic corporate bond market goes forward and domestic corporations continue to benefit from the favourable prospects for funding on the global market. The restoration of profitability and the subsequent increase in domestic corporations' internal financing ability thanks to the recovery of aggregate demand will play a key role in broadening the range of alternative sources of financing of the real economy.

Lastly, it should be noted that the supply of bank credit particularly to SMEs will be supported by the Hellenic Fund for Entrepreneurship and Development (ETEAN), the European Investment Bank (EIB) and the newly founded Greek Investment Fund through the co-financing of bank loans as well as through the provision of guarantees to cover for bank credit (or other interventions, e.g. participation in share capital). Besides, at the European level, technical preparations are in progress to implement new initiatives for promoting (through the guarantee and securitisation of bank loans) bank financing to SMEs.

5 BOND MARKETS

In 2013 and the first months of 2014, investors' interest in Greek securities rose at the international level. This happened because the perceived idiosyncratic risks of the Greek economy declined considerably, given the successful fiscal adjustment and the implementation of reforms. However, an overall improvement in investor sentiment regarding the euro area's prospects has been observed, as a result, among other things, of (a) the ECB's resolve to safeguard the integrity of the Monetary Union, (b) the establishment of the Banking Union, which bolsters the EU financial system, (c) the headway in terms of fiscal and structural adjustment also in other Member States, and (d) the establishment of a stricter framework which now governs economic policies and averts the accumulation of macroeconomic imbalances in the euro area.

Pressing ahead with the reform policy, which increases confidence in the Greek economy and enhances its growth prospects and the sustainability of fiscal discipline and stability, is expected to contribute to a further decline in Greek government bond yields. An agreement with the country's official creditors, stipulating more favourable terms of loan repayment based on progress made in the adjustment of the Greek economy, would considerably help in this direction.

Greek government securities

In 2013 and over the January-May 2014 period, Greek government bond yields followed a downward path. At end-May 2014 the yield on the ten-year Greek government bond stood at 6.29%, i.e. much lower than the level recorded before the downgrading of Greece's sovereign debt below investment grade (21 April 2010) (2013 average level: 10%). The yield differential vis-à-vis its German counterpart narrowed at end-May 2014 to 494 b.p., compared with 840 b.p. on average in 2013 (and its highest level of 1,167 b.p. at end-March as a result of the Cyprus crisis) (see Chart V.3). Over the January-May 2014 period, the average daily value of transactions on the Electronic Secondary Securities Market (HDAT) was €23 million (2013: €6 million) and €320 million (2013: €245 million) on the Dematerialised Securities System – where securities that are not traded on HDAT are also settled.

The downward trend of yields contributed to the creation of favourable conditions for the issue of Greek government bonds for the first time since March 2010. On 10 April 2014, €3 billion were raised through the issue of a five-year bond with an annual coupon of 4.75%. Demand from international investors was strong: the issue was oversubscribed by at least eight times and the amount raised was upsized from the €2.5 billion sought by the Greek State. The five-year bond issue came to complement the range of maturity segments in the sovereign bond yield curve, which is now positively sloped across all lengths of up to 30 years. Furthermore, the regular issues of 13-month and 26-month Treasury bills continued, through which €15.6 billion were raised in total over January-May 2014, with an average weighted interest rate of 3.2% (2013: €39.4 billion with an average rate of 4.1%).

Chart V.3 10-year bond yields (January 2009-May 2014)

(daily data, in percentage points)

Source: Electronic Secondary Securities Market (HDAT), Bank of Greece.

Corporate bonds

Between end-2012 and May 2014, Greek non-financial corporations issued corporate bonds with maturities of 3 up to 7 years, at a total nominal value of €4.8 billion. The bulk of the funds raised was used for the repayment of bank credit, while the remainder was used to finance investment.

Given that also banks raised funds through the issuance of corporate bonds, amounting to €1.3 billion, it is clear that corporate bond markets could very well constitute an important source of financing of the Greek economy, insofar as risk assessment conditions in the secondary market continue to be positive, which in turn will hinge upon the international environment. It should be noted that between end-2012 and end-May 2014 the weighted average prices of outstanding corporate bonds have risen by about 10% since their issuance, thereby leading to a decline in yields to maturity, by up to 400 b.p. below the respective levels of coupons.

6 THE STOCK MARKET

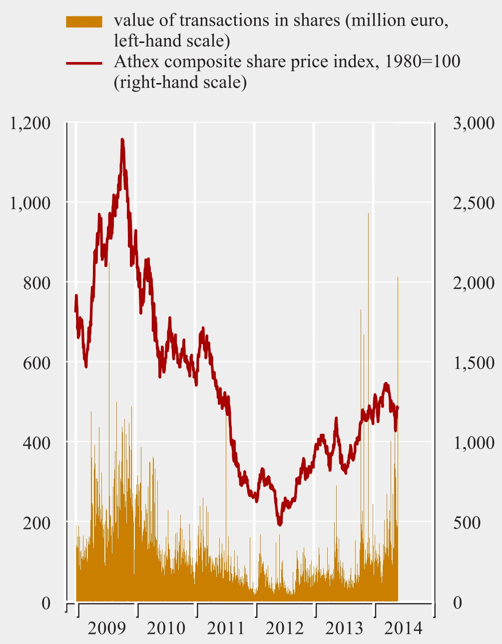
The Athens Exchange (Athex) composite share price index has been following an upward course since the end of the first half of 2012 (see Chart V.4), as investor confidence improved and, subsequently, positive expectations regarding the profitability prospects of listed companies emerged. Over the January-May 2014 period, the Athex composite index rose by 5% (2013: 28%), while the banking sub-index, following the capital increases by a number of banks, fell by 1% (2013: -21%). As a result, total market capitalisation came to €77 billion at end-May 2014. It should be noted that in the first five months of 2014 the Dow Jones EURO STOXX index for the euro area and the S&P 500 index for the United States rose by 5% and 4%, respectively.

Over the same period, the average daily value of transactions rose by 88%, year-on-year. This development was also underpinned by the strong participation of foreign investors. In the first four months of 2014, the inflow of foreign investors' funds into the Athens Exchange amounted to €507 million, compared with €258 million one year earlier. The average daily volatility in the composite index was quite stable (January-May 2014: 1.7%; 2013: 1.8%), whereas the sub-index of the banking sector declined (January-May 2014: 2.2%; 2013: 4.3%).

