

Bank of Greece

Summary
of the Annual Report
2004



April 2005

Bank of Greece

Summary
of the Annual Report 2004

Presented to the General Meeting of Shareholders
by Governor Nicholas C. Garganas



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

ISSN 1105 - 0527

CONTENTS

	PAGE
THE GREEK ECONOMY: DEVELOPMENTS, OUTLOOK AND ECONOMIC POLICIES AIMED AT SUSTAINING STRONG GROWTH	
1. Introduction	7
2. The international and European economic environment	9
3. Macroeconomic developments in Greece in 2004	12
3.1 Economic activity	12
3.2 Employment and unemployment	14
3.3 Developments in inflation	18
3.4 Balance of payments	20
4. Fiscal developments and prospects	22
4.1 The widening of the deficit	22
4.2 Public debt	26
4.3 The Excessive Deficit Procedure	28
4.4 The revised Updated Stability and Growth Programme (USGP) for 2004-2007	28
5. Monetary and financial developments in the euro area	29
6. Monetary and financial developments in Greece	31
6.1 Monetary developments and interest rates	31
6.2 Credit developments	32
6.3 Capital markets	33
7. The stability of the banking system	35
8. The economic outlook for 2005	41
9. Economic policies aimed at sustaining strong growth	43
9.1 Medium-term growth prospects	43
9.2 Challenges to economic policy	46
9.3 Policies for macroeconomic growth	47
9.3.1 Policies for achieving price stability	47
9.3.2 Fiscal policy	49
9.3.3 Pension and healthcare reforms	52
9.4 Economic reforms to enhance Greece's growth potential	56
9.4.1 The convergence process so far	56
9.4.2 Economic reforms to raise productivity growth	58
9.4.3 Economic reforms to raise employment and labour force participation rates	63
10. Summary and conclusions	64

APPENDIX I

1. Chronology of main monetary policy measures of the Eurosystem	69
2. Bank of Greece decisions concerning the establishment and operation of credit institutions and the supervision of the financial system	70

APPENDIX II Tables and charts	75
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ANNUAL ACCOUNTS OF THE BANK OF GREECE	131
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AUDITORS REPORT	136
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TABLES IN THE MAIN TEXT

I. Fiscal deficits	24
II. Decomposition of changes in the general government debt-to-GDP ratio	27
III. At-risk-of-poverty rates in EU countries	44

CHARTS IN THE MAIN TEXT

I. Economic growth rates in Greece and the euro area	12
II. Monetary conditions index (MCI) in Greece	13
III. Employment rate	15
IV. Unemployment rate 1990-2004	16
V. Harmonised index of consumer prices: Greece and the euro area, monthly data	17
VI. Harmonised index of consumer prices: Greece and the euro area, annual data	18
VII. Harmonised index of consumer prices excluding energy and unprocessed food prices: Greece and the euro area	19
VIII. Current account balance	20
IX. Gross fixed capital formation as a percentage of GDP	21
X. General government revenue, expenditure and deficit	23
XI. General government primary surplus and cyclically adjusted primary surplus	25
XII. Public debt/GDP ratio	26
XIII. ECB interest rates and the overnight money market rate (EONIA)	30
XIV. Fiscal policy stance: annual changes in the cyclically adjusted primary surplus	48

THE GREEK ECONOMY: DEVELOPMENTS, OUTLOOK AND ECONOMIC POLICIES AIMED AT SUSTAINING STRONG GROWTH

1. INTRODUCTION

The Greek economy continued to grow strongly in 2004, though at a somewhat slower pace than in 2003. According to provisional estimates of the National Statistical Service of Greece (NSSG), real GDP is estimated to have grown by 4.2% in 2004, thereby surpassing the European Union average for the ninth year running.

Inflation, as measured by the increase in the Harmonised Index of Consumer Prices (HICP), fell to 3.0% in 2004, from 3.4% in 2003. Even though inflation followed a downward trajectory during much of the year, the annual inflation rate picked up again in the fourth quarter of 2004, reaching the same level as in the final quarter of 2003. However, core inflation (as measured by the annual rate of change in the HICP excluding energy and unprocessed food) rose above the level of 2003, causing its differential with the euro area average to widen.

Despite the appreciation of the euro and further losses in competitiveness, a large increase in the volume of world trade provided a boost to Greek exports in 2004, especially of services, and contributed to the narrowing of the current account deficit to 3.9% of GDP in 2004, from 5.6% in 2003.

In spite of robust economic growth, employment growth is estimated to have been weak, and unemployment, at 10.5% on average in 2004, remained considerably above the euro area average. Labour market developments are, however, difficult to assess, since labour force survey data for 2004 are not fully comparable with the figures for previous years, due to statistical revisions introduced last year.

Regarding fiscal developments, the general government deficit widened to 6.1% of GDP in 2004. This overrun (relative to the initial forecast) was due to: (a) optimistic forecasts in the 2004 budget, which had been based on the equally optimistic initial estimate for the 2003 deficit; (b) an upward revision of the 2003 deficit, which also affected 2004 outcomes; (c) shortfalls in government budget revenue; and (d) substantial overruns in primary expenditure, related, in part, to the Olympic Games. The general government debt reached 110.5% of GDP in 2004, up from 109.3% in 2003.

In March of this year, the Ministry of Economy and Finance submitted a revised update of the Stability and Growth Programme covering the period 2004-2007, as required by the ECOFIN Council's decision giving notice to Greece to take the necessary deficit reduction measures so as to put an end to its present excessive deficit situation by 2006 at the latest. To underpin the implementation of the programme, the government announced a package of measures on 29 March 2005, which included an increase in indirect taxation, and reaffirmed its commitment to bringing the budget deficit below the 3% threshold next year.

The Greek economy is at a crucial juncture. After several years of high growth, which extended into 2004, the pace of economic expansion moderated in the second half of 2004 and the first months of 2005. This reflected, first, a return to more sustainable growth of domestic demand after the petering out of the stimulus arising from the expenditure associated with the Olympic Games and, second, the adverse impact of higher oil prices.

Looking forward, GDP growth is projected to moderate this year. The necessary implementation of a fiscal policy of consolidation, which includes lower public investment as well as expenditure cutbacks, is expected to weigh on aggregate demand growth. Private consumption growth is also expected to weaken in view of the acceleration of inflation projected for this year (mainly as a result of the increase in indirect taxation and the rise in oil prices). Consequently, based on the latest available information and estimates, the Bank of Greece expects that GDP growth will moderate this year, but will nonetheless remain strong at around 3%, i.e. much higher than the projected growth rate for the euro area as a whole.

Against the backdrop of an increase in indirect taxes, the persistence of high oil prices and a mild acceleration of unit labour costs in the business sector, average annual inflation is projected to rise to around 4% in 2005. Inflation should then subside once the effect of the increase in indirect taxation has run its course (as estimated, by April 2006). With the future path of global oil prices and the impact of the indirect tax increases being subject to a high level of uncertainty, however, upside risks to inflation exist. To help guard against the unfolding of these risks, it is of paramount importance that second-round effects stemming from wage increases and price-setting by firms throughout the economy be avoided.

Looking beyond 2005, growth and inflation prospects will depend critically on credible and determined policies to tackle macroeconomic imbalances and long-standing structural weaknesses. The upward revision of last year's fiscal data brought Greece's budget deficit ratio for 2004 to the highest level in the EU-25, while the public debt-to-GDP ratio has also remained very high. Higher unit labour costs and higher price inflation than in most trading partners over a number of years have eroded Greece's international competitiveness and contributed to large and persistent external deficits. Employment performance remains weak against a background of several years of strong growth, with the unemployment rate remaining high; also, the restrictions stemming from the regulatory environment and a multitude of bureaucratic procedures continue to weigh on entrepreneurial activity.

Strong and sustained growth in the medium term depends on two fundamental factors:

- First, macroeconomic stability must be ensured, so as to provide the appropriate environment in which policies aimed at improving the real economy can operate. At the present juncture, the policies announced by the government to achieve the needed fiscal consolidation must be successfully implemented, together with other policies aimed at ensuring price stability and strengthening price competitiveness.

- Second, structural reforms must be accelerated so as to put into place the conditions required to foster employment growth and a faster rise in productivity. The structural policies that could improve Greece's long-term economic performance are discussed in Section 9. Specifically, the section focuses on a number of key reform measures that are of particular importance for employment growth and for a faster rise in productivity, as they offer substantial scope for catching up with international best practices.

The achievement of the two fundamental requirements for sustained growth – macroeconomic stability and the strengthening of competitiveness through structural reforms – would help speed up Greece's economic and social convergence with the average of the EU-15, raise employment levels and foster a higher standard of living in Greece.

2. THE INTERNATIONAL AND EUROPEAN ECONOMIC ENVIRONMENT

The international economic environment was particularly favourable in 2004. The growth rate of world economic activity (5.1%) was the highest since 1976, with GDP growth strengthening simultaneously in the US, Japan, China and the euro area. The volume of world trade in goods and services rose by almost 10%, the fastest rate since 2000.

Monetary and credit conditions remained favourable and had a positive effect on the world economy. The key interest rates of central banks generally remained at very low levels, both in the regions such as USA and the United Kingdom, where they rose, and in Japan and the euro area, where they were left unchanged. *Real* short-term interest rates in the US and many euro area economies were negative, while real long-term interest rates were significantly lower than their average historical levels.

The significant rise of international oil prices had a negative, but rather limited, impact on the world economy. In the course of 2004, crude oil prices reached a peak in October, but in real terms they were lower than the levels recorded during the oil shocks of the 1970s. Moreover, relative to previous decades, the oil dependence of the advanced economies is now lower, while their capacity to adjust to oil price shocks is greater. Oil price increases had a dampening effect on world GDP growth during the second half of 2004, while they contributed to a small rise in inflation, although no second-round effects on wages and prices were observed.

Economic recovery in the euro area, which started in the second half of 2003, continued in 2004. The GDP growth rate rose to 2.1%¹ in 2004 (compared with an average

¹ Based on data adjusted for working-day effects, GDP growth in 2004 comes to 1.8%.

annual growth rate of 1% in the previous three years), but – on the basis of quarterly rates – decelerated during the year, particularly in the second half, as the strong rise in oil prices boosted inflation and had a negative effect on private consumption, while net exports were adversely affected by the appreciation of the euro.

Inflation in the euro area (as measured by the HICP) hovered slightly above 2% for most of 2004, mainly due to higher oil prices, and stood at an average annual level of 2.1%, as in 2003. Inflation fell to 1.9% in January 2005, before picking up to 2.1% in February and March.

In 2004 the fiscal position of the euro area as a whole remained practically unchanged based on the March 2005 fiscal notifications. The general government deficit, as a percentage of GDP, is estimated to have been marginally lower than in 2003 (2.7% compared with 2.8% respectively) and the cyclically adjusted deficit remained unchanged at 2.4% of GDP. In 2004 the ECOFIN decided that an excessive deficit existed in Greece and the Netherlands and issued recommendations to the two countries calling them to put an end to the excessive deficit situation.¹ France and Germany have already been subject to an Excessive Deficit Procedure since 2003 (both countries posted deficit ratios of 3.7% of GDP in 2004). General government debt in the euro area rose to 71.3% of GDP in 2004, from 70.8% in 2003. At an institutional level, the European Council decided on 22-23 March 2005 to amend the Stability and Growth Pact.

Developments in international foreign exchange markets in 2004 were characterised by a further depreciation of the US dollar against the major currencies. The year 2004 was the fourth consecutive year that saw a depreciation of the US dollar and an appreciation of the euro, although both developments were less marked than in 2003. In the first quarter of 2005, the euro exchange rate (the effective rate as well as bilateral exchange rates against the major currencies) was volatile, with some depreciating trend relative to December 2004 being dominant.

The depreciation of the US dollar occurred amid market concerns about the sustainability of the current account deficit of the United States. A further widening of this deficit to 5.7% of GDP in 2004 was due to a strong rise in private consumption and investment, which also led to higher GDP growth (4.4% in 2004, from 3.0% in 2003). The fiscal deficit in the United States is estimated to have fallen slightly, though remaining particularly high (4.3% of GDP). The continued rapid build-up of foreign reserves, mostly denominated in US dollars, by emerging economies in Asia and oil-producing countries, helped contain the depreciation of the US dollar.

The prospects for the world economy remain positive for 2005, though a small weakening of economic activity is forecast. Interest rates are expected to remain generally low, despite market expectations of a further small increase in key short-term nominal

¹ Six new Member States of the European Union were also subject to the Excessive Deficit Procedure in 2004: the Czech Republic, Cyprus, Hungary, Malta, Poland and Slovakia.

interest rates in certain advanced economies. Moreover, other factors that had exerted a beneficial effect on the world economy in 2003-04 should continue to do so in 2005. According to recent forecasts of the International Monetary Fund (April 2005), world GDP should rise by 4.3% in 2005, provided that international oil prices will not be significantly higher than assumed at that time,¹ and that a sudden adjustment of world macro-economic imbalances will not take place.

In the euro area, the rise in economic activity is expected to continue in 2005, but at a slower pace (1.6% according to the IMF and the European Commission) than in 2004, although it is expected to accelerate to 2.1-2.2% in 2006. According to ECB staff macroeconomic projections, the GDP growth rate in the euro area will range between 1.2% and 2% this year and between 1.6% and 2.6% in 2006. World economic recovery remains strong, thus supporting euro area exports. Within the euro area, investment should benefit from the very favourable financing conditions and the improved profitability of firms. Moreover, private consumption is expected to increase, supported by a rise in real incomes. With domestic demand rising, it is expected that economic growth in the euro area will become increasingly more self-sustained than in the recent past.

Inflation in the euro area is expected to fall below 2% during 2005, provided that no more external shocks occur. At this juncture there are no indications of domestic inflationary pressures building up. Wage moderation is expected to continue, against the background of modest economic growth and lax labour market conditions.

The fiscal policy stance in the euro area is expected to be slightly tighter in 2005, as the cyclically adjusted deficit of general government, on the basis of recent forecasts of the European Commission, will fall to 2.1% of GDP, from 2.4% in 2004, while the nominal deficit will remain practically unchanged (as a percentage of GDP). The general government debt is projected to rise slightly to 71.7% of GDP in 2005.

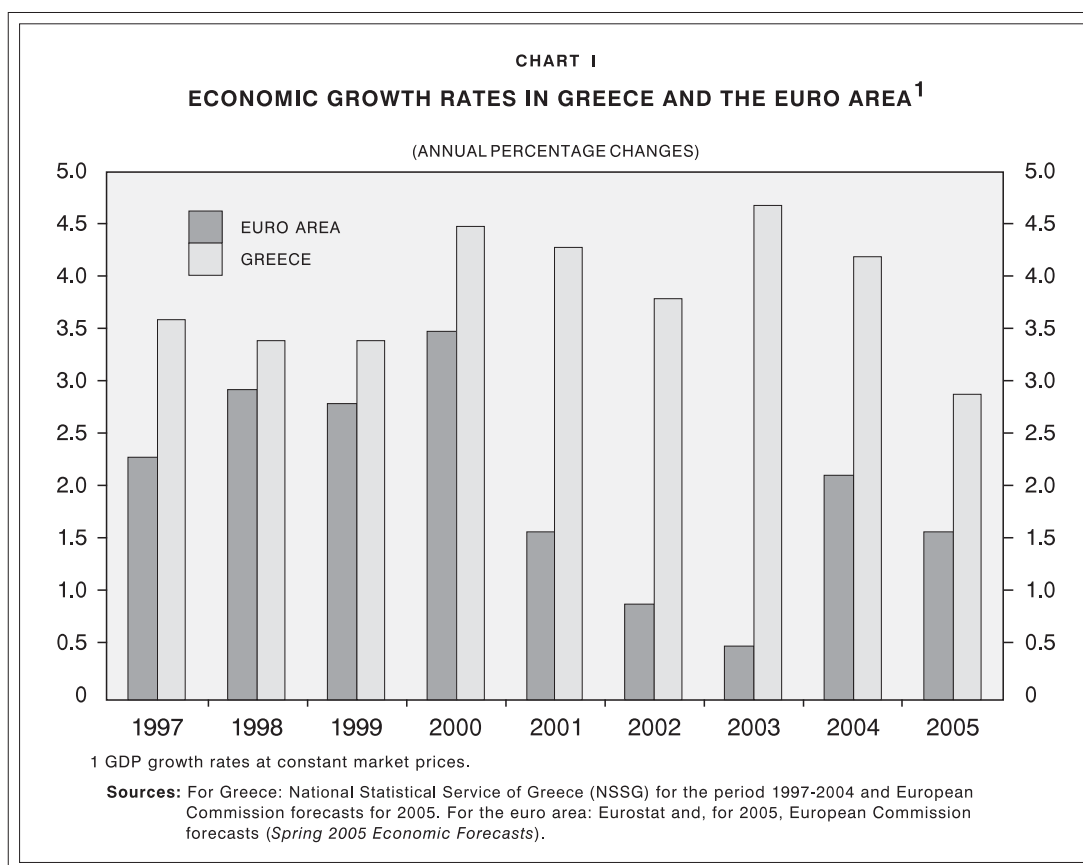
The above projections for global growth are subject to considerable downside risks. These include: First, the persistence of oil prices at high levels and their potential second-round effects on inflation. This risk is highlighted by the rise in world oil prices to new historically high levels in early April 2005. Second, the expected further increase in the current account deficit of the United States (to 5.7% of GDP) and the repercussions of its possible corrections through sudden and disorderly adjustment. Third, the persistence of relatively high fiscal deficits in most of the advanced economies in 2004, despite the favourable economic conjuncture, does not provide adequate room for manoeuvre in the event of a significant slowdown in the rate of economic growth.

1 The IMF's world forecast (World Economic Outlook, 13 April 2005) assumes average annual oil prices in 2005, at \$46.5 per barrel (average for three types of crude oil). The assumption of the European Commission (*Spring 2005 Economic Forecasts*, 4 April 2005) is \$50.9 per barrel (Brent crude oil). In the first quarter of 2005, the average Brent crude oil price was \$47.8 per barrel.