Over the first five months of 2014, Greek banks tapped into the stock market and raised a total of €8.3 billion. Non-financial corporations raised €69 million – an amount which may be low but is considerably higher compared to the respective period of 2013 (€20 million).

Chart V.4 Athens Exchange composite share price index and value of transactions (January 2009-May 2014)

(daily data)



Source:Athens Exchange.

7 DEVELOPMENTS IN THE BANKING SECTOR

Important and promising developments have taken place in the banking sector, especially after the Bank of Greece released the results of the stress test in March 2014. Soon after the release, the four core banks carried out sizeable capital increases attracting private investors, while two of these banks were able to regain access to global bond markets through the issue of senior debt. Serious challenges remain, most notably the challenge of effectively managing non-performing loans.

Greek commercial banks' financial results improved substantially in 2013, as after-tax profits of about €5 billion (see Table V.2) were posted for the first time in three years, a development which is however due to one-off events.[8]

With respect to operating results, income was higher than costs, a trend which is expected to take hold, given the continued fall in banks'

8 More specifically, in line with internationally recognised practices, a negative goodwill (amounting to €6.5 billion for banks and €6.8 billion for banking groups) was recorded from the acquisition of foreign banks' subsidiaries and branches in Greece by the core banks. Moreover, the hike in the corporate tax rate to 26% in 2013 from 20% in 2012 had a positive effect on banks' results via deferred tax assets.

Table V.2 Financial results of Greek commercial banks and banking groups (2012-2013)

(million euro)

	Banks			Banking groups		
	2012	2013	Change (%)	2012	2013	Change %
Operating income	**4,920**	**6,041**	**22.8**	**9,953**	**9,988**	**0.4**
Net interest income	5,069	4,760	-6.1	7,978	7,855	-1.5
– Interest income	14,084	10,651	-24.4	18,935	15,730	-16.9
– Interest expenses	9,015	5,891	-34.7	10,957	7,874	-28.1
Net non-interest income	-148	1,282	-	1,975	2,132	8.0
– Net fee income	634	591	-6.7	1,412	1,422	0.8
– Income from financial operations	-747	13	-	-34	349	-
– Other income	-35	677	-	597	361	-39.6
Operating costs	**-4,552**	**-4,395**	**-3.5**	**-6,731**	**-6,792**	**0.9**
Staff costs	-2,623	-2,535	-3.3	-3,714	-3,764	1.4
Administrative costs	-1,601	-1,581	-1.3	-2,399	-2,475	3.1
Depreciation	-328	-278	-15.2	-618	-553	-10.5
Net income (operating income less costs)	**368**	**1,647**	**347.7**	**3,222**	**3,196**	**-0.8**
Provisions for credit risk	-9,189	-5,791	-37.0	-10,489	-7,471	-28.8
Other impairment losses[1]	-1,614	-1,133	-29.8	-1,672	-819	-51.0
Non-recurring profits/losses[2]	-94	6,545	-	-198	6,809	-
Pre-tax profits	**-10,529**	**1,268**	**-**	**-9,137**	**1,715**	**-**
Taxes	1,590	3,492	-	1,351	3,282	-
Profits/losses from discontinued operations	-62	1	-	-82	-45	-45.0
After tax profits	**-9,001**	**4,761**	**-**	**-7,868**	**4,951**	**-**

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

financing costs and their intensified efforts to cut operating expenses.[9] Nevertheless, net income (operating income less operating expenses) was insufficient to cover provisions for credit risk.

Loan portfolio quality deteriorated further, although the rate of increase in NPLs decelerated in the course of 2013. The NPL ratio stood at 31.9% at end-December 2013, up from 24.5% at end-December 2012. This deterioration was comparatively smaller in housing loans (2013: 26.1%, 2012: 21.4%) and more pronounced in corporate loans (2013: 31.8%, 2012: 23.4%) and consumer credit (2013: 47.3%, 2012; 38.8%). The coverage ratio (accumulated provisions to NPLs) remained broadly unchanged (2013: 49.3%, 2012: 49.1%).

At end-March 2014, the results of the stress test exercise were released, estimating the aggregate capital needs of Greek banks for the period June 2013-December 2016 at €6.4 billion under the Baseline Scenario and at €9.4 billion under the Adverse Scenario.[10] As a starting point, the reference Core Tier 1 capital as at June 2013 and as defined for the pur-

9 In 2013 operating costs were affected by the cost of personnel voluntary retirement schemes and extraordinary contributions to the Hellenic Deposit and Investment Guarantee Fund.
10 *2013 Stress Test of the Greek Banking Sector*, Bank of Greece, March 2014.

poses of the exercise,[11] along with banks' accumulated provisions for credit risk as at June 2013, were used to estimate capital needs. Then, the Bank of Greece adjusted conservatively the information obtained from banks' restructuring plans (such as projected operating profitability and its components, estimated gains from potential sale of assets, etc.), factoring in the results of the independent diagnostic study conducted by BlackRock, assessing future losses on Greek banks' loan portfolios in Greece and abroad. Thus, banks' credit loss projections, as estimated by BlackRock, and the conservative assumptions of the Bank of Greece on the coverage ratio for the end-June 2013 to December 2016 period had an upward effect on capital needs. Conversely, banks' estimated operating profitability and capital enhancement strategies (e.g. sale of non-core business or international subsidiaries) had a downward effect on the estimation of capital needs.

The results of the bank stress test exercise were well received by the markets, which rated very highly the transparency and the conservative approach of the exercise. With regard to conservatism, apart from the aforementioned downward adjustment of the estimated (by credit institutions themselves) operating profitability, the diagnostic study reviewed 94% of the Greek banks' loan balances on a consolidated basis. Furthermore, for the purposes of the exercise, the Bank of Greece required banks to have sufficient provisions by end-2016 to cover:

– at least 95% of lifetime losses as estimated by BlackRock under the Baseline Scenario and 85% in the Adverse Scenario; and

– at least 52% of the NPLs as estimated by BlackRock for end-2016 under the Baseline Scenario.

Markets' rising confidence in the credibility of the stress tests and the prospects of Greek banks in general is evidenced by the successful capital increases carried out by the four core banks in just two months. The increases amounted to a combined total of €8.3 billion and attracted wide participation from foreign investors. Indeed, Piraeus Bank and Alpha Bank were able to cover not only the capital needs identified by the stress tests, but also secured sufficient funds to buy back the preference shares held by the Greek State under the capital injections provided in implementation of Law 3723/2008. International investor confidence is also evidenced by Greek banks' regained access to global bond markets. More specifically, Piraeus Bank and the National Bank of Greece proceeded to the issuance of senior debt amounting to €500 million and €750 million with a maturity of three and five years, respectively. The issues were significantly oversubscribed (by six and three times, respectively).

Moreover, banks have submitted plans to cover the capital shortfalls identified in the Adverse Scenario. According to the Memorandum, the restructuring plans must be assessed by the Bank of Greece by end-June 2014. It should be noted that several banks have already covered their needs through capital increases, while the plans also comprise a number of mitigating actions and policies (e.g. sale of non-core business or foreign subsidiaries).

After its successful restructuring and recapitalisation, the Greek banking sector continues to be faced by serious challenges, most notably that of effectively managing non-performing loans. To this end, important steps have been taken at the institutional level. Law 4224/2013 provides for the creation of a permanent mechanism for resolving non-performing loans of both businesses and households. A pivotal role is played by the Government Council for Private Debt Management, consisting of the Ministers of Finance, Development, Justice and Labour, with a mandate to develop policies, suggest legislative changes and, in general, prepare actions towards resolving non-performing loans of the private sector. The Bank of Greece was assigned

11 Reference Core Tier 1 is calculated after imposing a cap on net Deferred Tax Assets (DTA) at 20% of total Core Tier 1.

with the task of drafting a Code of Conduct for the management of private sector arrears, taking into account the definitions of "cooperative borrowers" and "reasonable living expenses", as provided by the Government Council.

The Code was prepared in line with best international practices, the principles of the International Association of Restructuring, Insolvency & Bankruptcy Professionals (INSOL), the respective frameworks of other EU Member States which are faced with similar challenges (Ireland, Cyprus, Portugal) as well as the proposals of parties (e.g. banks, consumers' associations, etc.) involved in the consultation process. The Code establishes general principles of conduct and introduces best practices which aim at strengthening confidence, mutual commitment and the exchange of the required information between the borrower/debtor and the lender. The ultimate objective is to ensure that both parties can weigh the pros and cons of the various options/alternatives for the debt servicing (loan restructuring) or the final settlement of non-performing loans, with a view to working out the most appropriate solution on a case-by-case basis. The Code outlines the steps, the deadlines and the minimum content of information that both banks and borrowers must submit, so that risks as well as the repayment capacity of each borrower are effectively assessed. Possible options include the repayment of interest only or of a lower interest instalment over a short period, the granting of a grace period, the deferred payment of one or several loan instalments, the settlement of arrears, etc.

At the same time, the Bank of Greece has also established the organisational requirements that banks should meet in line with the Code. For instance, credit institutions should be able to provide concrete proof to the Bank of Greece that they have put in place an appropriate system and procedures for the implementation of the Code, as well as internal procedures to monitor compliance with the Code and applicable laws, with a view to ensuring a lawful and consistent treatment of borrowers. Furthermore, banks should be adequately manned to meet the number of customers in each branch, while their staff must be duly trained and qualified, with the necessary communication skills to efficiently deal with cases coming under the Code. Overall, the implementation of the Code aims at alleviating the burden on borrowers facing proven temporary difficulties in servicing their debts, but also at maximising recovery from non-performing loans. To enhance the Code's effectiveness, the establishment of ancillary mechanisms is envisaged, such as public awareness campaigns or a network of professional advisors/consultants responsible for informing borrowers and assisting them in taking rational decisions.

In addition to the big challenge of managing non-performing loans, an important effort is currently under way to recover the claims of banks under liquidation. On an initiative of the Bank of Greece, the management of banks under liquidation is now performed in a uniform manner, as, apart from the creation of a Special Liquidation Committee, special liquidators must submit to the Bank of Greece data concerning the course of recovered amounts, on a monthly basis and in a given format, which are then assessed against quarterly data. The Bank of Greece is constantly monitoring the expenses of liquidators, and is currently exploring the advisability and the modalities of an operational integration of part or all special liquidation cases. The success of the policy pursued is evidenced by a sizeable improvement in the figures of recovered claims, particularly if account is taken of the fact that non-performing loans overdue by more than 360 days account for 85.1% of total loans in the portfolios of banks under liquidation. Total recovered amounts from loans in the portfolios of banks under liquidation, from the first liquidation up to 31 December 2013, came to €324.9 million, i.e. the recovery rate was 8%,[12] following an upward trend especially from the

12 The recovery rate is calculated as the ratio of the amounts recovered through liquidation to the fair value of loans under liquidation (i.e. the difference between total loans and provisions).

first quarter of 2013 onwards, when the recovery rate was only 3.7%. Based on this dynamics and the expected further improvement in the effectiveness of procedures, the medium-term target for the recovery rate is close to 20%.

Apart from effective management, recovered amounts are expected to increase on account of the consolidation of positive growth rates in the Greek economy. This will inevitably fuel a decline in troubled loans, as the repayment capacity of households and non-financial corporations will steadily improve.

The enhanced management of troubled assets is set to have favourable chain effects on banks' ability to finance sound entrepreneurship, as banks' lending capacity is inextricably linked with the smooth and timely repayment of outstanding loans.

Lastly, relying on the experience they acquired from the restructuring of the banking sector, banks could also have a significant contribution to the sectoral restructuring of the Greek economy. Banks have already established relations with firms that are active in distressed sectors, with a view to contributing to their effective overhaul. Banks must now make their contribution to the restructuring of productive capacity and help the new growth model gain traction. Therefore, they must undertake the necessary action to:

- channel credit into truly viable enterprises, whether new or old;

- encourage business partnerships, with a view to boosting dynamics, export-orientedness and competitiveness of domestic firms in global markets; and

- support initiatives conducive to bold sectoral restructuring.