3. MACROECONOMIC DEVELOPMENTS IN GREECE IN 2004

3.1 *Economic activity*

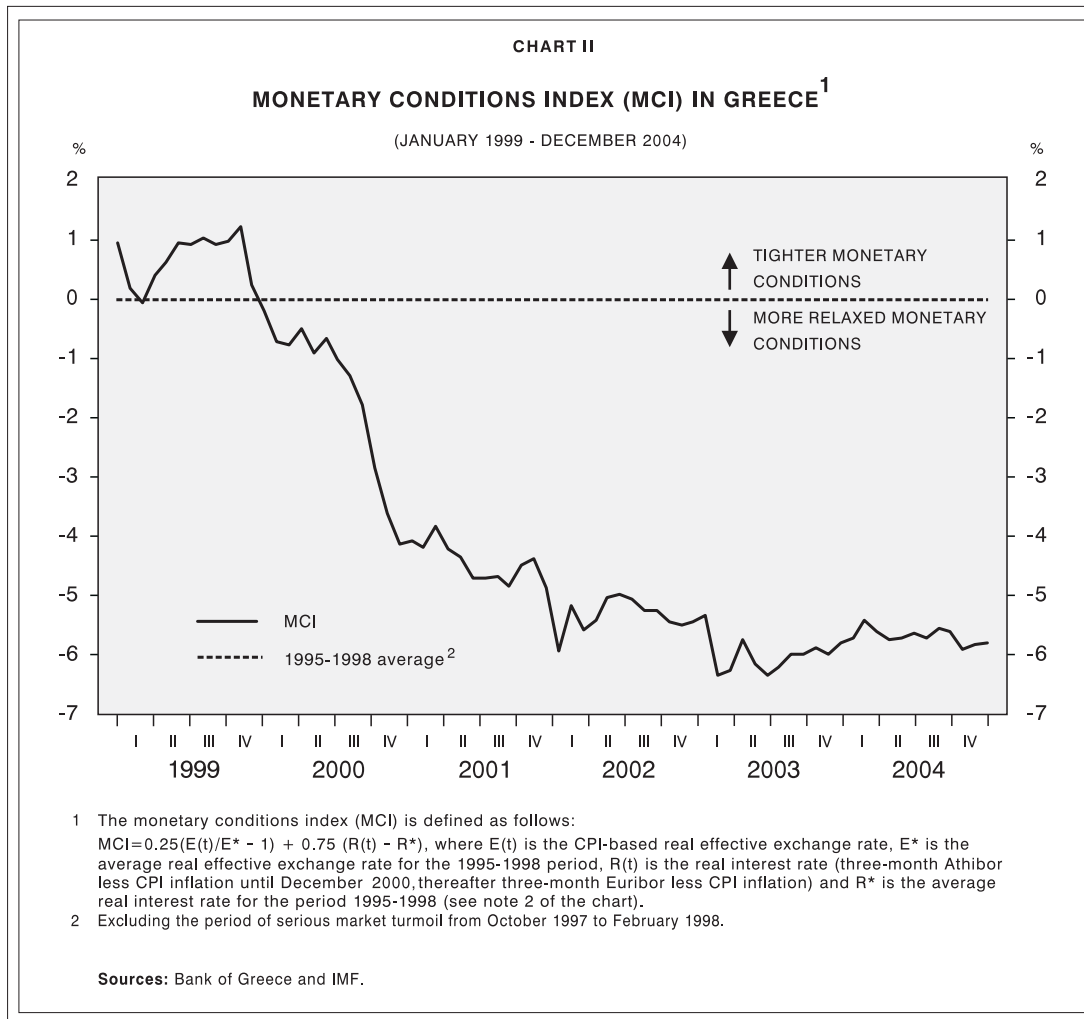
Following the satisfactory growth rate of the Greek economy in 2003 (4.7%), economic activity in Greece began to slow down in the second half of 2004 and, according to the most recent estimates of NSSG, GDP grew at an average rate of 4.2% in 2004. On the basis on these estimates, the Greek economy is still –along with Ireland and Luxembourg– one of the fastest growing economies in the European Union, significantly outperforming the euro area as a whole (see Chart I).



From the demand side, favourable monetary conditions (see Chart II), fiscal developments and the favourable international environment contributed to GDP growth in 2004. Real interest rates remained very low in 2004, thus supporting private consumption and private investment. Fiscal developments, though undesirable (since –mainly due to the impact of the Olympic Games– they caused a further increase in the government budget deficit, which puts macroeconomic stability at risk), helped sustain strong GDP

growth, both by providing a stimulus to private consumption and public investment and by supporting certain income categories. Moreover, a sharp pick-up in the volume of world trade boosted exports of services, in particular shipping receipts.

According to provisional national accounts data of NSSG, the strong increase, though at a slower rate, in domestic demand has been the key growth factor of the Greek economy on the demand side, as in previous years, contributing 4.6 percentage points to



GDP growth. In contrast, the contribution of the external sector to GDP growth was negative for the third consecutive year, albeit smaller than in 2003 (-0.5 percentage point in 2004, -1.3 percentage points in 2003).

Private consumption is estimated to have risen at a high, though decelerating, rate in 2004 (3.3% compared with 4.0% in 2003), reflecting the continued expansion of consumer credit, the cumulative rise in the value of households' wealth in recent years and an increase in households' disposable income. This increase was somewhat smaller than in

2003, owing to the significantly weaker growth of non-labour income. However, disposable income rose faster than private consumption, causing a further increase in households' average propensity to save. Public consumption rose at a very fast rate in 2004 (6.5%, compared with a decrease of 2.3% in 2003), reflecting a fiscal relaxation.

The growth rate of gross fixed capital formation fell to 4.9% in 2004, down from the particularly high rate of 13.7% in 2003. This mainly reflected a slower growth in business investment (by both public and private enterprises), as well as no change in residential investment. Taking into consideration the relatively sound financial position of Greek enterprises and the conditions of ample liquidity prevailing in the market, the corporate sector's reluctance to invest may reflect firms' assessments concerning a weaker demand outlook over the medium term, partly owing to the intensification of international competition, combined with a further deterioration in competitiveness. This assumption is supported by survey results, indicating that business confidence, as well as the economic sentiment indicator, in 2004 stood at levels lower than their averages over recent years. Moreover, business confidence indicators deteriorated after April 2004 (although confidence of the services sector partly rebounded in the first quarter of 2005).

Notwithstanding increases in foreign demand, exports of goods, according to national accounts estimates of the NSSG, fell by 1.3%, due to the cumulative loss of competitiveness in recent years. In contrast, exports of services recovered, rising by 18.4%. In particular, according to Bank of Greece data, transport receipts (mainly from shipping) rose at an impressive rate, almost by 40% at current prices, which is attributed to the recovery of both the volume of world trade and of freight rates.

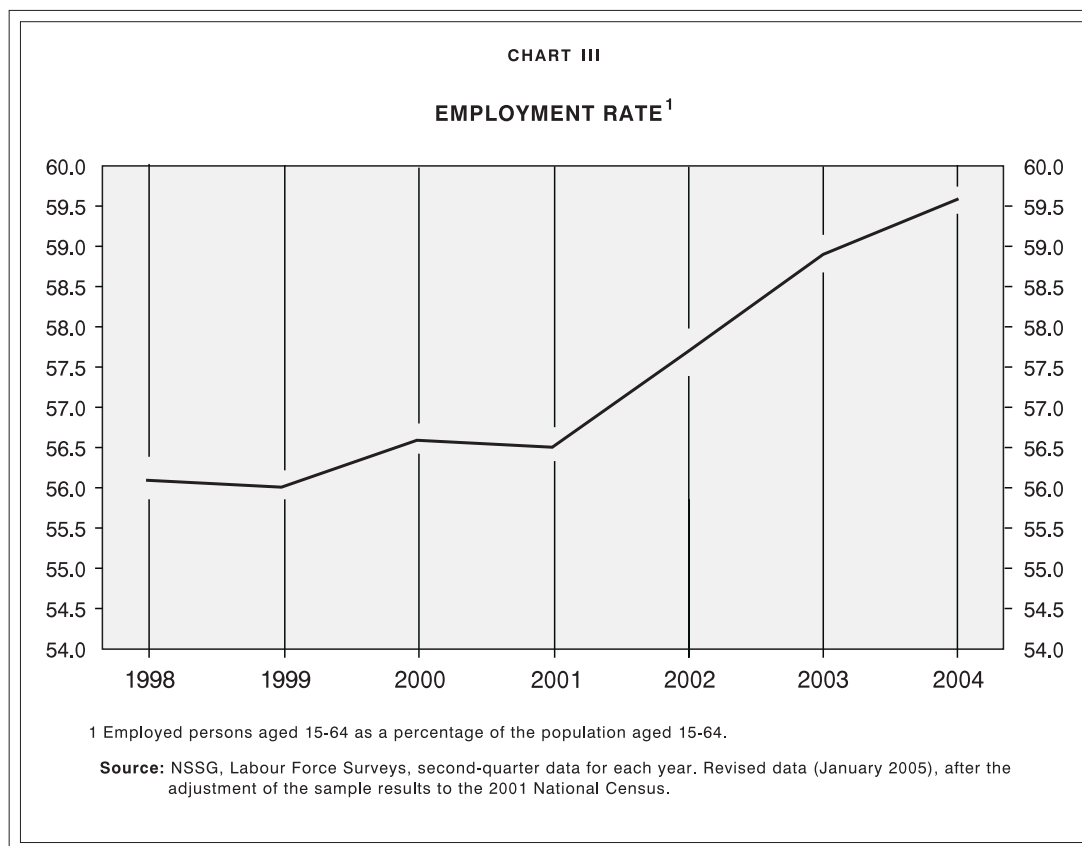
The growth rate of imports of goods and services accelerated (to 8.2%, from 4.8% in 2003) and significantly exceeded the growth rate of final domestic demand (4.2%). The pick-up in imports was partly to be expected, following their weakness in the preceding three years despite fast economic growth.

However, supply did not rise in line with demand, causing a further increase in Greece's positive output gap. The average growth rate of the potential output of the Greek economy during recent years has been lower than the average growth rate of demand, despite the big increase in gross fixed capital formation and the satisfactory rise in the labour force (due to the inflow of immigrants). This is attributed to delays in the implementation of structural reforms and in the promotion of policies aiming to upgrade human resources, so that they can deal with increasingly complex and rapidly changing modern technologies. For these reasons, it has not been possible to make full and effective use of productive resources and to embody the expected favourable effects from investment in productivity.

3.2 Employment and unemployment

Strong GDP growth in 2004 and the hosting of the Olympic Games naturally contributed to an increase in employment. The size of this increase and the branches of eco-

conomic activity affected cannot be accurately determined, since the new data of the Labour Force Survey do not allow comparison with the previous year. Yet, it is estimated that the rise in employment was recorded mainly in the first half of the year and was broadly based across the sectors of the economy. By contrast, in the second half of 2004, while employment in trade and services kept rising, it fell in construction. Data from the Employment Observatory of the Manpower Employment Organisation (OAED) concerning employment flows in the private sector show that fewer new jobs were created in 2004 than in 2003.

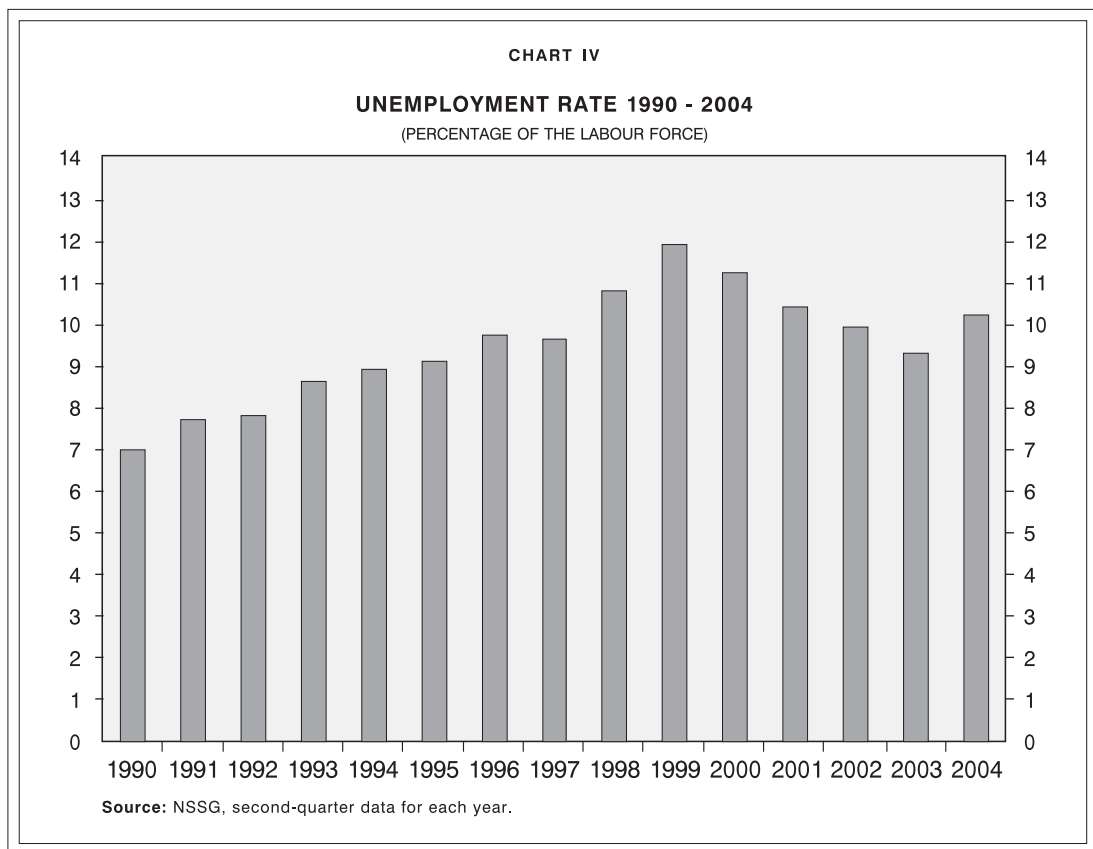


The employment rate in Greece has risen in recent years, but is still one of the lowest among the 15 most advanced economies of the European Union (EU-15). In 2004, the employment rate (i.e. employed persons as a percentage of the total population aged 15-64) was 59.4% on average in Greece (see Chart III), compared with 64.7% in the EU-15.¹ This is attributed to the significantly lower rates of female employment (Greece: 45.2%, EU-15: 56.8%) and youth employment (people aged 15-24 years, Greece: 26.8%, EU-15: approximately 40%). These divergences in employment rates

¹ For EU-15, data for the first nine months of 2004.

partly explain the gap between *per capita* GDP in Greece and that in the EU-15 (see Section 9.4).

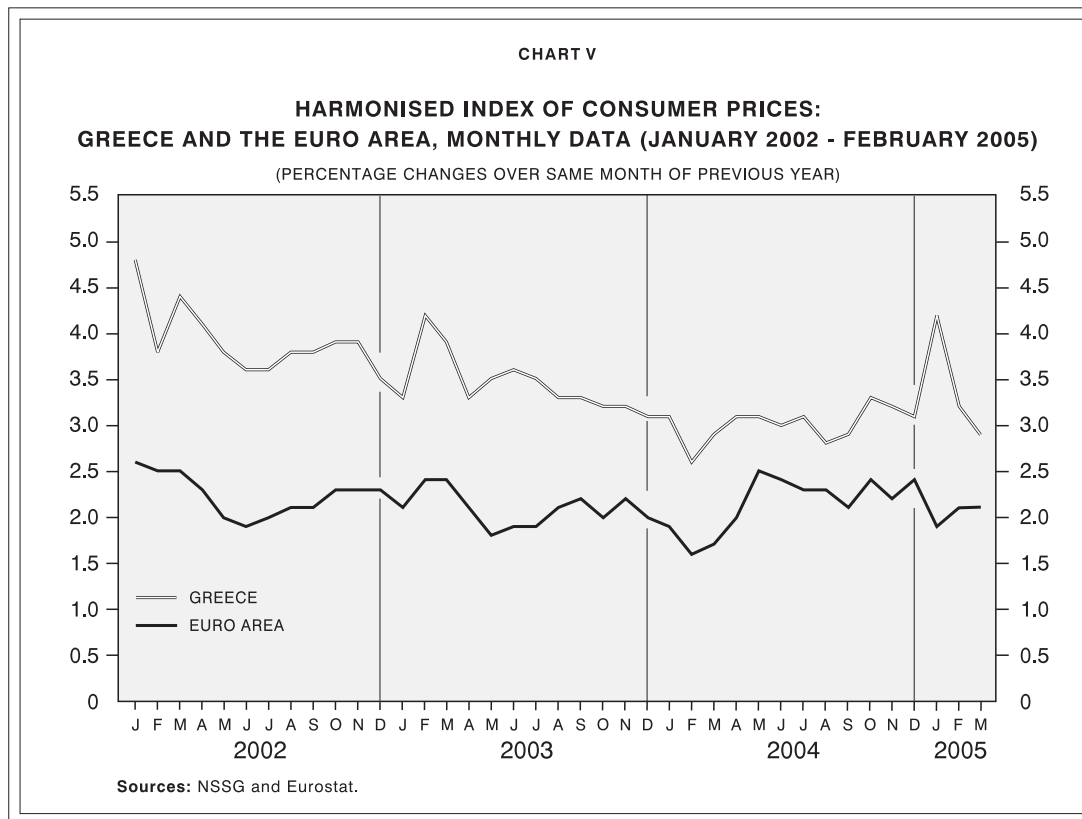
Despite the increase in employment, unemployment remained high in 2004 (see Chart IV). The unemployment rate stood at 10.5% on average in 2004 and is still significantly higher in Greece than in the EU-15 (8.0%). The unemployment rates of women (16.2%) and young people aged 15-24 (26.9%) are particularly high, while a considerable proportion of the unemployed (55%) are long-term unemployed. Also a matter of concern is the fact that 41.5% of the total number of unemployed persons have no previous



work experience (they are new entrants into the labour market). Alongside excess labour supply, there are indications of vacancies and tightness as far as certain “cutting edge” skills are concerned. Mismatches between supply and demand of labour suggest that there is a need to adapt education and training systems, as well as to increase the effectiveness of OAED and of private-sector employment agencies.

For the current year, the revised Stability and Growth Programme of March 2005 estimates (according to a baseline scenario and two alternative scenarios) that employment will increase by 0.9-1.5% and the unemployment rate will fall by 0.2-0.5 percentage point or remain unchanged. As suggested by business surveys conducted in the first quar-

ter of this year in industry, construction, retail trade and services, enterprises appear to be pessimistic about the short-term outlook for employment. At the same time, however, the expected positive effects from the implementation of policy measures included in (the recently passed) tax and development laws, as well as from the promotion of public-private partnerships (co-financed projects), the targeted more efficient absorption of funds available under the third Community Support Framework (CSF III) and the simplification of procedures for starting business activity in manufacturing should be taken into consideration.