The Greek banking system has now a stronger potential than before. Banks could therefore constitute a driver of the private business sector's productive restructuring, bearing in mind the ensuing gains for the economy as a whole.

CHRONOLOGY OF MAIN MONETARY POLICY MEASURES OF THE EUROSYSTEM

20 MARCH 2013

The Governing Council of the European Central Bank (ECB) adopted Guideline ECB/2013/4 (2013/170/EU) of 20 March 2013 which suspends the Eurosystem's minimum requirements for credit quality thresholds applicable to marketable debt instruments issued or fully guaranteed by the central governments of euro area Member States under a European Union/International Monetary Fund programme, unless the Governing Council decides that the respective Member State does not comply with the conditionality of the financial support and/or the macroeconomic programme. This Guideline lays down a haircut schedule applying to marketable debt instruments issued or fully guaranteed by the Hellenic Republic.

21 MARCH 2013

The Governing Council of the ECB decided to maintain the current level of Emergency Liquidity Assistance (ELA) to the central Bank of Cyprus until 25 March 2013. Thereafter, Emergency Liquidity Assistance (ELA) could only be considered if an EU/IMF programme is in place that would ensure the solvency of the concerned banks.

22 MARCH 2013

The Governing Council of the ECB decided to prevent, as of 1 March 2015, the use as collateral in Eurosystem monetary policy operations of uncovered government-guaranteed bank bonds that have been issued by the counterparty itself or an entity closely linked to that counterparty.

As of 1 March 2015, the Eurosystem will also no longer accept covered bonds issued by the counterparty where the asset pool contains uncovered government-guaranteed bank bonds also issued by that counterparty or an entity closely linked to that counterparty.

Until 28 February 2015, counterparties may submit as collateral uncovered government-guaranteed bank bonds that they themselves have issued, up to the nominal value of these bonds, as approved by the Governing Council on 3 July 2012.

2 MAY 2013

The Governing Council of the ECB decided to decrease the interest rate on the main refinancing operations by 25 basis points and the interest rate on the marginal lending facility by 50 basis points to 0.50% and 1.00%, respectively, as from 8 May 2013, while the interest rate on the deposit facility will remain unchanged at 0.00%.

It also decided to continue conducting its main refinancing operations (MROs) as fixed rate tender procedures with full allotment for as long as necessary, and at least until 8 July 2014. This procedure will also remain in use for the Eurosystem's special-term refinancing operations with a maturity of one maintenance period, which will continue to be conducted for as long as needed, and at least until the end of the second quarter of 2014. The fixed rate in these special-term refinancing operations will be the same as the MRO rate prevailing at the time. Furthermore, the Governing Council of the ECB has decided to conduct the three-month longer-term refinancing operations (LTROs) to be allotted on 31 July, 28 August, 25 September, 30 October, 27 November and 18 December 2013 and 29 January, 26 February, 26 March, 30 April, 28 May and 25 June 2014 as fixed rate tender procedures with full allotment. The rates in these three-month operations will be fixed at the average rate of the MROs over the life of the respective LTRO.

Finally, the Governing Council of the ECB has decided that marketable debt instruments issued or fully guaranteed by the Republic of Cyprus and fulfilling all other eligibility criteria shall again constitute eligible collateral for the purposes of Eurosystem credit operations, as from 9 May 2013, subject to special haircuts. The application of the minimum credit rating threshold in the collateral eligibility requirements for the purposes of the Eurosystem's credit operations shall be suspended. In this decision, the Governing Council has taken into consideration the Memorandum of Understanding concluded between the Republic of Cyprus and the European Commission and endorsed by the Member States, reflecting the economic and financial adjustment programme for Cyprus.

18 JULY 2013

The Governing Council of the ECB decided to review its risk control framework, which lays down its collateral eligibility rules and haircuts applied when accepting collateral in Eurosystem monetary policy operations. The measures taken together have an overall neutral effect on the amount of collateral available. In the biennial review of its risk control framework, the Governing Council decided in particular to:

– update the haircuts for marketable and non-marketable instruments;

– adjust the risk control measures for retained covered bonds to take into account the additional risk which results from the use of such securities by the issuer itself;

– replace the current requirement of two "triple A" ratings with the requirement of two "single A" ratings for the six classes of asset-backed securities (ABS) subject to loan-level reporting requirements, reflecting their improved transparency and standardisation;

– reduce the haircuts applicable to ABS eligible under the permanent and temporary Eurosystem collateral framework.

In addition, the Governing Council decided to adjust the eligibility criteria and haircuts applied by National Central Banks (NCBs) to pools of credit claims and certain types of the additional credit claims (ACC) eligible under the temporary Eurosystem collateral framework that was implemented in December 2011.

9 SEPTEMBER 2013

The Governing Council of the ECB decided to enhance the loan-level reporting requirements for residential mortgage-backed securities (RMBSs) and ABSs backed by loans to small and medium-sized enterprises (SME ABSs) that are used as collateral in Eurosystem monetary policy operations. As of 16 October 2013, RMBS and SME ABSs for which the mandatory level of compliance with reporting requirements has not been attained and for which the data provider has neither given an explanation for that non-compliance nor provided action plan for achieving full compliance, will become ineligible for use as Eurosystem collateral.

10 OCTOBER 2013

The ECB and the People's Bank of China (PBC) agreed to establish a bilateral currency swap arrangement to purchase and subsequently repurchase Chinese yuan and euro from each other. The swap agreement, which will be valid for three years, will have a maximum size of 350 billion yuan when yuan are provided to the ECB and of €45 billion when euro are provided to the PBC.

31 OCTOBER 2013

The Bank of Canada, the Bank of England, the Bank of Japan, the ECB, the Federal Reserve, and the Swiss National Bank decided to convert their existing temporary bilateral liquidity swap arrangements to standing arrangements, that is, arrangements that will remain in place until further notice.

7 NOVEMBER 2013

The Governing Council of the ECB decided to decrease the interest rate on the main refinancing operations and the interest rate on the marginal lending facility by 25 basis points to 0.25% and 0.75%, respectively, as from 13 November 2013, while the interest rate on the deposit facility will remain unchanged at 0.00%.

It also decided to continue conducting its main refinancing operations (MROs) as fixed rate tender procedures with full allotment for as long as necessary, and at least until 7 July 2015. This procedure will also remain in use for the Eurosystem's special-term refinancing operations with a maturity of one maintenance period, which will continue to be conducted for as long as needed, and at least until the end of the second quarter of 2015. The fixed rate in these special-term refinancing operations will be the same as the MRO rate prevailing at the time. Furthermore, the Governing Council of the ECB has decided to conduct the three-month longer-term refinancing operations (LTROs) to be allotted on 30 July, 27 August, 24 September, 29 October, 26 November and 17 December 2014 and 28 January, 25 February, 25 March, 29 April, 27 May and 24 June 2015 as fixed rate tender procedures with full allotment. The rates in these three-month operations will be fixed at the average rate of the MROs over the life of the respective LTRO.

22 NOVEMBER 2013

The Governing Council of the ECB decided to suspend repayments of the three-year longer-term refinancing operations (LTROs) during the year-end period.

24 JANUARY 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 gradually reduce its US dollar liquidity-providing operations, in view of the considerable improvement in US dollar funding conditions and the low demand for such operations. More specifically, the operations with a maturity of three months will continue until 30 April 2014, while those with a maturity of one week will continue to be conducted at least until 31 July 2014.

5 JUNE 2014

The Governing Council of the ECB decided to decrease, as of 11 June 2014, the interest rate on the main refinancing operations by 10 basis points to 0.15%, the interest rate on the marginal lending facility by 35 basis points to 0.40%, and the interest rate on the deposit facility by 10 basis points to -0.10%.

Second, it decided to conduct a series of targeted longer-term refinancing operations (TLTROs), which will mature in September 2018. Counterparties will be entitled to an initial borrowing allowance equal to 7% of the total amount of their loans to the euro area non-financial private sector, excluding loans to households for house purchase, outstanding on 30 April 2014. The financing initially provided to credit institutions will be in the order of €400 billion. Two successive targeted longer-term refinancing operations will be conducted in September and December 2014. In addition, from March 2015 to June 2016, all counterparties will be able to borrow, quarterly, up to three times the amount of their net lending to the euro area non-financial private sector, excluding loans to households for house purchase, over a specific period in excess of a specified benchmark. Net lending will be measured in terms of new loans minus redemptions. The interest rate on these operations will be fixed over the life of each operation, at the rate on the Eurosystem's main refinancing operations prevailing at the time of take-up, plus a fixed spread of 10 basis points. Starting 24 months after each

TLTRO, counterparties will have the option to make repayments. A number of provisions will aim to ensure that the funds support the real economy. Those counterparties that have not fulfilled certain conditions regarding the volume of their net lending to the real economy will be required to pay back borrowings in September 2016.

Third, the Governing Council decided to extend the existing eligibility of additional assets as collateral, notably under the additional credit claims framework, at least until September 2018.

Fourth, the Governing Council decided to intensify preparatory work related to outright purchases in the ABS market to enhance the functioning of the monetary policy transmission mechanism. Under this initiative, the Eurosystem will consider purchasing simple and transparent asset-backed securities with underlying assets consisting of claims against the euro area non-financial private sector.

Fifth, the Governing Council decided to continue conducting the MROs as fixed rate tender procedures with full allotment for as long as necessary, and at least until the end of the reserve maintenance period ending in December 2016. Furthermore, it decided to conduct the three-month longer-term refinancing operations (LTROs) to be allotted before the end of the reserve maintenance period ending in December 2016 as fixed rate tender procedures with full allotment. The rates in these three-month operations will be fixed at the average rate of the MROs over the life of the respective LTRO. Furthermore the Governing Council has decided to discontinue the Eurosystem's special-term refinancing operations with a maturity of one maintenance period, following the operation to be allotted on 10 June 2014.

Finally, it decided to suspend after 10 June 2014 the weekly fine-tuning operation sterilising the liquidity injected under the Securities Markets Programme.

STATISTICAL APPENDIX

TABLES

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

Period		General index (2009=100)	General index: Percentage change over previous year	Goods (2009=100)	Goods: Percentage change over previous year	Services (2009=100)	Services: Percentage change over previous year	CPI excluding fresh fruit/vegetables and fuel (2009=100)	CPI excluding fresh fruit/vegetables and fuel: Percentage change over previous year	CPI excluding food and fuel (2009=100)	CPI excluding food and fuel: Percentage change over previous year
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
2012	I	108.7	2.0	110.0	2.5	106.9	1.4	104.1	0.9	103.9	0.6
	II	110.7	1.5	113.9	2.0	106.7	0.9	106.0	0.7	106.2	0.5
	III	109.0	1.3	111.0	1.9	106.6	0.6	104.3	0.3	104.1	0.1
	IV	110.9	1.1	115.0	2.5	105.7	-0.7	105.5	-0.5	105.5	-0.7
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
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

Source: Calculations based on ELSTAT data.

Table 2 Balance of payments

(million euro)