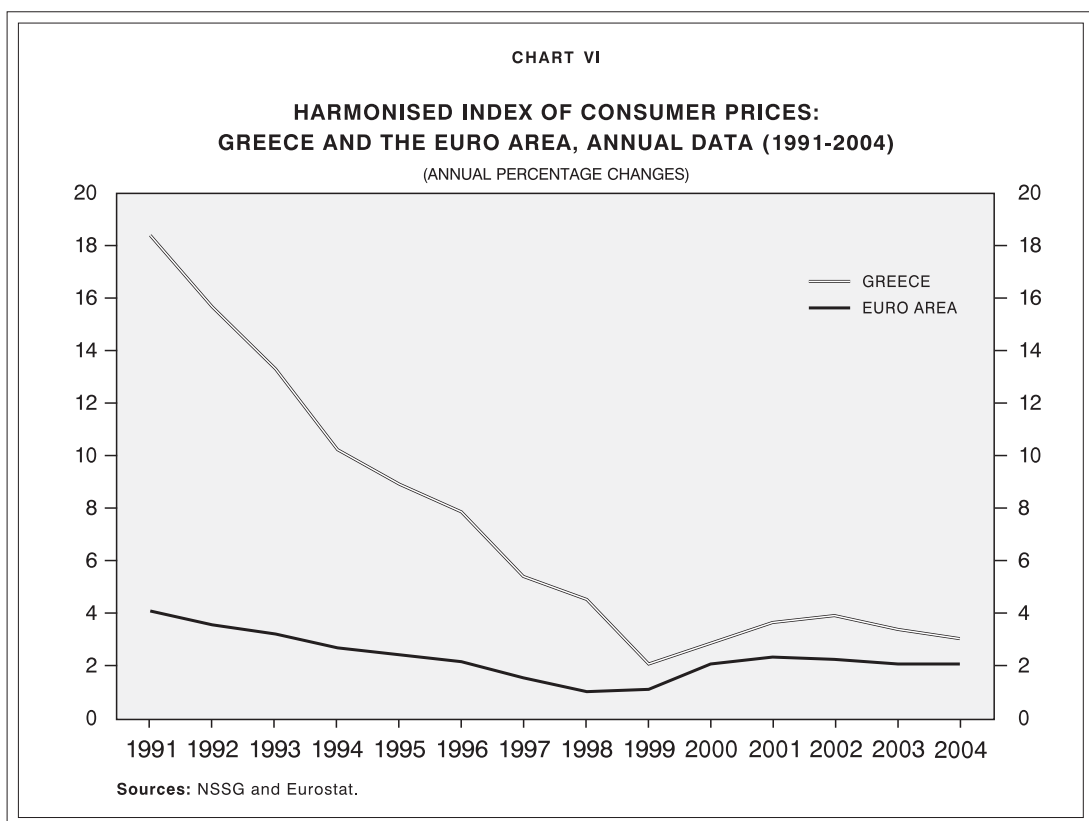
The effort to deal with unemployment and possibly the effort to reduce its duration should benefit from the greater emphasis on a personalised approach to the unemployed, which will be made possible by upgrading and streamlining the operation of Employment Promotion Centres (KPA), as well as by continuing the programmes for the acquisition of work experience (“Stage”). In any case, the most probable scenario is that the expected rise in GDP will absorb only part of the increase in the labour force, causing the unemployment rate to remain roughly unchanged this year (see also Section 8).

The low employment rate and the high unemployment rate still continue to represent major challenges for the Greek economy. Dealing with these challenges will require

policy actions such as those mentioned above, as well as policy actions that will yield results over a longer-term horizon (see Section 9.4).

3.3 Developments in inflation

The annual rate of increase in the Harmonised Index of Consumer Prices (HICP) was 3.2% in the fourth quarter of 2004, i.e. the same as in the final quarter of 2003, but its average for 2004 fell to 3.0% from 3.4% in 2003, mainly because the drop in fresh fruit

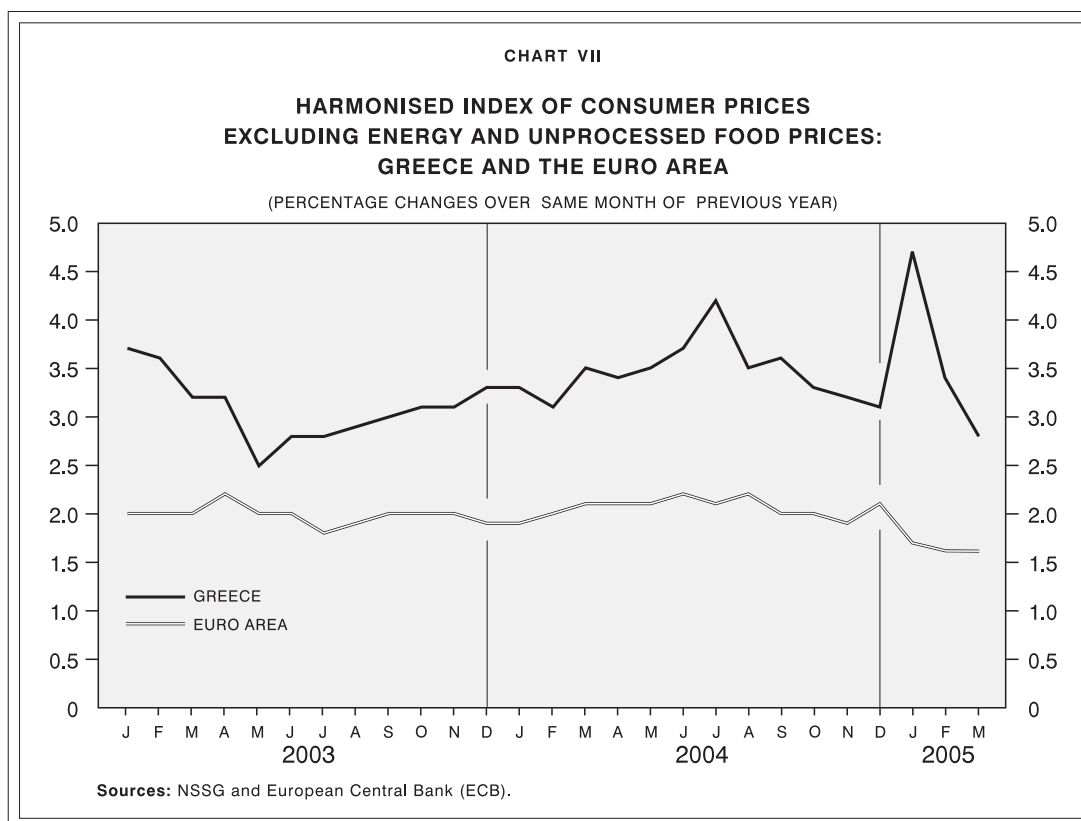


and vegetable prices more than offset the faster rise in fuel prices in 2004, compared with 2003, and the increase in core inflation (see Charts V and VI).

Core inflation, as measured by the annual rate of change in HICP excluding energy and unprocessed food, increased to an average of 3.4% in 2004 from 3.1% in 2003 – see Chart VII. This chiefly reflects the faster growth of unit labour costs in the whole economy relative to the previous year, combined with persisting demand-side pressures, as well as the indirect effects of oil price increases (dating back to the second quarter of 2003) on the prices of other goods and services. The appreciation of the euro, by containing imported inflation, moderated these inflationary pressures somewhat.

The upward trend in core inflation, the considerably faster rise in wholesale prices of domestic industrial products for home consumption (in contrast to a very small rise in the prices of imported goods) and, finally, the stronger growth of export prices (whether expressed in euro or in foreign currency) suggest that domestic inflationary pressures, combined with the lower inflation rates enjoyed by Greece's trading partners and the appreciation of the euro, are having a negative effect on the price competitiveness of Greek products in both the domestic and foreign markets.

Indeed, during the four-year period 2001-2004, the differential between the *cumulative increase* in the prices of goods and services (excluding energy and unprocessed food) in



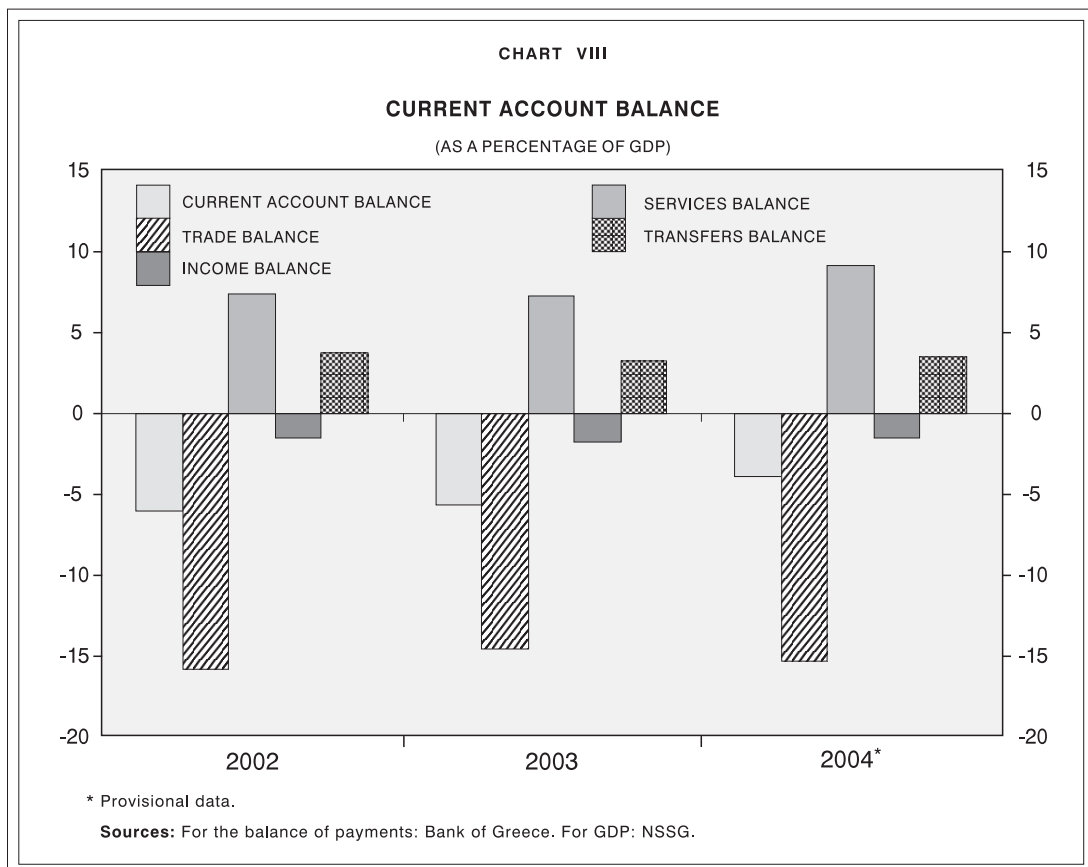
Greece (15.0%) and the corresponding increase in the euro area (8.8%) was more than six percentage points. This implies an appreciable loss of price competitiveness for Greece vis-à-vis other euro area countries. Moreover, price competitiveness against non-euro area countries is affected by the continuing appreciation of the euro. Obviously, following the adoption of the single currency, such a loss in competitiveness cannot be dealt with by an exchange rate adjustment at the national level but requires the use of other policy instruments.

More generally, the persistence of high core inflation is due to the same factors that underlie the inflation differential vis-à-vis the euro area, i.e. macroeconomic conditions and inadequate competition in certain markets which do not operate efficiently.

3.4 Balance of payments

The *current account deficit*¹ narrowed considerably to 3.9% of GDP in 2004, compared with 5.6% in the previous year (see Chart VIII) and an average of 6.2% in the four-year period 2000-2003.

The persistently high current account deficit in recent years reflects to some extent the process of real convergence – as shown by the notable upswing of private investment – and the relaxation of fiscal policy. Between 1999 and 2004, total fixed capital for-

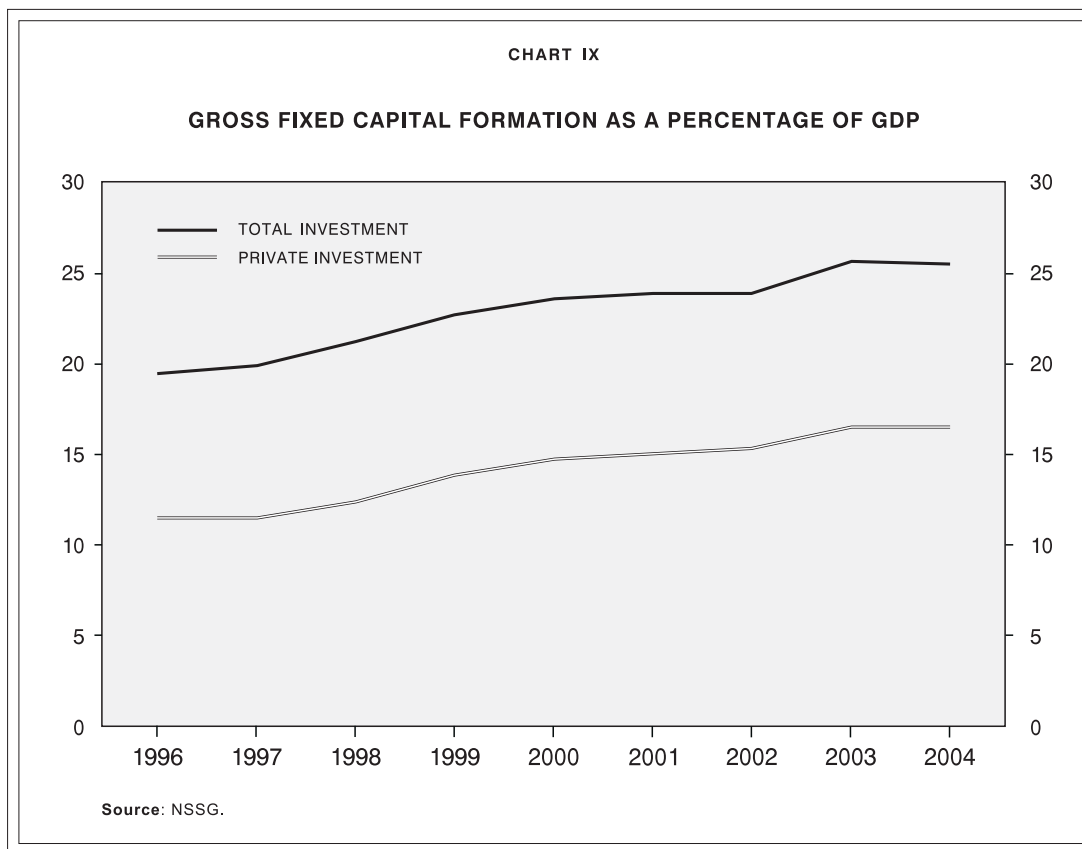


mation increased by 2.8 percentage points of GDP to reach 25.5% of GDP in 2004, one of the highest rates in the EU (see Chart IX). Most of this increase came from private investment, which rose by 2.2 percentage points of GDP, while public investment grew by 0.6 percentage point of GDP. Following a period of protracted downturn, private savings picked up appreciably over the same period, rising from 15.1% of GDP in 1999 to 19.2% of GDP in 2004 and thus outpaced investment growth. This improvement can be

¹ Including capital transfers (mainly from the EU Structural Funds).

explained by strong GDP growth and the reduction in inflation to low and predictable levels, which indicates that the deterioration of the current account deficit came as a result of a relaxed fiscal policy. In fact, public savings dropped by 3.1 percentage points of GDP to -1.4% of GDP 2004, from 1.7% of GDP in 1999.

The widening of the current account deficit between 2000 and 2003 and its persistence at relatively high levels in 2004 despite its reduction, reflect, in addition, the fact that Greece is at a different stage of the business cycle compared to that of its main EU trading partners, the structural weaknesses of the Greek economy, as well as the loss of competitiveness due



to a further increase in relative prices and the appreciation of the euro. Thus, as has been pointed out in earlier Bank of Greece reports, a sustainable decrease in the current account deficit will require further reforms aimed at raising productivity and competitiveness.

The substantial (€2.2 billion) reduction in the current account deficit to €6.4 billion in 2004 was the result of three main factors: *First*, gross receipts from transport (mostly shipping) services rose spectacularly by about 40%, reflecting the sharp growth of the world trade in goods, which boosted demand for maritime transport and pushed tanker and dry bulk freight rates up to historically high levels. *Second*, exports of goods improved remarkably. This improvement was almost exclusively due to sales (exports) of

used vessels to renew the commercial fleet, whereas aggregate receipts from exports of other goods remained virtually unchanged. *Third*, capital transfers (mostly transfers from the EU Structural Funds to the general government sector) increased considerably, whereas current transfers (mostly EU-CAP-related transfers) declined.¹ The sharp reduction in the current account deficit occurred despite the pick-up in imports following three years of stagnancy, a rise due, to some extent, to the completion of projects related to the Olympic Games and to a cumulative loss of competitiveness (also felt in the domestic market). Finally, net receipts from travel services increased as well, partly due to the successful management of the Olympic Games.

Turning to the *financial account*, financial investment (i.e. the sum of FDI, portfolio investment and “other” investment) recorded a net inflow of €5.2 billion in 2004. This reflects net inflows in both portfolio and direct investment, which, however, were largely offset by a net “other” investment outflow. It should be noted that, as in the previous year, the pronounced decline in reserve assets stemmed from the ongoing restructuring of the Bank of Greece’s portfolio towards euro area bonds and away from assets denominated in non-euro area currencies (mainly US dollars). As a result, the financial account balance, which is the sum of financial investment flows and the change in reserve assets, showed a significant net inflow, which more than offset the current account deficit.

Although net FDI inflows remained low, investment in Greece by non-residents (mainly from other EU Member States) almost doubled compared with 2003. This recovery is quite encouraging, particularly considering the declining path of FDI in international markets. Portfolio investment recorded a net inflow of €13.7 billion, reflecting €21.6 billion of Greek government bond purchases by foreign investors, compared with €18.8 billion in 2003. Residents’ holdings of foreign bonds also rose considerably (€10.3 billion), partly due to the Bank of Greece’s portfolio restructuring.

Finally, “other” investment showed a net outflow of €9.1 billion, reflecting higher assets (mainly domestic credit institutions’ deposits and repo holdings abroad) and, to a lesser degree, a decrease in liabilities (primarily due to loan repayment and, secondarily, to a drop in non-residents’ deposits and repo holdings in Greece).