		January-December			January-March		
		2011	2012	2013	2012	2013	2014
I	**CURRENT ACCOUNT BALANCE (I.A+I.B+I.C+I.D)**	**-20,633.5**	**-4,615.0**	**1,396.7**	**-4,431.8**	**-2,238.9**	**-1,048.7**
I.A	***TRADE BALANCE (I.A.1–I.A.2)***	***-27,229.1***	***-19,619.0***	***-17,229.4***	***-5,872.2***	***-4,522.4***	***-4,558.9***
	Oil trade balance	-11,126.9	-10,220.0	-7,697.5	-3,142.9	-2,299.1	-2,187.3
	Non-oil trade balance	-16,102.1	-9,399.1	-9,531.9	-2,729.3	-2,223.4	-2,371.6
	Ship balance	-3,261.2	-1,042.6	-1,483.3	-356.8	-300.0	-512.4
	Trade balance excl. oil and ships	-12,840.9	-8,356.4	-8,048.7	-2,372.5	-1,923.3	-1,859.2
	I.A.1 Exports of goods	*20,230.6*	*22,020.6*	*22,534.8*	*4,930.9*	*5,446.6*	*5,447.6*
	Oil	6,187.7	7,426.4	7,941.2	1,470.8	1,920.6	1,969.5
	Ships (receipts)	754.7	737.8	443.0	178.0	109.4	85.6
	Other goods	13,288.2	13,856.5	14,150.7	3,282.2	3,416.6	3,392.5
	I.A.2 Imports of goods	*47,459.6*	*41,639.7*	*39,764.2*	*10,803.2*	*9,969.0*	*10,006.5*
	Oil	17,314.6	17,646.3	15,638.7	4,613.7	4,219.7	4,156.8
	Ships (payments)	4,015.9	1,780.4	1,926.2	534.8	409.5	598.1
	Other goods	26,129.2	22,213.0	22,199.3	5,654.7	5,339.9	5,251.7
I.B	***SERVICES BALANCE (I.B.1–I.B.2)***	***14,629.6***	***15,138.9***	***16,978.9***	***1,521.0***	***1,477.0***	***1,940.8***
	I.B.1 Receipts	*28,609.2*	*27,526.4*	*27,959.5*	*4,717.9*	*4,146.2*	*4,637.0*
	Travel	10,504.7	10,442.5	12,152.2	412.6	401.8	489.1
	Transport	14,096.6	13,287.4	12,089.9	3,367.7	2,883.1	3,125.0
	Other services	4,007.9	3,796.5	3,717.4	937.6	861.3	1,022.9
	I.B.2 Payments	*13,979.6*	*12,387.4*	*10,980.6*	*3,196.8*	*2,669.3*	*2,696.2*
	Travel	2,266.5	1,843.9	1,835.2	414.4	359.0	416.0
	Transport	7,234.4	6,328.0	5,553.0	1,639.8	1,405.9	1,327.4
	Other services	4,478.7	4,215.5	3,592.4	1,142.7	904.4	952.8
I.C	***INCOME BALANCE (I.C.1–I.C.2)***	***-8,594.8***	***-1,566.4***	***-2,819.0***	***-1,459.6***	***-884.4***	***-640.0***
	I.C.1 Receipts	*3,322.1*	*3,832.2*	*3,542.4*	*966.0*	*877.5*	*897.1*
	Wages, salaries	188.0	200.8	209.3	49.0	54.1	48.4
	Interest, dividends, profits	3,134.1	3,631.4	3,333.1	917.0	823.4	848.7
	I.C.2 Payments	*11,916.9*	*5,398.6*	*6,361.4*	*2,425.6*	*1,762.0*	*1,537.1*
	Wages, salaries	470.0	468.0	453.0	119.7	107.7	104.3
	Interest, dividends, profits	11,447.0	4,930.7	5,908.4	2,305.9	1,654.2	1,432.8
I.D	***CURRENT TRANSFERS BALANCE (I.D.1–I.D.2)***	***560.8***	***1,431.5***	***4,466.2***	***1,379.0***	***1,691.0***	***2,209.3***
	I.D.1 Receipts	*4,435.0*	*5,125.6*	*7,687.8*	*2,631.2*	*2,778.7*	*3,178.9*
	General government (mainly transfers from the EU)	3,254.9	4,060.2	6,410.6	2,356.4	2,376.8	2,869.4
	Other sectors (emigrants' remittances etc.)	1,180.1	1,065.4	1,277.3	274.8	402.0	309.5
	I.D.2 Payments	*3,874.2*	*3,694.1*	*3,221.6*	*1,252.2*	*1,087.7*	*969.6*
	General government (mainly payments to the EU)	2,485.4	2,647.9	2,433.0	926.7	917.9	816.0
	Other sectors	1,388.8	1,046.2	788.6	325.5	169.8	153.5
II	**CAPITAL TRANSFERS BALANCE (II.1– II.2)**	**2,671.8**	**2,327.6**	**3,040.8**	**1,053.4**	**1,092.5**	**1,461.2**
	II.1 Receipts	*2,932.7*	*2,564.6*	*3,380.6*	*1,118.7*	*1,194.5*	*1,536.5*
	General government (mainly transfers from the EU)	2,798.5	2,486.0	3,298.9	1,101.5	1,173.1	1,520.1
	Other sectors	134.2	78.6	81.7	17.2	21.4	16.4
	II.2 Payments	*260.8*	*237.1*	*339.8*	*65.2*	*102.0*	*75.3*
	General government (mainly payments to the EU)	12.7	13.7	9.7	2.0	0.9	5.0
	Other sectors	248.1	223.3	330.1	63.3	101.2	70.2
III	**CURRENT ACCOUNT AND CAPITAL TRANSFERS BALANCE (I+II)**	**-17,961.7**	**-2,287.5**	**4,437.4**	**-3,378.4**	**-1,146.4**	**412.5**
IV	**FINANCIAL ACCOUNT BALANCE (IV.A+IV.B+IV.C+IV.D)**	**17,838.1**	**2,658.2**	**-3,607.7**	**4,584.3**	**361.9**	**-1,219.3**
	IV.A DIRECT INVESTMENT [1]	***-452.6***	***827.1***	***2,405.5***	***-892.2***	***-29.6***	***93.4***
	By residents abroad	-1,274.9	-527.3	472.1	-246.0	-74.6	-194.9
	By non-residents in Greece	822.3	1,354.3	1,933.4	-646.1	45.0	288.3
	IV.B PORTFOLIO INVESTMENT [1]	***-19,778.3***	***-99,903.9***	***-6,583.1***	***-37,033.7***	***2,470.8***	***309.9***
	Assets	4,139.0	-58,086.1	1,023.6	-11,807.5	3,804.4	-7.9
	Liabilities	-23,917.3	-41,817.8	-7,606.7	-25,226.2	-1,333.6	317.8
	IV.C OTHER INVESTMENT [1]	***38,050.0***	***101,744.1***	***677.0***	***42,530.1***	***-2,087.3***	***-583.6***
	Assets	7,638.7	13,863.4	17,491.9	10,247.8	15,850.6	679.5
	Liabilities	30,411.3	87,880.7	-16,814.9	32,282.3	-17,937.9	-1,263.1
	(General government loans)	*39,873.9*	*109,093.9*	*30,061.2*	*38,731.1*	*7,940.8*	*-1,725.7*
	IV.D CHANGE IN RESERVE ASSETS [2]	***19.0***	***-9.0***	***-107.0***	***-20.0***	***8.0***	***-1,039.0***
V	**ERRORS AND OMISSIONS**	**123.6**	**-370.8**	**-829.8**	**-1,205.9**	**784.6**	**806.8**
	RESERVE ASSETS [3]	***5,332.0***	***5,500.0***	***4,172.0***	***5,434.0***	***5,461.0***	***5,457.0***