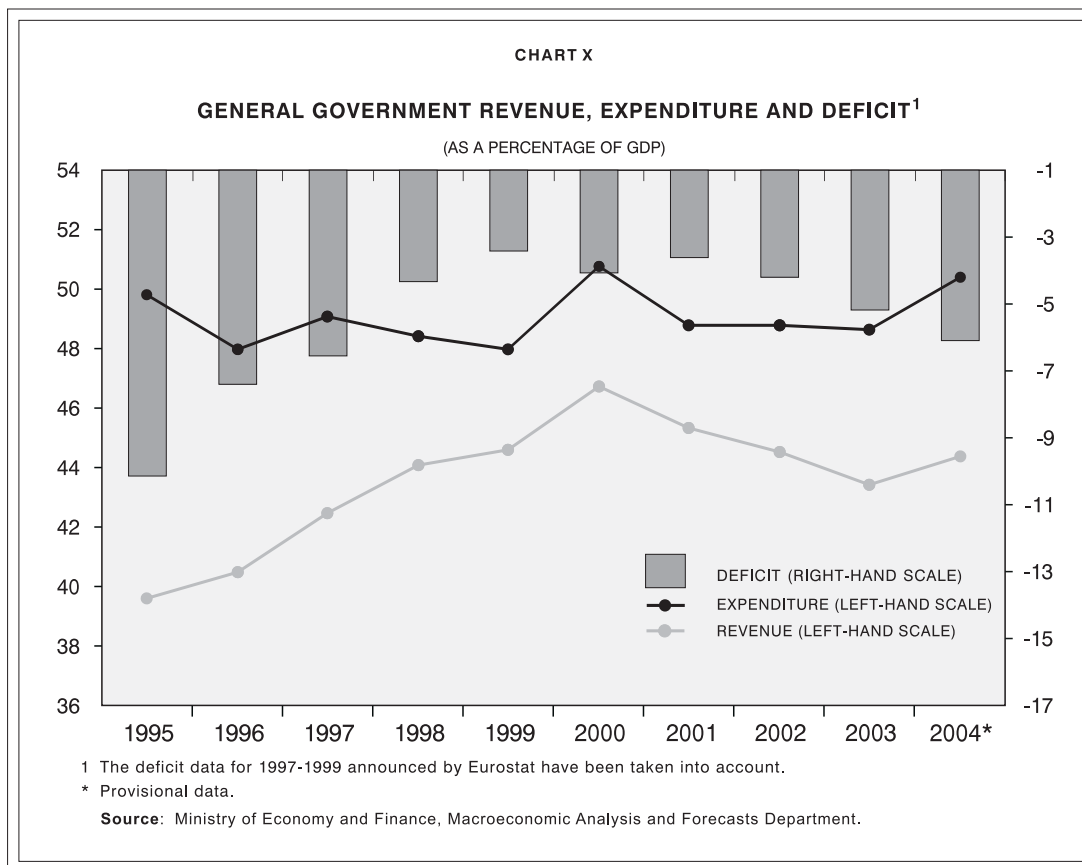
4. FISCAL DEVELOPMENTS AND PROSPECTS

4.1 *The widening of the deficit*

Despite robust economic growth, the general government deficit rose further in 2004, driving fiscal imbalances to worrying levels. At the same time, the Excessive Deficit Procedure was triggered for Greece in May 2004.

¹ It should be noted that the current account, as compiled on a *national accounts basis*, shows current transfers *only*.

According to the latest revision of fiscal data (March 2005), the general government deficit (on a national accounts basis) increased by 0.9 percentage point of GDP in 2004 relative to the previous year and stood at 6.1% of GDP (see Chart X), being the highest in the euro area. This deterioration was entirely due to a 1.3% increase in the central government deficit (on an administrative basis), which was partly offset by developments in the other sectors of general government (mainly social security funds and local government) and central government transactions that are not recorded on an administrative basis. Specifically, regarding central government (in accordance with data on an adminis-



trative basis), total expenditure increased by 12.1% (see Table I), mainly due to higher primary expenditure of the *ordinary* budget, especially for personnel outlays (salaries and pensions), grants, restitution of revenue collected on behalf of third parties and tax refunds. In fact, primary expenditure of the ordinary budget grew by 15.1%, compared with increases of 12.8% in investment budget expenditure and of a mere 0.5% in interest payments. The revenue of central government increased by 8.2% (although it remained almost unchanged as a percentage of GDP), owing to substantially higher Public Investment Budget (PIB) revenue, the bulk of which stemmed from EU transfers. Specifically,

TABLE I
FISCAL DEFICITS
(Million euro)

	Outcome 2003	Budget 2004	Outcome 2004*	Budget 2005	Outcome 2004*/ Outcome 2003	Budget 2005/ Outcome 2004*
Central government (administrative basis)						
Revenue¹	41,704	47,740	45,117	49,710	8.2	10.2
1. Ordinary budget	39,881	43,620	42,035	46,310	5.4	10.2
2. Public investment budget	1,823	4,120	3,082	3,400	69.1	10.3
Expenditure¹	51,551	54,000	57,785	58,227	12.1	0.8
1.1 Ordinary budget ²	43,116	44,750	48,270	50,177	12.0	4.0
– Interest payments	9,416	9,750	9,466	9,800	0.5	3.5
1.2 Ordinary budget primary expenditure	33,700	35,000	38,804	40,377	15.1	4.1
2. Public investment budget	8,435	9,250	9,515	8,050	12.8	-15.4
Net deficit²(-)	-9,847	-6,260	-12,668	-8,517		
% of GDP	-6.4	-3.8	-7.7	-4.8		
General government (national accounts basis)						
Deficit (% of GDP)	-5.2	-1.2	-6.1	-3.5³		
Primary deficit (-)/surplus (+)	0.6	4.7	-0.4	1.9³		
(% of GDP)						

1 For comparability purposes, tax refunds have been recorded in expenditure and have not been deducted from revenue.

2 Excluding amortisation payments.

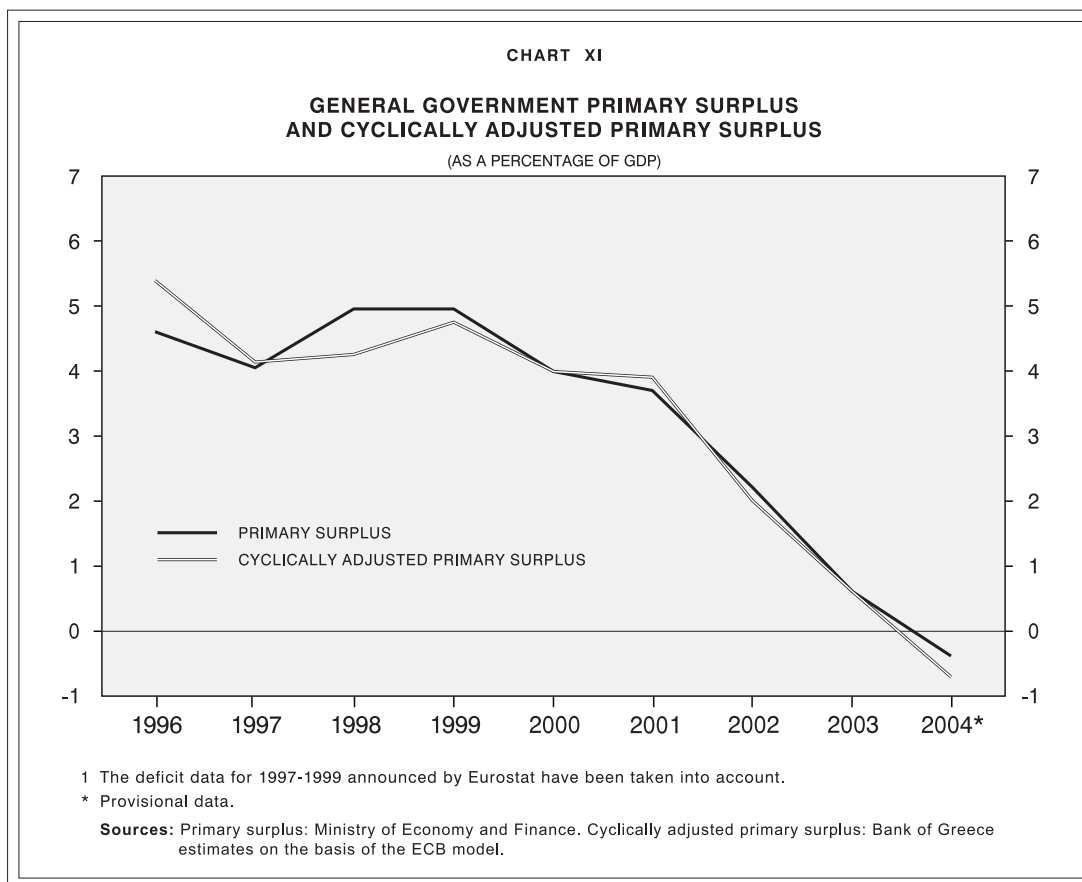
3 Updated Stability and Growth Programme, March 2005.

* Provisional data.

Source: Ministry of Economy and Finance.

PIB revenue rose by 69.1% and ordinary budget revenue by 5.4%.¹ As a result of these developments, the primary balance of general government (on a national accounts basis) turned from a surplus of 0.6% of GDP in 2003 to a deficit – for the first time since 1993 – of 0.4% of GDP in 2004 (see Chart XI).

The general government deficit in 2004 was much higher than the initial budget forecast (made in November 2003) of just 1.2% of GDP. The overrun was due to: (i) optimistic forecasts in the 2004 budget, which reflected an equally optimistic initial estimate



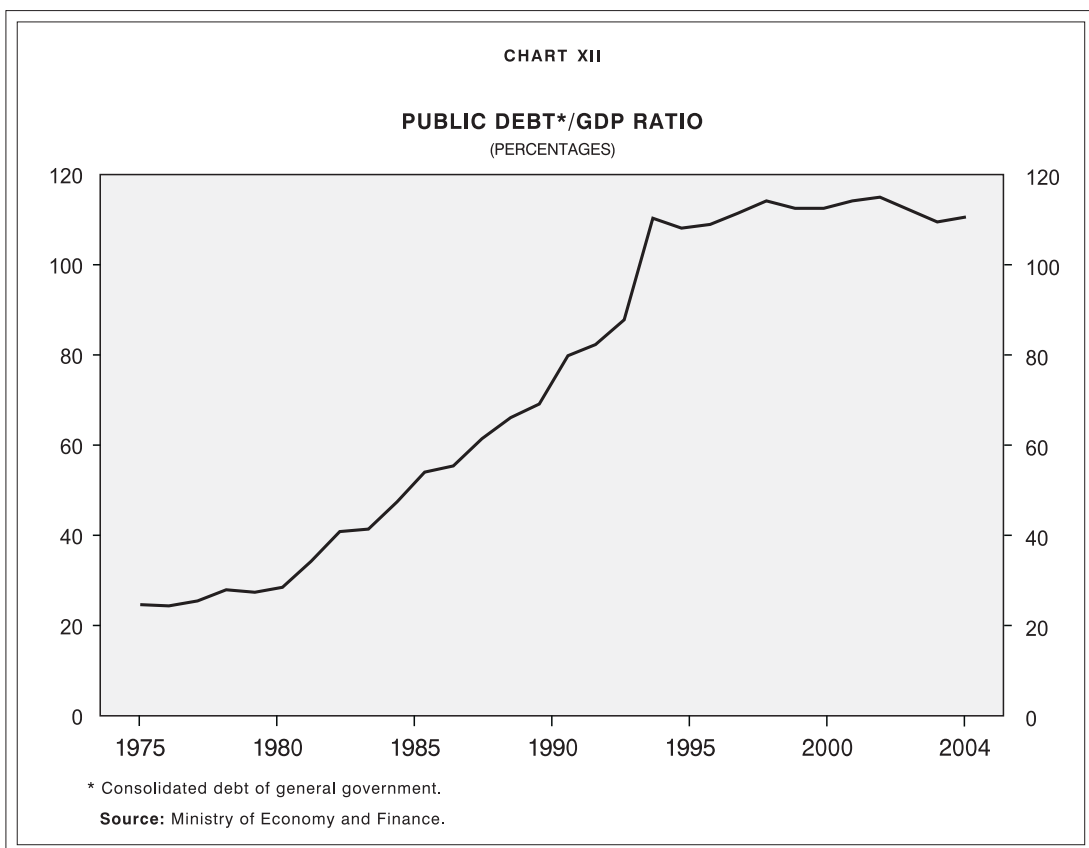
of the 2003 deficit, (ii) the fiscal audit, which led to a revision of figures for 2004 (e.g. fuller recording of defence expenditure), (iii) lower ordinary budget revenue and inflows from EU Structural Funds,² and (iv) a large overrun in primary outlays for salaries and pensions, for the preparation and hosting of the Olympic Games, for grants and for restitution of revenue collected on behalf of third parties.

1 The shortfall in budget revenue was contained by additional measures taken in July 2004 (Law 3259/2004), which provided for the settlement of pending tax cases and the collection of tax arrears.

2 Despite their rapid increase in 2004, receipts from EU funds were 25% less than the budget forecast.

4.2 Public debt

On the basis of revised data, the consolidated general government debt stood at 110.5% of GDP at the end of 2004, compared with 109.3% in 2003 (see Chart XII).¹ Greece's debt ratio is the highest in the EU-25 and almost double the Maastricht Treaty reference value of 60% of GDP. The high level of debt, in conjunction with high deficits, renders the current fiscal position unsustainable and would entail significant risks in the event of an increase in interest rates on government borrowing or a substantial decrease in the growth rate.



Following the revision of deficit and debt figures, the stock-flow adjustment for the years 1998 to 2003 declined, on average, to 3.7% of GDP (from 5.2% of GDP according to earlier estimates), while for 2002-2003 in particular it stood at low levels (1.8% and 0.7% of GDP respectively, see Table II). This decline reflected the fact that

¹ In the context of the “fiscal audit”, significant revisions were made in the figures for general government debt, bringing them up on average by 7.7 percentage points per year for the period 2000-2003. The revision of debt figures reflected the inclusion of state liabilities in the form of interest-bearing coupons and new estimates on intra-government debt.

TABLE II
DECOMPOSITION OF CHANGES IN THE GENERAL GOVERNMENT DEBT-TO-GDP RATIO¹
(In percentage points of GDP)

	1990	1991	1992	1993	1994	1995	1996	1997 ²	1998 ²	1999 ²	2000	2001 ³	2002 ³	2003 ³	2004 ^{3,4}
General government debt ratio	79.6	82.2	87.8	110.1	107.9	108.7	111.3	114.0	112.4	112.3	114.0	114.8	112.2	109.3	110.5
Annual percentage changes in the debt ratio	10.6	2.6	5.6	22.3	-2.2	0.8	2.6	2.7	-1.6	-0.1	1.7	0.8	-2.6	-2.9	1.2
- Effect of primary surplus	6.5	3.0	2.1	2.2	-2.7	-2.6	-4.6	-4.0	-5.0	-4.9	-4.0	-3.7	-2.2	-0.6	0.4
- Effect of GDP changes and interest rate changes	-4.0	-7.8	-1.7	-0.4	-1.1	0.3	1.5	-0.8	-0.3	1.2	-0.5	-1.4	-2.2	-3.0	-2.3
- Stock-flow adjustment ⁵	8.1	7.4	5.2	20.5	1.6	3.1	5.7	7.5	3.7	3.6	6.2	5.9	1.8	0.7	3.1

1 The formula used for the decomposition of changes in the debt-to-GDP ratio is the following:

$$\left[\frac{D_t}{Y_t} - \frac{D_{t-1}}{Y_{t-1}} \right] = \frac{PB_t}{Y_t} + \left[\frac{D_{t-1}}{Y_{t-1}} \cdot \frac{i_t - g_t}{1 + g_t} \right] + \frac{SF_t}{Y_t}$$

where D_t = general government debt

PB_t = primary balance

Y_t = GDP at current prices

g_t = nominal GDP growth rate

i_t = average nominal interest rate on government debt

SF_t = stock-flow adjustment

2 Debt and primary balance figures are Eurostat estimates.

3 According to data submitted to Eurostat in March 2005 in the context of the Excessive Deficit Procedure.

4 Provisional data.

5 The stock-flow adjustment includes expenditure or assumption of liabilities which do not affect the deficit but *increase* debt, as well as revenue (e.g. privatisation proceeds) which does not affect the deficit but *reduces* debt.

Sources: Ministry of Economy and Finance, Eurostat and estimates of the Bank of Greece.

the revised deficit figures also included expenditure (e.g. for the procurement of military equipment) that had not been recorded in the deficit in the past, but affected the level of debt (as they were financed by borrowing). However, in 2004 the stock-flow adjustment rose to 3.1% of GDP.

4.3 The Excessive Deficit Procedure

On 5 July 2004 the ECOFIN Council, following a recommendation by the European Commission, decided that Greece was in excessive deficit and issued a recommendation under Article 104(7) of the Maastricht Treaty calling on Greece to correct its excessive deficit situation by 2005 at the latest. The fiscal measures reported by Greece to the European Commission in November 2004, albeit in the right direction, were not considered sufficient. Therefore, on 18 January 2005 the Council decided, under Article 104(8) of the Treaty, that Greece had not taken effective measures to correct the deficit. Subsequently, on 17 February 2005 the Council adopted a Decision under Article 104(9) on recommendation by the Commission, asking Greece to take additional measures by March 21 to correct its excessive deficit. Specifically, the Council called upon Greece to bring its deficit under 3% of GDP by end-2006 at the latest by (i) strictly implementing the 2005 budget and (ii) adopting fiscal consolidation measures of a permanent nature, which should lead to a deficit reduction in 2006 of at least 0.6% of GDP. In addition, the Council urged the Greek authorities to continue fiscal consolidation after the excessive deficit had been corrected, by improving the cyclically adjusted fiscal balance by at least 0.5% of GDP per year in order to reach a close-to-balance or in-surplus position in the medium term. In March 2005 the Greek government reported to the European Commission new measures to increase revenue and contain expenditure, which were incorporated in the revised Updated Stability and Growth Programme for 2004-2007. The revised Programme was reviewed by the Commission on 6 April 2005 and by the ECOFIN Council on 12 April 2005. According to the Council Opinion on the Programme, the steps taken towards correcting fiscal imbalances and the government commitment made public on 29 March (i.e. to reduce the deficit below 3% of GDP by 2006) were in line with the Council recommendations in its notice given to Greece on 17 February and “therefore, no further steps in the Excessive Deficit Procedure are needed at present”. In October 2005, Greece will submit new fiscal figures and the situation will be reassessed.

4.4 The revised Updated Stability and Growth Programme (USGP) for 2004-2007

As mentioned above, on 21 March 2005 the government submitted to the European Commission a revised Updated Stability and Growth Programme (SGP) 2004-2007. The programme's baseline scenario suggests a drop in the fiscal deficit by 3.9 percentage points over

three years – from 6.1% in 2004 to 2.2% of GDP in 2007. The consolidation effort is front-loaded in 2005 (see Table I) and to a lesser extent in 2006, while a deficit reduction of only 0.6% of GDP is foreseen for 2007. The debt-to-GDP ratio (110.5% in 2004) is projected to decline significantly by 2007, nevertheless remaining very high at the end of the time horizon covered by the Stability and Growth Programme (99.9%). The overall fiscal adjustment will stem from a containment of expenditure by 1.5% of GDP and an increase in revenue by 2.3% of GDP. The containment of expenditure will be achieved through a decrease in investment and other capital expenditure (by 1.5% of GDP), drastic cuts in consumption and “other current expenditure” of general government (by 2.3% of GDP) and a reduction of interest payments (by 0.2% of GDP). By contrast, social transfers, which are also included in current expenditure, will increase by 2.5% of GDP. The anticipated boost to revenue from the measures announced on 29 March 2005 – i.e. an increase in VAT and in tobacco and alcohol excise taxes, curbing fuel tax evasion, and containment of expenditure for grants to public transport companies and of costs related to civil servants’ travel allowances – is estimated by the government at 0.6% of GDP in 2005 and 0.9% of GDP in 2006.

For 2005 in particular, the revised SGP projects a decrease of 2.6 percentage points in the general government deficit (on a national accounts basis), to 3.5% of GDP. This development will result exclusively from a drop in the central government deficit (on an administrative basis), as the surplus of the other general government subsectors (mainly social security funds) is expected to remain unchanged as a percentage of GDP.¹ Total budget revenue is expected to increase by 10.2% in 2005, while the rise in expenditure should be contained to 0.8%, through a weakening in the growth of ordinary budget expenditure to 4.0% and a 15.4% decrease in expenditure of the public investment budget.

5. MONETARY AND FINANCIAL DEVELOPMENTS IN THE EURO AREA

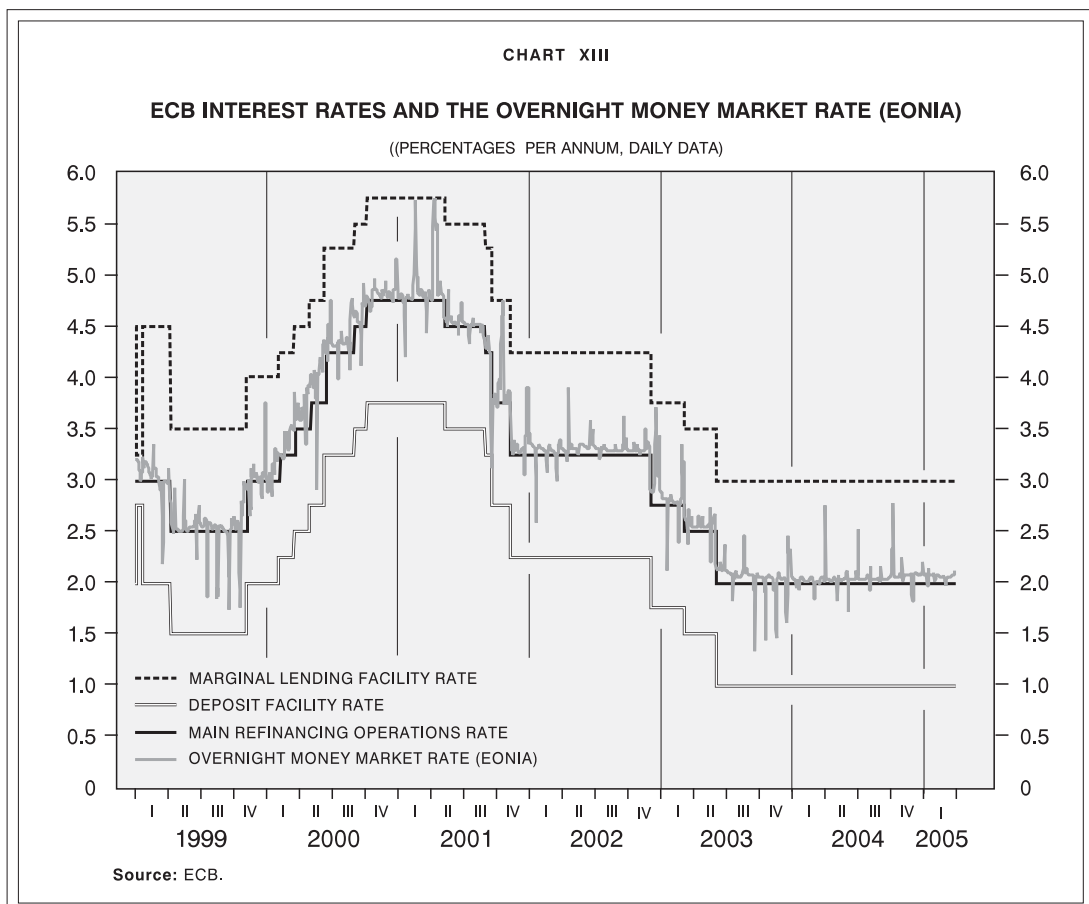
Throughout 2004 and in the first four months of 2005, the Governing Council of the European Central Bank (ECB) kept its key interest rates unchanged at the historically low levels prevailing since their last cut on 6 June 2003.² The decision of the Governing Council to leave the key rates unchanged reflected its assessment that, despite the *short-term* impact of rising oil prices, there was no significant evidence of inflationary pressures building up over the medium-term and that economic conditions in the euro area overall remained consistent with price stability. However, the Governing Council of the ECB has repeatedly stressed the need for vigilance with regard to any developments which would imply upside risks to price stability, mainly risks related to the possibility of a further rise

1 According to the USGP, the central government deficit is expected to come to 5.1% of GDP in 2005, against a budgeted 4.8%, owing to a downward revision of revenue. Moreover, the 2005 budget forecast a decrease in the general government deficit to 2.8% of GDP, compared with 5.3% of GDP in 2004 (the latter figure has been revised to 6.1% of GDP).

2 The minimum bid rate in the main refinancing operations was set at 2%, the marginal lending facility rate at 3% and the deposit facility rate at 1%.

in oil prices and significant second-round effects on consumer prices (through an increase in nominal wages), as well as to the fact that there is still substantially more liquidity in the euro area than is needed to finance non-inflationary growth.¹

Money market interest rates in the euro area remained at low levels in 2004, mirroring ECB key interest rates (see Chart XIII). Specifically, the three-month EURIBOR, which is the most representative short-term interest rate, as well as euro area government bond yields, stood at historical lows in 2004. Turning to euro area MFI interest rates, the



rates on deposits by households and non-financial corporations remained at low levels in 2004, as did lending rates, which fluctuated and, in most categories, declined somewhat during the year. As in the past, bank deposit and lending rates responded with a lag to changes in market rates.

¹ In this respect it should be noted that the annual growth rate of M3 in the euro area weakened in the first half of 2004, but strengthened in the second half. A strengthening was also seen in credit expansion to the private sector, especially in bank loans to both households and non-financial corporations in the euro area.

6. MONETARY AND FINANCIAL DEVELOPMENTS IN GREECE

6.1 Monetary developments and interest rates

The annual growth rate of the components of the Greek contribution to the euro area M3 (excluding currency in circulation) strengthened considerably in the second half of 2004. Over the same period, the annual growth rate of the respective euro area aggregate also accelerated, albeit to a lesser extent, remaining below the Greek figure throughout 2004 and in the first two months of 2005. Monetary developments both in Greece and in the euro area were driven by the very low level of interest rates (implying low opportunity cost of holding money), which encouraged shifts into more liquid assets. In Greece, however, the dynamics of M3 was intensified by a positive nominal GDP growth differential vis-à-vis the euro area and more sizeable portfolio shifts into M3. Moreover, total credit expansion in Greece strengthened significantly, as central government borrowing requirements were much higher in 2004 than in 2003.

The annual growth rate of total deposits included in M3 did not change significantly overall in 2004 (fourth quarter of 2004: 12.6%, fourth quarter of 2003: 12.2%), although the relatively low opportunity cost of holding money induced divergent developments across individual deposit categories. In particular, the annual growth rate of short-term deposits (overnight deposits) strengthened considerably, while that of deposits with an agreed maturity of up to two years decelerated significantly. Repurchase agreements (repos) continued to decrease in 2004, but their rate of decline moderated considerably. The change in the tax rates on repo yields (to 10% from 7%) and on interest income from deposits (to 10% from 15%), effective from January 2005, contributed to a further significant reduction of repo holdings and to an increase in deposits with an agreed maturity during the first two months of this year. Thus, the growth rate of total deposits accelerated, to stand at 17.2% in February 2005. The growth rate of money market fund units displayed a downward course in 2004 and turned negative in the fourth quarter. It remained negative in the first two months of 2005.

Bank deposit interest rates did not change considerably in 2004, as key ECB rates have remained unchanged since June 2003. More specifically, interest rates on new overnight deposits held by households and on deposits with an agreed maturity of up to one year increased slightly in 2004 and remained higher than the comparable euro area rates (by 23 and 35 basis points respectively). The interest rate on new repos remained virtually unchanged, not much different from the euro area average. In the first two months of 2005, deposit interest rates in Greece remained at the levels of the previous year, with the exception of the rate on deposits with an agreed maturity, which decreased slightly.

More marked movements were seen in interest rates on new bank loans, particularly in those on loans to households, which declined considerably in 2004, while changes in rates on loans to non-financial corporations were marginal. Specifically, a relatively large decline was recorded in consumer loan interest rates (102 basis points for loans with

a floating rate or with an initial rate fixation of up to one year and 50 basis points for the total of new consumer loans with an agreed maturity), while interest rates on housing loans fluctuated and declined to a lesser extent throughout 2004 (16 basis points for all new loans). During the first two months of 2005, consumer loan interest rates recorded increases of up to 41 basis points, while interest rates on all new housing loans did not change considerably. Developments in interest rates on new loans during 2004 contributed to a decline in the average rate on the amount outstanding of the most significant categories of loans to households. Lending rates in Greece, even though they have declined, remain higher than the euro area average, as is also the case with most deposit interest rates. The widest divergence is observed in loans to households, particularly in consumer loans without an agreed maturity, which include loans through credit cards, while housing loans and large corporate loans display less significant spreads.

6.2 Credit developments

The annual growth rate of total credit extended to the economy by Monetary Financial Institutions (MFIs, i.e. banks and money market funds) accelerated considerably during 2004 and stood at 8.6% in the last quarter of the year, compared with 3.2% in the fourth quarter of 2003. This development can be attributed to a slowdown in the rate of decline of credit to general government, while credit expansion to enterprises and households decelerated slightly. In particular, the annual rate of change in credit to general government was contained to -5.6% in the last quarter of 2004, from -15.9% in the fourth quarter of 2003, reflecting the ongoing decline – albeit at a slower pace – in MFI holdings of Greek government paper. The net borrowing requirements of central government (on a cash basis) increased significantly (2004: €15,605 million, 2003: €10,526 million), but were more than offset by foreign capital inflows for purchases of government paper. Credit expansion to enterprises and households slowed down slightly, as already mentioned (fourth quarter of 2004: 16.1%, fourth quarter of 2003: 17.1%), mainly reflecting developments in lending to enterprises. This deceleration continued into the first two months of 2005 and, combined with a further slowdown in the rate of decline of credit to general government, kept total credit expansion in February at 8.6%.

The annual growth rate of MFI lending to enterprises fell to 8.6% in the last quarter of 2004, from 11.0% in the last quarter of 2003. On the other hand, corporate bond issuance gained in importance during 2004, although these bonds are generally held by banks. Including total corporate bonds, the deceleration in the growth of total lending to enterprises is smaller (fourth quarter of 2004: 12.3%, fourth quarter of 2003: 13.9%). In any case, credit expansion to enterprises continues to indicate that their financing conditions remain relatively ample, as the rate of credit expansion was higher than both nominal GDP growth in 2004 (7.7%) and the rate of credit expansion in the euro area (fourth quarter of 2004: 4.1%). The weaker credit expansion to enterprises was due to a slower

rise in credit to industry, “other” sectors (which include construction companies) and tourism (although credit expansion to the latter remains strong). By contrast, a considerable acceleration was observed in credit expansion to agriculture and, mainly, trade. The decline in the growth rate of lending to enterprises continued into the first two months of 2005, and in February this rate stood at 5.0%.

The annual growth rate of credit to households remained virtually unchanged at a high level, standing at 28.0% in the fourth quarter of 2004. This overall stability masked a deceleration in the growth of housing loans (fourth quarter of 2004: 23.8%, fourth quarter of 2003: 27.1%), partly reflecting securitisation operations conducted in June 2004, and a strengthening in consumer loans, which gained new momentum after a relative decline in 2002-2003 and grew at an annual rate of 37.9% in the last quarter of 2004 (fourth quarter of 2003: 24.8%). In the first two months of 2005, the growth rate of housing loans recovered somewhat (February 2005: 25.4%), while that of consumer loans fell slightly (February 2005: 35.0%).

The relative importance of loans to households increased further in 2004, as they represented a share of 71.4% in total credit expansion to enterprises and households (2003: 59.3%), significantly above the euro area average (2004: 55.3%, 2003: 56.9%). Thus, at the end of 2004 the outstanding amount of loans to households accounted for 44.1% of total loans to enterprises and households, compared with 39.7% at end-2003 (2002: 36.4%). Owing to strong credit expansion, households’ indebtedness as a percentage of GDP has been following an upward trend, although it remains lower than the euro area average. Specifically, in 2004 it stood at 31.2% (2003: 26.2%), compared with 50.4% in the euro area (2003: 48.4%).

6.3 Capital markets

In 2004, capital markets were characterised by the favourable conditions that prevailed in government bond markets and a marked recovery of equity prices in the stock market.

Greek government bond yields moved broadly in line with the respective euro area yields. After a fall in the first three months of 2004, government bond yields increased significantly in the second quarter of the year, due to greater optimism surrounding the global economy and expectations of a rise in US interest rates.¹ However, in the second half of 2004, yields followed a continuous downward course, which reflected investor concerns regarding the impact that rising oil prices and the appreciation of the euro against the US dollar could have on euro area growth. The decline in yields concerned the entire maturity spectrum, but was more pronounced at the longer end of the yield curve, as the growth outlook of the euro area economy remained subdued in 2004.

¹ On 30 June 2004, for the first time in five years, the Federal Reserve increased its key interest rate by 25 basis points.

In greater detail, the yield on the 10-year Greek government bond fell to 3.80% at end-December 2004, 62 basis points down relative to end-December 2003, before recovering somewhat to 3.86% at end-March 2005. The yield differential between the Greek 10-year bond and the comparable German bond was 12 basis points at end-December 2004, unchanged from its level one year before. It should be noted that the downgrading of Greece's credit rating by Standard and Poor's and Fitch (following fiscal data revisions) had no impact on this differential. In the first three months of 2005 the yield differential widened and stood at 22 basis points at end-March. This is largely explained by the fact that the new Greek benchmark bond issued in mid-February matures 6.5 months later than the corresponding German bond.

Transactions in the secondary market for Greek government securities (HDAT) reached very high levels. The average daily value of transactions rose to €3.8 billion in 2004, having increased by 39% compared with 2003. Trading mainly concerned long-term securities, particularly 10-year bonds.

In the primary market for government securities, the amount of funds raised was higher in 2004, with Greek and foreign investors showing particularly strong preference for Greek government bonds. Primary market activity involved new issues and reopenings of past issues, mainly via syndication procedures and, to a lesser extent, by auctions. The weighted average maturity of securities issued in 2004 fell to 6.85 years, from 7.22 years in 2003.

Reflecting similar developments mainly in euro area stock markets, stock prices on the Athens Exchange (Athex) followed a generally upward path in 2004, which was particularly pronounced in the last four months of the year. Between end-December 2003 and end-December 2004, the Athex composite stock price index rose by 23.1%.¹ This upward trend continued in the first two months of 2005, but came to a halt in March. The average daily value of transactions stood at €141 million in 2004, around the level recorded in 2003. Total funds raised through the stock market rose slightly in 2004, compared with the low levels in 2002-2003 (€476 million in 2004, €378 million in 2003). It should be noted that the rise in the Athex composite share price index in 2004 was significantly stronger than the increase in the Dow Jones EURO STOXX broad index in the euro area (10.0%) or the Standard and Poor's 500 index in the United States (9.0%). On the basis of developments in stock prices and corporate profitability, the P/E ratio is estimated to have risen in 2004 for all Athex-listed shares and particularly for those of the banking sector.

Despite the significant increase in the Athex composite stock price index, the Greek mutual fund market recovered only slightly in 2004. A rise mainly in prices and, to a lesser extent, in the number of units in circulation led to a small increase in the value of total mutual fund assets (4.1%). Among the individual categories of mutual funds, the assets of bond-type mutual funds recorded a particularly pronounced increase, reflecting favourable conditions in international bond markets in 2004. The assets of balanced-type

¹ This rise in the composite index was the third highest in euro area stock markets.

and equity-type mutual funds also increased, though to a lesser extent. By contrast, the assets of money market mutual funds declined. With regard to equity-type mutual funds, it should be noted that the increase in their assets was due to a rise in the price of units in circulation which more than offset a decline in their number.

In the context of the transposition of all relevant European Union Directives into national legislation, regulations relating to Undertakings for Collective Investment in Transferable Securities (UCITS) were adopted in 2004. These concerned the expansion and internationalisation of mutual fund activities, the introduction of specialised mutual fund categories (index funds, funds of funds) and the strengthening of investor protection. These provisions aim to improve the functioning of the mutual fund market.

7. THE STABILITY OF THE BANKING SYSTEM

The recovery of Greek commercial banks' income observed in 2003 continued in 2004, albeit at a slower pace. However, despite a moderate increase in the operating costs of most banks in 2004, the net pre-tax profits for banks as a whole on a non-consolidated basis¹ dropped by 11.5%, as extraordinary expenses mainly associated with the implementation of employee voluntary retirement plans or balance sheet consolidation measures weighed heavily on the results of certain banks. If the impact from the voluntary retirement plans is not taken into account, the decrease in profits for banks as a whole in 2004 is only 2.0%. However, profits on a consolidated basis, i.e. at group level, rose by 9.9% in 2004.