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
2010	Jan.	232,890	212,594	20,296	24,210	75,628	133,051
	Feb.	229,686	210,106	19,580	23,798	74,853	131,034
	March	227,648	209,163	18,485	23,493	74,292	129,863
	Apr.	222,576	204,904	17,672	23,352	72,943	126,281
	May	220,107	201,635	18,472	23,058	72,069	124,980
	June	216,768	197,434	19,334	24,374	70,595	121,799
	July	212,253	194,139	18,114	22,525	69,797	119,931
	Aug.	213,003	194,153	18,850	22,217	69,371	121,415
	Sept.	212,903	195,238	17,665	23,619	67,785	121,499
	Oct.	211,516	194,030	17,486	22,399	67,813	121,303
	Nov.	209,127	190,742	18,385	22,523	66,082	120,523
	Dec.	209,522	191,989	17,533	22,865	66,706	119,951
2011	Jan.	205,438	188,543	16,895	22,063	65,552	117,823
	Feb.	202,815	186,494	16,321	21,057	64,428	117,330
	March	199,086	183,277	15,809	20,829	62,102	116,156
	Apr.	196,678	181,243	15,435	20,098	62,080	114,499
	May	191,815	176,699	15,116	20,333	60,569	110,914
	June	188,108	174,095	14,013	21,071	59,446	107,592
	July	187,143	173,435	13,708	19,941	58,552	108,649
	Aug.	188,574	174,787	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.	161,037	152,051	8,986	19,041	42,940	99,056

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
2010	Jan.	4.72	5.40	5.61	6.02	6.50		6.36
	Feb.	5.92	6.30	6.21	6.46	6.58		6.47
	March	5.51	5.84	5.83	6.24	6.45		6.47
	Apr.	7.91	7.87	7.87	7.83	7.46		7.08
	May	8.28	8.59	8.39	7.97	8.28		7.69
	June	9.41	9.50	9.57	9.10	9.68		9.11
	July	11.17	10.85	10.94	10.34	10.34		9.08
	Aug.	11.65	11.33	11.18	10.70	10.36		9.00
	Sept.	11.63	11.65	11.76	11.34	10.49		8.89
	Oct.	9.64	9.64	10.13	9.57	9.41		8.39
	Nov.	13.08	12.27	12.91	11.52	10.35		9.13
	Dec.	13.75	12.89	13.66	12.01	10.75		9.15
2011	Jan.	13.78	12.94	13.32	11.73	10.58		8.89
	Feb.	13.40	13.04	13.18	11.40	10.14		8.64
	March	15.33	15.49	14.37	12.44	10.57		8.87
	Apr.	19.11	18.04	16.30	13.86	11.27		9.40
	May	24.28	20.87	17.86	15.94	13.19		10.52
	June	26.48	22.83	19.04	16.69	13.97		11.54
	July	28.96	24.37	19.66	16.15	13.73		10.98
	Aug.	26.74	24.43	19.68	15.90	13.19		10.06
	Sept.	31.51	28.88	22.27	17.78	13.97		10.08
	Oct.	34.61	29.53	22.59	18.04	14.16		11.00
	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

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			
			Total	Non-financial corporations				Other financial institutions and insurance companies	Sole proprietors and unincorporated partnerships	Total	Housing	Consumer credit	Other
				Total	of which								
					Industry	Trade	Shipping						
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
2010	Jan.	250,167	130,610	124,477	22,964	33,407	10,350	6,133		119,557	80,704	35,876	2,977
	Feb.	251,173	131,520	124,916	23,031	33,182	10,618	6,604		119,653	80,878	35,792	2,984
	March	251,062	131,392	125,192	23,042	33,202	10,701	6,201		119,669	81,173	35,490	3,007
	Apr.	250,982	131,529	124,844	22,992	33,103	10,686	6,685		119,453	81,125	35,326	3,002
	May	252,072	132,718	126,164	23,060	33,087	11,729	6,554		119,355	81,110	35,194	3,050
	June	260,352	126,525	120,823	25,423	26,724	19,340	5,702	13,904	119,924	81,430	36,292	2,202
	July	258,943	125,529	119,080	24,991	26,718	18,339	6,449	13,929	119,485	81,334	35,960	2,192
	Aug.	258,777	125,452	119,229	24,662	26,633	18,708	6,224	13,812	119,512	81,450	35,898	2,163
	Sept.	258,476	123,543	116,978	24,471	25,873	17,798	6,564	15,618	119,316	81,201	35,834	2,281
	Oct.	257,256	122,772	116,233	24,687	25,663	17,141	6,539	16,429	118,055	80,033	35,621	2,401
	Nov.	258,023	123,361	117,005	24,540	25,607	18,108	6,356	16,444	118,217	80,302	35,443	2,472
	Dec.	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	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

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: Overnight deposits[1,2] Total	Deposits by households: Overnight deposits[1,2] of which Savings deposits[2]	Deposits by households: Deposits with an agreed maturity up to one year	Deposits by non-financial corporations: Overnight deposits[1,2]	Deposits by non-financial corporations: 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
2010	Jan.	0.43	0.37	2.18	0.37	1.21	1.35
	Feb.	0.44	0.38	2.35	0.36	1.29	1.44
	March	0.43	0.38	2.61	0.38	1.61	1.58
	Apr.	0.43	0.37	2.98	0.36	1.71	1.75
	May	0.42	0.37	3.42	0.38	2.06	1.96
	June	0.43	0.38	3.61	0.32	3.37	2.11
	July	0.43	0.38	3.71	0.31	3.40	2.16
	Aug.	0.43	0.38	3.66	0.32	3.14	2.12
	Sept.	0.43	0.38	3.61	0.33	2.98	2.09
	Oct.	0.44	0.38	3.68	0.34	2.98	2.12
	Nov.	0.44	0.38	3.65	0.35	3.27	2.11
	Dec.	0.44	0.38	3.68	0.36	3.29	2.15
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