As regards the income structure, net interest income as a percentage of total operating income grew slightly in 2004 (to 74.9%, from 74.2% in 2003), exceeding considerably the corresponding average for EU banks as a whole (around 59% in 2003), which partly reflects the higher share of loans in Greek banks' portfolios. Despite increasing competition, net interest income as a percentage of banks' assets remained almost unchanged at 2.8%, compared with an average of 1.4% for all EU banks in 2003. This reflects the growing share of loans – notably consumer loans, which afford higher margins – in banks' assets, as well as the declining share of holdings of fixed-income securities, which have a considerably lower margin. Within non-interest income, a rise in net income from commissions and variable-yield securities largely offset a substantial decline in income from financial operations. Thus, the share of non-interest income in total operating income decreased only slightly (to 25.1%, from 25.8% in 2003). Generally, the continued reliance of Greek banks on their credit operations, notably income from retail business, is a positive characteristic, as it enhances the stability and quality of their income.

¹ That is, the results of the parent company, not including those of its subsidiaries.

The decrease in banks' profits on a non-consolidated basis in 2004 led to a drop in both their return on equity (ROE) (from 13.0% in 2003 to 10.8% in 2004) and return on assets (ROA) (from 0.9% to 0.7%). At the banking group level, both ratios, despite falling slightly in 2004, were definitely higher than on a non-consolidated basis (16.1% and 1% respectively in 2004, compared with 16.5% and 1% in 2003).

A 15.2% rise in regulatory own funds¹ in 2004 resulted in a marked increase in the capital adequacy ratio (CAR) of Greek commercial banks as a whole to 13.5% in 2004 on a non-consolidated basis, up from 12.8% in 2003. If the total shortfall in banks' provisions in relation to the Bank of Greece requirements² is taken into account, the CAR drops by a mere 0.6 percentage point, but remains at a satisfactory level. The CAR also rose on a consolidated basis, from 12% in 2003 to 12.8% in 2004. By contrast, the non-consolidated CAR, which is calculated on the basis of core (Tier I) capital only, showed a further small decline to 9.6% in 2004, from 10.1% in 2003 and 10.6% in 2002, but is still higher than the corresponding EU average (8.8% in 2003). Underlying the decline in this ratio was a moderate increase of 4.6% in Tier I capital in 2004, while supplementary (Tier II) capital grew substantially (by 50.8%).

The continuing strong credit expansion to the private sector, notably to households, increases bank profitability, but is also a potential source of additional credit risk. It should be noted that the non-performing loans to total loans ratio remained virtually unchanged at 7% in 2004, although there were divergent developments in individual categories of loans (a decline in the case of consumer loans and housing loans and a rise in corporate loans). The net non-performing loans (less provisions) to total loans ratio also changed little (3.4% in 2004, compared with 3.5% in 2003), while the net non-performing loans to own funds ratio of banks declined marginally (from 27% to 26.6%). At the same time, the provisioning coverage of non-performing loans rose from 49.9% in 2003 to 51.1% in 2004. However, with respect to consumer and housing loans in particular, the following should be taken into account: First, over the short term, the non-performing loans to total loans ratio is affected favourably by continued strong credit expansion, as any servicing problems typically arise some time after the initial granting of loans. Second, a considerable part of loans that are refinanced by being transferred to other banks may involve potential servicing problems. This risk is mitigated by the high value of real estate collateral, especially for housing loans. However, the latter has declined as a proportion of total debt per borrower. This is so because real estate collateral is often used to secure both a loan for house purchase or construction and a repair or consumer loan granted to the same borrower. Therefore, the Bank of Greece has recommended that total lending to each borrower should not exceed 80% of the market value of the respective real estate collateral.

1 Regulatory own funds refer to those balance sheet items that, according to Bank of Greece Governor's Act 2053/92 (as currently in force), count against capital requirements for banking risks. These items are divided into core capital, which is considered to provide full coverage against risks, and supplementary capital.

2 See Bank of Greece Governor's Act 2442/99 (as currently in force).

For consumer loans, Bank of Greece Governor's Act 2557/26 January 2005 recently increased the provisioning ratios as follows: (i) from 70% to 90% for non-performing loans one year past due or in permanent arrears; and (ii) from 84% to 100% for doubtful loans. The purpose of this arrangement was, on the one hand, to address the potential credit risk implications of strong credit expansion in the field of consumer loans and, on the other hand, to encourage banks to write off doubtful loans rather than maintaining them on their balance sheets. At the same time, in view of the relatively low credit risk entailed by performing loans backed by residential mortgages, the Bank of Greece reduced from 0.7% to 0.5% the provisioning ratios for these loans, provided that the amount of the loan does not exceed 70% of the objective value of the residential property. It should be pointed out, however, that the generally applicable provisioning framework does not substitute for banks' obligation to regularly review their credit standards and constantly improve their credit risk measurement and management systems.

In recent years, Greek banks have taken major steps towards upgrading their credit risk measurement and management systems. Several banks have already introduced credit scoring models for the approval of consumer loans, while some banks have developed probability of default models. The development of similar systems and, most importantly, their integration into banks' decision-making are necessary conditions for the adoption of the internal-ratings-based approach to the calculation of capital adequacy against credit risk under the new supervisory framework ("Basel II").

However, even those banks which will opt for the less sophisticated, standardised approach should also adjust their systems accordingly, as this will increase their ability to manage risks effectively in an environment of strong competition and economic uncertainty.

The quality of banks' loan portfolios is affected not only by their credit standards and credit risk management systems, but also by developments in borrowers' financial position. In 2004, the financial position of households and firms benefited from Greece's macroeconomic environment, which was characterised by strong growth and low interest rates.

Households' indebtedness as a percentage of nominal GDP rose to 31.2% at end-2004, from 26.2% at end-2003, but this percentage in Greece is still lower than the corresponding average in the euro area as a whole (50.4% in 2004). The ratio of households' indebtedness to the total value of residential property and equities held by them directly or indirectly (through mutual funds) also remains low (around 6% at end-2004, compared with 5.3% at end-2003). Besides, total households' interest payments on housing and consumer loans as a percentage of their disposable income¹ are estimated at 2.8% in 2004, compared with 2.5% in 2003. On the basis of these ratios, households' indebtedness, despite rising over time, overall appears to remain at moderate levels. However, strong credit expansion to households may lead to increased credit risk in the future, notably if economic activity were to slow down, which would affect households' disposable income, or if interest rates were to rise from their current historical lows. Hence, as the Bank of

¹ Gross disposable income, as derived from National Accounts data.

Greece has pointed out repeatedly, banks should not ease their credit standards under the pressure of competition, while households should evaluate carefully – on the basis of realistic estimates about their income prospects and interest rate developments – their ability to meet their debt obligations.

Developments in residential property prices can be an additional source of credit risk to banks, as they affect the value of real estate collateral. These prices have recently tended to stabilise, following a period of continuous rise. Although a future fall in residential property prices in certain segments of the market cannot be ruled out, substantial correction would seem unlikely, especially if economic conditions develop in line with current forecasts.

In 2004, the pace of credit expansion to enterprises fell considerably short of that to households and overall showed a small slowdown in relation to 2003, albeit with marked differences across sectors. Thus, strong credit expansion to the business sector does not seem in itself to be a potential source of higher credit risk for banks. As regards developments in the financial position of enterprises, on the basis of available published data compiled by the Bank of Greece from a sample of 554 non-financial corporations, the recovery of business profitability observed in 2003 does not seem to have continued in 2004.

Specifically, the net pre-tax profits of all the sample firms declined by 1.2% in 2004, although their total sales increased by 11.1%. The small decrease in overall profitability reflected an 8.4% drop in the services and other activities sector, mainly owing to a considerable fall in the profits of the construction and telecommunications sectors. By contrast, the profits of the sample retail firms rose by 23.6% in 2004, while the profits of industrial firms increased slightly (by 3.9%), albeit with marked differences across branches. Besides, in the overall sample, the ratio of financial costs to gross profits, which is a measure of the firms' financial vulnerability, improved from 5.7% in 2003 to 5.3% in 2004, which is particularly low, although some branches show a much higher ratio.

These findings from the sample in question mainly concern big – by Greek standards – firms and therefore do not necessarily hold true for small and medium-sized enterprises in general. Some indications about developments in the financial position of small and medium-sized enterprises in 2004 are provided by changes in firms' bad credit record data, which include a large number of small and medium-sized enterprises. Specifically, in 2004 both the value of unpaid cheques and the amount of payment orders increased substantially (by 33.2% and 59.5% respectively), while the rise in the amount of bankruptcy petitions was clearly smaller (4.6%).

However, as many small firms do not have easy access to bank credit, the problems facing them probably did not affect considerably the non-performing loans to total loans ratio (for the business sector as a whole), which increased only slightly in 2004 (to 7.8%, from 7.4% in 2003).

As regards interest rate risk, a large part of the loans granted by Greek banks carry floating rates, which mitigates the impact on net interest income from any rise in interest rates. However, this impact may become stronger in the future, as certain banks, in the

face of a growing deposit gap, have already had recourse to financing through market-based debt, which makes them more vulnerable to interest rate changes. Besides, interest rate changes can have an impact on banks' own funds, to the extent that they affect the valuation of their open positions in debt securities and in financial derivatives on debt securities and interest rates. However, it should be pointed out that, on a non-consolidated basis, capital requirements against general position risk of the trading book from interest rate changes for all the banks that use the standardised approach decreased by 4.5% in 2004 and remain at particularly low levels (0.8% of own funds).

With respect to the other market risks, on a non-consolidated basis for all the Greek commercial banks that use the standardised approach, the capital requirements against equity price risk of the trading book and foreign exchange risk correspond to very small percentages of banks' own funds (0.31% and 0.34% respectively on 31 December 2004). Therefore, these risks should not have a significant impact on the stability of the Greek banking system.

By contrast, operating risk has gained importance worldwide, reflecting the growing complexity of banking operations and banks' increased IT dependency. Against this background, the Bank of Greece has recently supplemented the institutional framework concerning banks' internal control systems and further specified the principles and standards for the development and operation of banks' information systems and for the organisational structure and internal control of banks' IT functions, with a view to ensuring effectiveness and security. Besides, the new supervisory framework ("Basel II"), which will be implemented as from 31 December 2006, introduces capital requirements against banks' operating risk.

Liquidity risk is estimated to have increased, mainly as a result of continued strong credit expansion. Hence, the Bank of Greece amended the existing framework on the monitoring of credit institutions' liquidity and defined two new supervisory ratios of liquidity, laying down their thresholds (Bank of Greece Governor's Act 2560/1 April 2005).

The Bank of Greece attaches particular importance to the resilience of the Greek banking system to potential shocks – notably in terms of adequate capital buffers for absorbing shocks. To this end, banks were requested to carry out stress tests, simulating extreme but plausible worst-case scenarios (as determined by the Bank of Greece) of credit and market risk factors,¹ in order to assess the impact on own funds and CAR.

In 2004, the IMF accepted Greece's application for being included in the IMF's Financial Sector Assessment Program (FSAP), in the context of which the stability of the financial sectors of many countries (including EU Member States) has already been evaluated. During the assessment exercise, which is still under way, the IMF FSAP mission focuses, in addition to the resilience of the banking system to shocks, on the institutional framework for banking supervision and its implementation in Greece against the 25 Core Principles for Effective Banking Supervision and the standards established

¹ Including probability of default, loss given default, interest rates, equity prices and the euro exchange rate.

by the Basel Committee on Banking Supervision. The final conclusions of this evaluation will be available soon.

To sum up, in the current circumstances, the Greek banks' CAR provides an adequate buffer for safeguarding the stability of the banking system and exceeds the average for the euro area as a whole (11.9% in 2003). However, account should be taken of the impact on own funds from the introduction of the International Accounting Standards (IAS) as from 1 January 2005, notably of IAS 19, which prescribes disclosure of liabilities arising from employee defined benefit plans. While no major implications are expected for the CAR of the banking system as a whole, certain banks will have to strengthen their capital base to restore their capital adequacy. Furthermore, the implementation of the new capital adequacy framework ("Basel II") as from 31 December 2006 will have repercussions on banks' CAR. The overall impact of all the above factors will depend on the alternative methods for calculating capital requirements to be adopted by banks, as well as on the composition and quality of their loan portfolios, in conjunction with cyclical developments. Given the uncertainty surrounding these factors, banks should further increase their own funds, taking into account that, as already mentioned, the new supervisory framework introduces capital requirements against operating risk. The Bank of Greece, for its part, has already taken important steps to prepare for the future implementation of the new supervisory framework in Greece.

The operating costs of most Greek banks increased at a relatively moderate pace in 2004, thus remaining as a percentage of banks' total assets at the levels of 2002 and 2003 (2.3%). Generally, in recent years Greek banks have made substantial efforts to control their operating costs and should continue to do so in the light of increasing competition. These efforts include the ongoing rationalisation of branch networks that resulted from past mergers, as well as the implementation of personnel voluntary retirement plans in some cases. Furthermore, mainly during the last two years, certain banks absorbed financial subsidiaries in order to cut operating costs, ensure better coordination and take advantage of economies of scale and scope.

Turning to the structure of the Greek credit system, the commercial banks' market share on the basis of assets fell to 80.9% in 2004, from 82.1% in 2003, while the share of specialised credit institutions grew marginally to 8.4%, from 8.0%. A small increase was observed in the market shares of cooperative banks and branches of foreign banks (to 0.7% and 10% respectively in 2004, from 0.6% and 9.3% in 2003). Measured by the market share of the five largest banks, the degree of concentration of the Greek credit system decreased from 66.9% in 2003 to 65% in 2004. Although the degree of concentration remains high, it does not seem to have hampered competition between credit institutions and is well below the corresponding figures of more than 80% recorded in three other euro area countries (Finland, Belgium, Netherlands).

The number of bank branches in Greece continues to rise (2004: 3,403, 2003: 3,300), albeit at a slower pace in the 2003-2004 period in comparison with earlier years. However, there is a trend towards smaller branch size and a focus on core activities and

consultancy, while back office operations have tended to become centralised. Nevertheless, on the basis of data for 2003, the number of employees per branch in Greece (19) remains higher than the corresponding EU average (15).

Alternative distribution channels, such as the internet, phone banking and automatic teller machines (ATMs), are increasingly being used in Greece. In particular, the number of ATMs rose from 5,468 in 2003 to 5,787 in 2004. Still, these channels are supplementary to branches, which retain their key role in the marketing and delivery of products. Besides, an extensive branch network also supports the expansion of Greek banks in the bankassurance sector through cross-selling. Given the growth of this sector, cooperation between the Bank of Greece as the banking supervisory authority and the recently created (by Law 3229/2004) regulatory authority for insurance companies would contribute to more effective supervision of bankassurance products and coordination between the supervisory authorities with a view to ensuring the stability of the financial sector.

The expansion abroad by Greek banks observed in the last decade increasingly focuses on the countries of Southeastern Europe, where Greek banks seek to strengthen their position, mainly through acquisitions of local banks, in order to take advantage of the expected fast and further development of the financial sector of these countries. The improved macroeconomic aggregates of the Southeastern European countries, the prospect that some may join the EU and the ongoing restructuring of their banking systems have reduced Greek banks' country-specific risk and their activities in these countries are expected to boost considerably profitability, mainly at the group level, in the coming years. However, as Greek banks' exposures to these countries have increased considerably, they should be subject to systematic and specialised monitoring and control, notably at the banking group level.

8. THE ECONOMIC OUTLOOK FOR 2005

Available statistical data and leading indicators suggest that the slowdown in Greece's growth rate since mid-2004 will continue throughout 2005. According to Bank of Greece forecasts published in the latest *Monetary Policy Report* (February 2005), average annual GDP growth was initially projected to reach 3.3% this year. However, as oil prices have continued to rise and consumer and investor expectations have slightly deteriorated further, Greece's growth rate could taper off to around 3% (from 4.2% in 2004 and 4.7% in 2003). As this growth in GDP is expected to absorb *part* of the labour force increase, unemployment is likely to remain unchanged from last year's level.

These GDP forecasts are subject to considerable uncertainties associated with oil price developments and the impact on inflation (and household disposable income) from the increase in indirect taxation, the prevailing imbalances in the global economy and long-term interest rate and exchange rate developments. The projections of the Bank of

Greece about the outlook of the Greek economy are quite similar to those of international organisations,¹ while the revised update of the Stability and Growth Programme (March 2005) estimates that Greece's GDP growth rate for 2005 will range between 2.9% and 3.9% (baseline scenario: 3.9%, alternative scenario 1: 3.3%, alternative scenario 2: 2.9%).

Domestic demand will once again be the main driver of growth this year, while the external sector's contribution, negative in 2004, is expected to be neutral. More specifically, private consumption growth should decelerate further, though remaining relatively strong on account of the continued rise in income and employment (albeit at a slower pace than in 2004), easy access to consumer credit at fairly low interest rates and the increase in the value of household assets in recent years (which has encouraged households' increased recourse to loans). According to the revised Stability and Growth Programme, the rise in public consumption will slacken to 1.5% in 2005. The growth of gross fixed capital formation is expected to decline for the second year running, reflecting significant cut-backs in the public investment programme (by 17.5% at constant prices on a national accounts basis). Business investment should increase at a relatively high rate (owing to favourable financing conditions and to the positive impact anticipated from the newly enacted development and tax laws), while residential investment is projected to pick up only slightly, after showing no change in 2004. Finally, total exports (goods and services) are expected to register a satisfactory increase, driven for the most part by exports of services (tourism and transport), while total import growth should fall markedly from its high level of 2004, mainly on account of weaker growth in investment.

Turning to *inflation*, the Bank of Greece has already projected a slight acceleration for 2005 in its latest *Monetary Policy Report* (February 2005), taking into account that last year's decline in inflation was mainly due to a decrease in fresh fruit and vegetable prices. However, the measures to increase indirect taxes, along with the recent oil price developments and trends, are likely to raise the average annual rate of both headline inflation (as measured by the HICP or the CPI) and core inflation to about 4%. Inflation projections are also subject to considerable uncertainties, mainly related to the dollar price of crude oil, the exchange rate of the US dollar versus the euro, developments in productivity (and consequently in unit labour costs) and, of course, the final impact from the increase in indirect taxation.

More specifically, there are four factors that can be expected to have an *upward* impact on inflation: (i) the significant rise in oil prices, which will have a much greater effect on inflation than in 2004, (ii) the increase in indirect taxation, which is expected to weigh perceptibly on year-on-year inflation (once the measures are fully implemented and if the entire increase is passed on to consumer prices), bringing average annual inflation up to 4% in 2005 according to some estimates,² (iii) the build-up, from 2004 onwards, of

1 The European Commission and the International Monetary Fund (April 2005) projected a GDP increase of 2.9% and 3.0% respectively, whereas an earlier forecast of the OECD (December 2004) had placed Greece's growth rate at 3.2%.