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 with an agreed maturity		Housing loans					Loans with an agreed maturity and a floating rate or an initial rate fixation of up to one year		
		Consumer loans without an agreed maturity[2,3]	With a floating rate or an initial rate fixation of up to one year	Average rate on total consumer loans with an agreed maturity	With a floating rate or an initial rate fixation of up to one year	Average rate on total housing loans	Loans without an agreed maturity[3,4]	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]	Up to €1 million	Over €1 million	
2009		14.39	8.59	9.33	3.52	3.94			6.07	4.62	3.52	6.02
2010		14.18	9.79	9.53	3.42	3.67			6.25	5.53	4.27	5.64
2011		14.98	10.16	9.96	4.28	4.33	10.12	8.76	7.50	6.77	5.74	6.68
2012		14.95	8.19	8.40	3.32	3.26	10.21	7.68	7.66	6.87	5.92	6.09
2013		14.71	7.62	7.53	2.92	2.82	9.67	7.36	7.39	6.51	5.77	5.60
2011	Jan.	14.59	10.73	9.84	3.93	4.05	9.58	8.27	6.81	6.14	4.89	6.17
	Feb.	14.64	10.44	9.88	3.91	4.04	9.72	8.40	6.90	6.23	5.37	6.41
	March	14.70	9.74	9.52	4.04	4.17	9.78	8.59	7.05	6.46	5.39	6.38
	Apr.	14.74	10.65	10.15	4.25	4.32	9.91	8.63	7.26	6.46	5.55	6.57
	May	14.89	10.48	10.22	4.26	4.33	9.98	8.86	7.34	6.59	5.48	6.62
	June	14.94	10.47	10.23	4.23	4.32	10.10	8.62	7.59	6.76	5.56	6.64
	July	15.06	11.03	10.45	4.44	4.52	10.19	8.74	7.65	6.85	5.76	6.79
	Aug.	15.24	10.77	10.55	4.54	4.57	10.35	9.14	7.76	6.92	5.88	6.89
	Sept.	15.26	9.70	9.95	4.49	4.51	10.44	8.93	7.91	7.12	6.04	6.94
	Oct.	15.24	10.07	10.22	4.65	4.56	10.43	8.97	7.92	7.27	6.20	7.02
	Nov.	15.23	9.30	9.57	4.48	4.40	10.50	8.97	7.93	7.18	6.13	6.90
	Dec.	15.22	8.49	8.92	4.18	4.14	10.46	8.94	7.90	7.26	6.64	6.82
2012	Jan.	15.18	8.76	9.17	3.98	3.97	10.37	9.19	7.90	7.20	6.10	6.63
	Feb.	15.14	8.80	9.09	3.77	3.75	10.34	8.58	7.86	7.02	5.81	6.46
	March	15.11	8.19	8.66	3.62	3.53	10.31	8.22	7.80	7.02	6.16	6.38
	Apr.	15.08	8.34	8.79	3.55	3.44	10.35	7.91	7.78	6.89	6.23	6.34
	May	15.01	8.27	8.69	3.54	3.40	10.32	7.89	7.69	7.05	5.84	6.21
	June	14.96	8.16	8.54	3.42	3.33	10.27	7.79	7.69	6.92	6.55	6.29
	July	14.91	7.88	8.10	3.13	3.07	10.21	7.33	7.61	6.87	5.71	5.92
	Aug.	14.83	8.32	8.40	2.99	2.94	10.14	6.82	7.57	6.71	5.82	5.88
	Sept.	14.79	7.75	7.89	3.01	2.95	10.08	7.31	7.54	6.79	5.46	5.77
	Oct.	14.80	8.04	8.01	2.88	2.84	10.08	7.17	7.49	6.75	5.70	5.76
	Nov.	14.80	8.11	7.93	2.94	2.88	10.05	7.03	7.49	6.75	5.62	5.63
	Dec.	14.79	7.60	7.47	3.04	2.98	10.03	6.96	7.52	6.46	6.07	5.76
2013	Jan.	14.77	7.91	7.64	2.99	2.91	10.03	7.03	7.46	6.67	6.40	5.88
	Feb.	14.77	8.10	7.69	3.04	2.96	10.02	7.82	7.52	6.66	5.84	5.79
	March	14.78	7.96	7.57	3.18	3.08	10.02	7.45	7.56	6.62	5.80	5.78
	Apr.	14.77	7.86	7.40	3.08	2.92	9.99	7.61	7.49	6.78	5.96	5.75
	May	14.73	7.70	7.60	2.84	2.76	9.96	7.61	7.45	6.52	5.37	5.53
	June	14.63	6.63	6.84	2.80	2.74	9.60	7.40	7.43	6.62	6.01	5.54
	July	14.64	7.50	7.28	2.85	2.72	9.53	8.05	7.42	6.47	5.72	5.55
	Aug.	14.68	8.41	8.33	2.89	2.74	9.54	7.34	7.36	6.49	5.49	5.54
	Sept.	14.66	7.40	7.47	2.93	2.76	9.37	7.14	7.20	6.63	5.93	5.56
	Oct.	14.86	7.51	7.62	2.85	2.77	9.36	6.95	7.19	6.40	6.14	5.61
	Nov.	14.66	7.32	7.60	2.75	2.68	9.23	7.15	7.29	6.20	5.80	5.50
	Dec.	14.62	7.16	7.35	2.81	2.78	9.34	6.79	7.29	6.06	4.73	5.12
2014	Jan.	14.72	7.98	8.17	2.70	2.70	9.20	7.76	7.24	6.32	6.00	5.66
	Feb.	14.71	7.80	7.94	2.73	2.73	9.17	6.66	7.23	6.17	5.88	5.40
	March	14.65	7.81	7.89	2.95	2.86	9.15	6.99	7.23	6.04	5.57	5.46
	Apr.	14.86	7.69	7.83	3.03	2.97	9.12	6.55	7.22	6.19	6.64	5.82

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.

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