2 These estimates are only tentative, since the full inflationary impact of the measures will depend on the pricing policies of businesses (in terms of absorption of VAT increases and the extent and direction of price rounding, etc.), as well as on demand developments.

inflationary pressures at the wholesale price level, and (iv) the fact that the rates for public utility services provided by both public and private enterprises¹ are projected to increase more this year than in 2004.

These upward effects on inflation are expected to be *partly offset* by (i) the average annual appreciation of the euro, which will continue to contain import prices, and (ii) the slackening of domestic demand growth, which will ease inflationary pressures.

9. ECONOMIC POLICIES AIMED AT SUSTAINING STRONG GROWTH

9.1 *Medium-term growth prospects*

The rapid growth of the Greek economy over the last ten years stemmed mainly from increased domestic demand, which was attributable to a combination of favourable factors, but also from an enhanced productive capacity, which was achieved through investment and structural changes. The improved macroeconomic environment, the reduced cost of borrowing and the deregulation of the credit system boosted private consumption and investment. Sizeable inflows of resources from the EU Structural Funds supported public investment and contributed to the improvement of economic infrastructures. Increased public expenditure connected with the 2004 Olympics also contributed to a rise in domestic demand in 2003-2004. At the same time, the structural measures that were implemented, albeit only partially helpful in addressing the economy's structural weaknesses, nevertheless helped increase the efficiency of the product and labour markets and raise the growth rate of "total factor productivity". These favourable developments resulted in a cumulative increase in Greece's real GDP *per capita* by about 37% over the last ten years. Furthermore, according to Bank of Greece estimates, the *real* average gross earnings of employees followed a steadily upward path, growing by 32% between 1994 and 2004.²

Notwithstanding a robust economic performance, a number of long-standing structural weaknesses have not been adequately addressed. Hence the Greek economy still lags significantly behind the more advanced economies of the EU. Inflation and the growth rate of unit labour costs have persistently remained above the respective euro area averages, eroding Greece's international competitiveness. Fiscal imbalances have widened significantly, with the public deficit and debt standing at very high levels. The structural problems in the product and labour markets have been only partially addressed, thus keeping

¹ Apart from telecommunications rates, which continue their downward trend.

² This figure is consistent with NSSG and Eurostat estimates, according to which real compensation per employee (including employers' social security contributions) rose by a cumulative 32.7% in the same period. In the euro area, on the basis of the latest available data, real compensation per employee rose by only 3.1% in the last eleven-year period (1994-2004). See European Commission, *Spring 2005 Economic Forecasts*, April 2005, Statistical Annex (Section 31).

productivity and the rate of employment at relatively low levels. The end result is that, despite the progress achieved as regards real convergence –with the country’s GDP *per capita measured in purchasing power parities* (PPPs) rising from 65.1% of the EU-15 average in 1995 to 75.8% in 2004¹– Greece still lags significantly behind the more advanced economies of the EU in terms of living standards and quality of life.² According to the

TABLE III
AT-RISK-OF-POVERTY RATES IN EU COUNTRIES

	1995	1996	1997	1998	1999	2000	2001	2002	2003
Austria	13	14	13	13	12	12	12	:	13 ²
Belgium	16	15	14	14	13	13	13	:	:
France	15	15	15	15	15	16	13 ¹	12	:
Germany	15	14	12	11	11	10	13 ¹	15	15
Denmark	10	:	10	:	10	:	10	:	:
Greece	22	21	21	21	21	20	20	:	:
United Kingdom	20	18	18	19	19	19	19 ¹	18	18
Ireland	19	19	19	19	19	20	21	:	:
Spain	19	18	20	18	19	18	19	19 ¹	19
Italy	20	20	19	18	18	18	19	:	:
Luxembourg	12	11	11	12	13	12	12	:	10 ²
Netherlands	11	12	10	10	11	11 ¹	12	12	:
Portugal	23	21	22	21	21	21	20	20 ²	19 ²
Sweden	:	:	8		8		9	11 ¹	:
Finland	:	8	8	9	11	11	11 ¹	11	11
EU-15	17	16	16	15	15	15	16³	:	:

1 Break in the statistical series.

2 Provisional data.

3 Eurostat estimates.

:

: data not available.

Note: The year indicated is the survey year; the income data used refer to the year before. For the definitions of the “at-risk-of-poverty-rate” and “the risk-of-poverty threshold” see the main text.

Source: Eurostat (calculations based on European Community Household Panel survey data).

aforementioned calculations, GDP *per capita* (in PPPs) in 2004 was 24% lower than the EU-15 average. Moreover, the income distribution in Greece was more uneven than in the EU-15, as both its unemployment rate and its key poverty and other inequality indicators exceeded the respective EU-15 averages.

1 According to Eurostat and NSSG data. In addition, GDP *per capita* (in PPPs) rose from 65.4% of the euro area average in 1995 to 77.6% in 2004. However, as noted by Eurostat, comparisons over time of GDP in PPPs should be treated with caution.

2 See also some of the structural indicators in Table 27 of Appendix II.

The average *unemployment rate* in 2004 was 10.5% in Greece (according to the NSSG labour force survey), compared with 8% in the EU-15 (based on Eurostat data). In addition, the “*at-risk-of-poverty rate*” – i.e. the share of persons with a *monetary* income (after social transfers) below the “*risk-of-poverty threshold*”¹ – in 2000 was 20% in Greece, as opposed to 16% in the EU-15, notwithstanding some comparability problems (see Table III). Specifically, it is estimated that the at-risk-of-poverty rate is approximately 3 percentage points lower when certain (imputed) non-cash incomes of special importance in our country² are also taken into consideration. Disproportionately high contributions to the country’s at-risk-of-poverty rate come from the elderly, the persons living in rural areas, the members of households headed by a primary sector employee, a pensioner or an unemployed person, and the members of households headed by a person of a low education level. In particular, the elderly (those aged 65 or over) remain the population group facing the highest at-risk-of-poverty rate (33% in 2000 for Greece compared to 19% for the EU-15). This high indicator explains the larger part of the differential between Greece and the EU, since for the non-elderly (those aged less than 65) the at-risk-of-poverty rate in Greece is similar to that in the other EU-15 countries (17% and 16% respectively). Likewise, the at-risk-of-poverty rate in rural areas is more than double that in urban areas, reflecting mainly the relatively low level of farmers’ pensions.

Finally, the *inequality* observed in the distribution of the *monetary* disposable income of households declined in Greece – as well as in most EU countries – in the 1994-2000 period, but remained greater than in the EU-15. Specifically, in our country the “S80/S20” ratio (i.e. the income share held by the richer 20% of the population to the corresponding share held by the poorer 20%) decreased from 6.5 in 1994 to 5.7 in 2000, compared with a corresponding decrease from 5.1 to 4.6 in the EU-15. Over the same period, a similar decline from 35 to 33 in Greece and from 31 to 30 in the EU-15³ was seen in the Gini coefficient, which measures the inequality of income distribution.⁴

Given the considerable shortfall of Greece’s GDP *per capita* vis-à-vis the EU-15 average, it is obvious that the achievement of real convergence will require steadily *higher* rates of growth for a number of years. However, as already mentioned, real GDP growth

1 The “risk-of-poverty threshold” is defined by Eurostat and the OECD as the income that is equal to 60% of the median of the income distribution of the total population.

2 See NSSG, “2002 Survey of household income and living conditions” (press release of 16 July 2003); Eurostat, *Structural Indicators* (data from the European Community Household Panel survey and the EU Survey of Income and Living Conditions) – 2001 survey (on 2000 income data). The percentage for Greece remained at 20% according to the 2002 survey and rose to 21% according to the 2003 one. These surveys refer to the monetary income of households, overlooking some imputed income items particularly important for our country, such as imputed rents implied from the very high percentage of owner-occupied houses, the “own consumption” observed in –mainly– agricultural households, benefits in kind (e.g. childcare facilities, social tourism, in-house care) etc. Indeed, on the basis of the latest available Family Budgets Survey (on 1999 data), which records total imputed income, the at-risk-of-poverty rate comes to 17.3%, i.e. almost 3 percentage points lower than when imputed income is not taken into account.

3 Data from the 1995 and 2001 surveys. In the case of inequality indicators as well, taking into account imputed income data leads to significantly lower inequality.

4 The Gini coefficient indicates the share of total income that should be redistributed so as to achieve an absolutely equal income distribution. Therefore, the closer it is to 100, the more unequal is the income distribution.

is expected to slow down appreciably in 2005. Furthermore, there are considerable uncertainties surrounding economic prospects for 2006 and the following years. At least for the next two years it is likely that fiscal consolidation will limit the rate of growth in demand (including investment), while further erosion of competitiveness – as long as the inflation differential between Greece and its trading partners persists – may reduce gains from the continuing global activity growth. In addition, the sustained high oil prices will also undercut growth. Overall, the aforementioned macroeconomic imbalances and structural weaknesses hinder the attainment of sustainable fast rates of growth.

Against the background of globalisation and the ongoing enlargement of the EU, the international environment will continue to present the Greek economy with considerable opportunities – which are also serious challenges that can only be met if the country's international competitiveness is improved on an early basis. The economies of the new and the candidate Member States of the EU, as well as the emerging economies of Southeastern Asia – typically characterised by low labour costs, low tax rates on businesses and labour income, and, more generally, a business-friendly environment – are highly competitive in international product markets, but also in terms of attracting foreign direct investment. At the same time, these rapidly growing markets offer export and investment opportunities for Greece as well as other countries. With the projected slowdown in global activity in the next years after a series of high rates of growth in recent years, competition in both the domestic and foreign markets is expected to intensify, as is often the case when demand weakens. The consequences will be unfavourable for the Greek economy if it fails to improve its productivity and international competitiveness considerably. In this regard, it should be noted that, owing to the cumulative erosion of price competitiveness in the last several years, the recent increase in Greek exports (mainly services) is almost entirely attributable to the rise in global economic activity.

9.2 Challenges to economic policy

Achieving rapid economic growth presupposes macroeconomic stability, notably correction of the fiscal imbalance and securing a low rate of inflation. At the same time, it requires a considerable increase in Greece's productive capacity through investment and a more effective input utilisation.

At this juncture, a matter of top priority for ensuring macroeconomic stability is the effective implementation of the policy measures for achieving fiscal consolidation that are envisaged in the revised Updated Stability and Growth Programme. Fiscal consolidation can support sustainable growth by contributing to the attainment of low inflation, reducing public debt and strengthening household and business confidence. Price stability is also crucially important for improving price competitiveness and thus growth prospects. In a monetary union, countries that systematically record higher than average increases in prices and unit labour costs tend to face chronic problems of low employment and growth.

Today, with an independent monetary policy no longer being an option, alternative adjustment policies have to be relied upon. This is yet another reason why developments in public finances must come under control.

Along with policies that directly aim at ensuring macroeconomic stability, there is also a need for policies that seek to improve supply conditions. The Greek economy's productive capacity has not managed to cope with increasing aggregate demand in the last few years, and this was one of the factors behind the widening – up to 2004 – positive output gap, the relatively high inflation and the large current account deficit. The productive capacity can be raised through structural reforms in the labour market, as well as in public administration, health and education. Such reforms can simultaneously contribute to a substantially less economic inequality and much improved living standards. Especially as regards poverty, to the extent that it is related to unemployment, this problem can be dealt with through structural changes that contribute to the creation of new jobs and a higher GDP *per capita*. However, to the extent that poverty relates to socially weak citizens, there should be support from the state on the basis of a well thought-out long-term plan.

9.3 Policies for macroeconomic growth

9.3.1 Policies for achieving price stability

Following a sharp reduction in the run-up to Stage III of EMU, inflation in Greece picked up again in the course of 2000, just before the adoption of the euro in January 2001, and has persistently remained above the euro area average since then. The inflation differential between Greece and the euro area remained broadly unchanged at 1.4 percentage points in the 2001-2003 period, then fell slightly to 0.9 percentage point in 2004¹ and is expected to rise again in 2005, when inflation is expected to pick up once more and stand at around 4% following the increases in indirect taxes. Such relatively large and persistent positive inflation differentials vis-à-vis the euro area are a cause of concern since, if not addressed by domestic economic policies, they will lead to a sustained erosion of competitiveness, and will affect adversely output growth and employment in Greece.

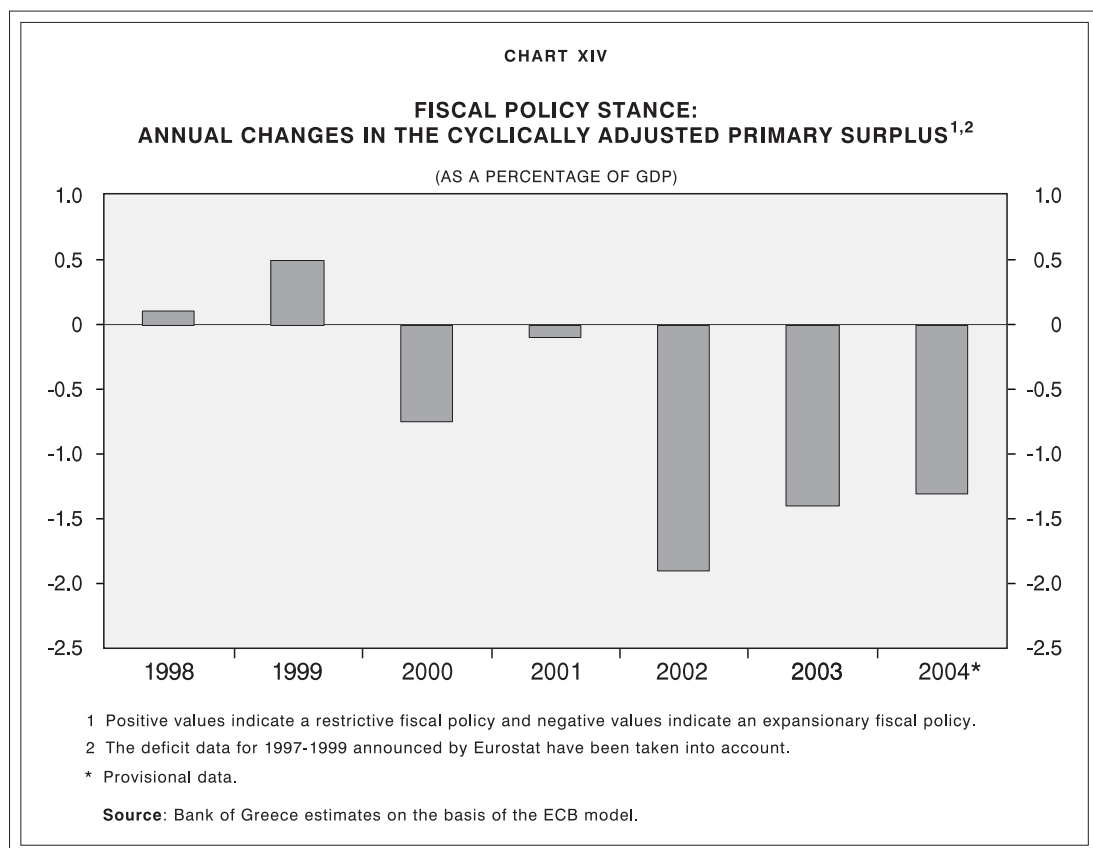
As discussed in previous reports of the Bank of Greece, the inflation differential observed between Greece and the euro area is much wider than what the so-called “Balassa-Samuelson effect”² would imply. Rather, an examination of the factors lying behind inflation suggests that the positive deviation of Greek inflation from the euro area

1 Mainly because the decline in fresh fruit and vegetable prices more than offset a rise in core inflation (relative to 2003), the differential of which vis-à-vis the euro area average widened.

2 Specifically, in countries that are in a process of real convergence, higher productivity growth in the (exposed) sectors of tradable goods leads to high wage increases, which tend to spill over into the (sheltered) sectors of non-tradable goods, where productivity growth is typically lower. Thus, average inflation rises above that of more mature economies, whose productivity growth in exposed sectors is slower than in less mature economies.

average recorded since 2001 is linked to significant differences in the rate of increase in unit labour costs, which reflect the fact that wage increases in Greece outpace the rise in productivity. Differences in profit margins are another important factor explaining the inflation differential. At the same time, high inflation is also partly attributable to the fast growth of domestic demand, the expansionary fiscal policies pursued in the last several years (see Chart XIV) and the emergence of a relatively large positive output gap.

As already mentioned, the primary objective of the ECB's single monetary policy is price stability in the euro area as a whole. This implies that it is up to Greece's national



economic policies (i.e. fiscal and structural policies) and the social partners' contribution during the wage bargaining process to eliminate the persistent inflation differential, so as to prevent further losses in competitiveness. It is therefore self-evident that fiscal policy has to be firmly committed to the objective of a budgetary position close to balance or in surplus on a medium-term basis, as required by the Stability and Growth Pact.

Fiscal policy, while being a necessary means of adjustment, is surely not sufficient to contain inflation effectively. This is partly due to the fact that, although fiscal policy can affect prices by reducing excess demand, it does so with considerable time lags and thus may have an unfavourable short-term impact on economic activity. To limit the potential

unfavourable effects of a tight fiscal policy on activity and employment, efforts geared to reducing inflation should be accompanied by wage increases consistent with price stability. In other words, as already proposed in previous Reports, the rate of increase in nominal wages should gradually converge towards the sum of the Greek productivity growth rate and the average inflation rate of the euro area (rather than that of Greece), until the inflation differential between Greece and the euro area is effectively eliminated and price stability is achieved. At the same time, it is necessary to strengthen competition, so as to contain the rise in profits within normal levels. Until the inflation differential is eliminated, this policy will prevent further erosion of the country's international competitiveness vis-à-vis its euro area trading partners. Of course, as already noted, at the current juncture increased indirect taxes are expected to lead to higher inflation this year in Greece. However, the annual rate of inflation is expected to subside again when the negative impact of the increase in indirect taxation has run its course by April 2006, provided that there are no second-round effects on prices through higher wages. *Consequently, in order to ensure that the pickup in inflation is only temporary*, it is important that the social partners react responsibly and sensibly to developments. In effect, this means that the temporarily higher inflation must not be "incorporated" in wage increases or in firms' pricing policies across the economy. Finally, well-designed structural reforms – particularly measures aimed at removing nominal wage and price rigidities – can also speed up the wage and price adjustments needed to cope with the loss in competitiveness, as such reforms will prevent the re-emergence of lasting inflation differentials in the future.

9.3.2 Fiscal policy

Fiscal consolidation, in the context of the revised Updated Stability and Growth Programme 2004-2007, as well as in the longer run, is a top priority for the years ahead. The magnitude of fiscal imbalances is indicated by the very high levels of the general government deficit and debt, which are the highest in the euro area. Furthermore, the impact of population ageing on pension and health expenditures is expected to be quite large and growing after 2015 and to be the largest (as a percentage of GDP) in the euro area. If fiscal imbalances are not addressed effectively on time, the public sector's creditworthiness and macroeconomic stability will be jeopardised. There will also be unfavourable implications for the viability of the social security and health systems, specifically as regards their ability to cover pension and health expenditures, as well as for the quality of services the public sector provides. Instead, early progress with the correction of fiscal imbalances will help safeguard such social and public benefits, in an environment of economic stability and growth.

The revised Updated Stability and Growth Programme 2004-2007, which was discussed in Section 4, is a positive first step in a long and difficult process of fiscal consolidation. Programme implementation will require a substantial and resolute effort in order to attain the targeted deficit reduction and to fulfil the government's commitment to cor-

rect the excessive deficit situation by 2006, in accordance with the decision issued on 17 February 2005 by the Council of Ministers of Economy and Finance (ECOFIN).

Over the longer term, fiscal policy should be geared towards attaining a budgetary position of close to balance or in surplus, so as to facilitate debt reduction to sustainable levels, i.e. not exceeding the reference value of 60% of GDP provided for by the Treaty on European Union. Besides the envisaged sharp reduction of the deficit in 2005 and 2006, there will be a need for a durable further improvement in the fiscal position through structural changes in public expenditure and revenue collection. Purely indicatively, a debt reduction to, say, 60% of GDP by 2015 would require – on the basis of certain assumptions regarding mainly nominal GDP growth and interest rates – primary surpluses of more than 4% of GDP annually,¹ compared with a primary deficit of 0.4% of GDP in 2004. The gradual decline in government debt will imply lower interest payments, thus releasing considerable resources for other uses. There will also be a need for strict control and review of current expenditures, broadening the tax base and curbing tax evasion. This will ensure that the deficit reduction will be consistent with undertaking adequate public investment in infrastructures and human capital, as well as with implementing further cuts of direct tax rates, which are desirable both because high tax rates act as economic disincentives and because there is intense “tax competition” among the EU countries.

As regards expenditure control in particular, last year’s Annual Report² briefly discussed international experience with the implementation of “rules” for public expenditure control³ and suggested major areas of priority in this respect – viz., personnel outlays (38.8% of the overall 2004 ordinary budget expenditure), restitution of revenue collected on behalf of third parties (mainly payments to local authorities, 7.8% of the overall ordinary budget expenditure), and subsidies (18.6% of the overall ordinary budget expendi-

1 This purely indicative calculation of the required level of primary surplus assumes, until 2015, a nominal annual GDP growth of 6% and an average nominal interest rate on government borrowing of 5.5% (unchanged from 2004). On the basis of these assumptions, a decrease in general government debt from 110.5% of GDP in 2004 to 60% of GDP in 2015 would require primary surpluses of 4.2% of GDP per year. With particular regard to pension expenditures, this assumption is in line with the available projections (see footnote 4 on page 51). However, pension expenditures will be increasing between 2015 and 2050, implying the need for even higher annual primary surpluses if the decrease in public debt to 60% of GDP is to be sustained after 2015. Moreover, if the primary surplus is achieved gradually (i.e. according to the consolidation path outlined by the updated Stability and Growth Programme and then through an annual increase in the primary surplus of 0.5% of GDP), the public debt target of 60% would be achieved in 2017.

2 Bank of Greece, *Annual Report 2003*, April 2004, pp. 69-70.

3 These rules usually include ceilings on the annual rate of growth and the size of public expenditure, and, in order to be effective, should fulfil certain requirements – notably transparency. The targeted fiscal variables should be clearly defined, their evolution should be monitored systematically and the outcome should be measurable. The rules should be permanent and cover not only central government, but also all other components of general government (e.g. public hospitals, local authorities, universities, etc.), while annual targets should be consistent with medium-term targets. Moreover, it should be clear which agency or person is responsible for the achievement of each target and the final outcome should be evaluated by independent auditors. Finally, there is a need for an appropriate institutional framework, which could include preparing multi-annual budgets; establishing a system to evaluate public expenditures during the drafting of the budget (e.g. zero-basis budget); a more timely preparation and submission of the budget and the accompanying information to Parliament; and restructuring the budget, e.g. by introducing individual budgets for each and every component of general government.

ture), all of which rose strongly in the 2000-2004 five-year period (at average rates of 9.2%, 9.9% and 13.9% respectively). Also, particular attention should be paid to called guarantees, through which central government assumes additional liabilities. As a percentage of GDP, the outstanding balance of government-guaranteed loans followed a downward path between 1990 and 1999, when it amounted to 6.3% of GDP. However, since 2000 it has started to rise again, reaching 8.7% in 2004.¹ Government guarantees called raise not only the general government's expenditure and deficit on a national accounts basis, but also public debt.²

Implicit pension liabilities³ associated with increasing expenditure due to population ageing have to be taken into consideration in setting the medium-term budgetary objective. Indicatively, according to projections made on the basis of certain assumptions both in the Stability Programme and by the European Commission,⁴ total old-age pension expenditures will increase appreciably after 2015. Specifically – compared to 2005 – they will rise by 4.9 percentage points of GDP by 2030 and by 10.2 percentage points by 2050.⁵ It is obvious that the budgetary implications of population ageing cannot be dealt with through fiscal policy measures alone, i.e. through higher taxation and a cut in other outlays, as this would jeopardise economic growth and undermine the capacity to provide basic public services. In addition to the measures that must be taken immediately to counteract population ageing, a comprehensive approach is needed,

1 The outstanding balance of guaranteed loans increased twofold, from €7,131.3 million in 1999 to €14,344.3 million at the end of 2004.

2 To the extent that the called guarantees relate to debt of borrowers outside general government.

3 “Implicit liabilities” stand for the present value of future pension liabilities (net of contributions). Purely indicatively, according to OECD projections made in 1996 on 1994-1995 data, if government contributions are included in the revenue of social security funds the present value of net pension outlays amounted to 110% of 1994 GDP. Excluding government contributions, this percentage comes to 196% of GDP (see OECD, *OECD Economic Surveys: Greece 1996-1997*, 1997, p. 91), or – according to slightly later projections – to 193% of GDP (see Paul Mylonas and Christine de la Maisonneuve, “The problems and prospects faced by pay-as-you-go pension systems: a case study of Greece”, OECD Economics Department Working Paper No. 215, May 1999). Of course, these estimates, made in 1997-1999, could not possibly have taken into account the more recent demographic data from the 2001 Census or the upshot of Law 3029/2002 on social security.

4 See European Commission, D.G. Economic and Financial Affairs, *March 2005 Revised Update of the Stability Programme of Greece (2004-2007) – An Assessment*, 22 April 2005, pp. 19-22 and 30-32, for comments on the projections included in the March 2005 Stability Programme and the EU Economic Policy Committee (EPC) Report *The impact of ageing populations on public finances – overview of analysis carried out at EU level and proposals for a future work programme*, 22 October 2003. In these projections, future pension expenditure developments take into account the demographic projections that were revised on the basis of the 2001 Census, publicised by the National Actuarial Authority and included in the September 2002 *Greek Report on Pension Strategy* submitted to the European Commission (available at http://europa.eu.int/comm/employment_social/social_protection/docs/el_pensionreport_el.pdf). In this respect, see also Bank of Greece, *Monetary Policy, Interim Report 2002*, November 2002, Box 2, pp. 103-07. As mentioned in the Stability and Growth Programme, the National Actuarial Authority is currently preparing projections that will include the latest demographic data and the effects of the legislation adopted in 2002.

5 The same projections imply increases of 5.4 percentage points of GDP by 2030 and 11.5 percentage points of GDP by 2050 in total age-related expenditure. The latter includes (in addition to old-age pensions) healthcare expenditures, which will increase (by 0.9% of GDP by 2030 and by 1.6% of GDP by 2050) and expenditures for education and social benefits, which will slightly decrease (by 0.4% of GDP by 2030 or by 0.3% of GDP by 2050). No projections are available for Greece regarding care for the elderly expenditures (*other* than healthcare).

including (i) fiscal consolidation to increase primary surpluses and reduce public debt, (ii) policy measures to increase the employment rate, and (iii) early reform of the social security system. It is therefore of vital importance to commence the public dialogue on this reform as soon as possible.

9.3.3 Pension and healthcare reforms

As already mentioned, in the next decades Greece – as well as most other developed countries – is expected to face unprecedented demographic changes that will considerably affect its economy and society as a whole. Current demographic projections show that the Greek population of working age (15-64 years old) will start to diminish after 2010.¹ Average lifetime has increased, reflecting the improved living conditions and health level. At the same time, the fertility rate (number of children per woman) is slightly below 1.3, less than the 2.1 threshold needed to renew the population. From 2005 to 2030, the population aged 65 or over will rise by 38%, and from 2005 to 2050 by 86%. On the contrary, the population aged 15-64 will *decrease* by 4.5% and by 18% in the same periods respectively. As a result, the elderly dependency ratio (i.e. the number of persons aged 65 or over as a percentage of the number of those aged 15-64) will rise from 26% in 2005 to 37% in 2030 and to 58% in 2050.²

These demographic changes will have major implications not only for the pension system but more generally for prosperity and living standards. First of all, as already mentioned, pension expenditures are projected to rise from 12.4% of GDP in 2005 to 22.6% of GDP in 2050. The total of outlays *affected* by population ageing should increase from 21.1% of GDP in 2005 to 32.6% in 2050, given that healthcare expenditures would rise from 5.0% to 6.6% of GDP,³ while expenditure for education and unemployment benefits would decrease (due to a change in the population's age composition) from 3.7% to 3.4% of GDP. At the same time, although the increase of the workforce's average age (due to ageing) should normally entail more experience and thus higher productivity, it also

1 According to the projections of both Eurostat (see "Eurostat 2004 Demographic Projection (Baseline scenario)" in the European Commission Green Paper entitled *Confronting demographic change: a new solidarity between the generations*, COM (2005) 94 final, 16 March 2005, and also "Population projections 2004-2050: EU25 population rises until 2025, then falls", press release 48/8 April 2005) and the *Greek Report on Pension Strategy*, September 2002 (see footnote 4 on page 51). However, according to the latter, total population will start to decrease after 2035 (having reached 11,674,000 people), while for the former it will start falling after 2020 (having reached 11,427,000 people).

2 *Greek Report on Pension Strategy* (2002). The inverse of this ratio, expressing the proportion of contributors to pensioners and currently standing at 3.5, is projected to fall to 2.7 by 2030 and to 1.7 by 2050. Moreover, the latest Eurostat projections (8 April 2005) indicate that the elderly dependency ratio in Greece should increase from 26.4% in 2004 to 35.5% in 2025 and to 58.8% in 2050.

3 The rise in health expenditures is rather limited because employees still pay social security contributions for healthcare after retirement. In addition, as suggested by relevant research, the stronger impact on healthcare expenditures occurs during the last six months of a person's life, regardless of his/her age (see D. Wise, "Program Report on Economics of Aging", *NBER Reporter*, 22 June 2003). Thus, increasing life expectancy has a lesser upward effect on health expenditures than on pension expenditures.

implies lower adaptability to new technologies, which ultimately lessens productivity growth.¹ In turn, these developments are additional factors weighing on the social security system's viability and the fiscal position.

In order to address the population ageing challenge, in particular to help counterbalance the expected decrease in the working-age population, the employment rate has to be raised, including by increasing the average effective age of retirement. As already noted,² an increase of the employment rate requires the mobilisation of the "unexploited employment reserves", by encouraging legal immigrant work, combatting unemployment (which mainly affects women and the young), offering incentives (and removing disincentives) for the participation of women and, finally, encouraging the participation of older persons.

The number of economic immigrants has grown significantly in the last fifteen years. *Foreigners* represent a share of 7.3% in the population of Greece (2001),³ at least 6.4% in employment (second quarter of 2004),⁴ at least 12.6% in the directly insured by the Social Insurance Institute (IKA) (April 2004)⁵ and 11.0% in the IKA's revenue from social security contributions (2003).⁶ Moreover, according to a recent UN report,⁷ sustained migration flows such as the ones observed in recent years can play a role in preventing reductions of the working-age population in developed countries⁸ and in limiting the increase in the total dependency ratio (the ratio of the population aged 0-14 and 65 or over to the working-age

1 A recent study focusing on the *European* economy estimated – based on certain assumptions – that the net effect of population ageing could be a deceleration of the annual labour productivity growth rate in the EU, by 0.25 to 0.5 percentage point, while – also on account of demographic trends – between 2005 and 2050 the EU's annual potential growth rate is expected to fall by 0.8 percentage point compared with average growth rates achieved in the 1990s. See European Commission, *Effects of ageing on long run labour productivity growth: a theoretical and empirical assessment*, 2004.

2 *Greek Report on Pension Strategy*, pp. 22-23.

3 Based on the 2001 Census data (796,700 people in a total of 10,964,000), which are considered to be the most precise. For a detailed discussion (in Greek) see the extensive report of the Labour Institute (INE) of the Greek General Confederation of Labour (GSEE) and the Confederation of Civil Servants (ADEDY) *2003-2004 Survey on the forms of social inclusion of economic immigrants in the Region of Attica*, 2004.

4 According to the sample Labour Force Survey of the NSSG, which still underestimates the number of foreign workers, but less than it did in the past.

5 Press release (15 March 2005) by the Social Insurance Institute (IKA): the number of foreigners insured was 222,569 in a total of 1,762,829 IKA members in April 2004. However, according to data published by the Immigration Policy Institute (IMEPO) on 15 February 2005, a survey conducted by the National Centre for Social Research (EKKE) on behalf of the IMEPO reports that the immigrants insured by the IKA were 346,000 people in 2003, while there were also 45,000 foreigners insured by the Farmers' Pension Fund (OGA) in 2004 and approximately 10,000 by the Fund for Craftsmen and Small Traders (TEBE) in 2002.

6 Based on 2003 data published by the IMEPO on 15 February 2005 (contributions to the IKA by foreigners: €0.9 billion, total revenue from contributions: €8.1 billion).

7 United Nations, Department of Economic and Social Affairs, *World Economic and Social Survey 2004-International Migration*, November 2004.

8 With respect to the effect of migration flows on population the report suggests that without immigrant inflows Europe would have experienced a population decline of 4.4 million between 1995 and 2000 (since even with about 5 million immigrants in this period its population increased by only 600,000). In addition, it estimates that without net migration the population of the more developed regions of the world would decline by 200 million between 2000 and 2050.

population, i.e. those aged 15-64).¹ The UN report concludes that the entry of temporary or permanent immigrants may *partially offset* the consequences of population ageing for social security systems, but it *cannot ensure* the financial sustainability of these systems. Thus, as stated in the report, meeting the challenge of ageing population “will require a comprehensive strategy that should also include reassessing the retirement age and benefits and increasing the labour-force participation of the working-age population”.

Issues related to dealing with unemployment and encouraging the participation of women and the young in the labour market are discussed further below.² Encouraging the participation of older people entails increasing the *effective average* age of retirement. In 2002, the Barcelona European Council³ called on all EU countries to seek “a progressive increase of about 5 years in the *effective average* retirement age by 2010”, while the recent Brussels European Council confirmed that raising employment rates and extending working life, coupled with reform of social protection systems, are the best means of safeguarding the present level of social protection in the EU.⁴ The *average* age of retirement – which is lowest in Greece among the EU-15 countries⁵ – is a crucial parameter of the pension system because it affects both the outlays and the revenue of social security funds.⁶ Therefore, its increase would be a far more effective measure than a change in any other parameter of the social security system. It should be stressed that increasing the effective average age of retirement does not necessarily involve raising the statutory age of entitlement to pension. Efforts could initially focus on limiting the phenomenon of early retirement, by providing strong financial incentives for staying active up to the statutory age of retirement⁷ (and even beyond that on a *voluntary* basis – i.e. if both employer and employee so desire), as well as disincentives to retiring early.

The efforts made during the last fifteen years to reform the pension system⁸ have been only partly successful. They have helped gain considerable time and improved the

1 According to the latest (8 April 2005) demographic projections by Eurostat (i.e. the “baseline scenario”, which is based on the assumption that the annual net migration to Greece in the 2005-2050 period will be around 35,000 to 42,000 people), this ratio will increase in Greece from 47.8% in 2004 to 56.4% in 2025 and to 81.1% in 2050.

2 See Section 9.4.2.

3 See “Presidency Conclusions”, 15-16 March 2002.

4 See “Presidency Conclusions”, 22-23 March 2005.

5 Comparative 1998 data published in the report: European Commission, Economic Policy Committee, *Progress Report to the ECOFIN Council on the Impact of Ageing Populations on Public Pension Systems*, Brussels, November 2000 (EPC.ECFIN/581/00-Rev.1), p. 25.

6 When insured persons retire, their fund not only starts paying them their pension but also stops receiving social security contributions from them and their employer. Thus, the cost for the fund is many times higher than the pension paid.

7 In Finland, pensions increase by up to 33% if the employee retires at the age of 68. In Canada, employees after the age of 60 cease to pay pension contributions. In Italy, when the statutory retirement age was changed from 60 to 65 years, very strong financial incentives were offered for the employees to continue working until that age.

8 These included: Law 1902/1990 and Law 2084/1992, which appreciably strengthened the system’s sustainability; the introduction of the Pensioners’ Social Solidarity Benefit (EKAS) in 1996; the thorough reformation of the operational framework of OGA launched in 1998; the merge of all the funds for the self-employed in 1999; the administrative modernisation of IKA launched in 2001; and Law 3029/2002, which contained provisions for the system’s permanent funding through the state budget, some parametric changes (in terms of replacement rate, the pension calculation base and the minimum retirement age), as well as an envisaged gradual integration of most main pension funds of wage-earners into the Social Insurance Institute – National Salaried Employees Ancillary Social Security Fund (IKA-ETEAM) by 2008 and convergence of social security legislation by 2017.

organisational structure of the system, but have not addressed the underlying expenditure pressures. A number of analysts¹ have made alternative suggestions, including – besides the self-evident need to prevent contribution evasion² – parametric reforms of the existing pay-as-you-go pension system (e.g. increasing the retirement age, cutting benefits) and the introduction of a mixed, partially funded system. However, reform efforts have not progressed, due to the lack of a consensus among social partners and of willingness on the part of the responsible parties, even though it is widely known and tends to be commonly accepted that population ageing will accelerate after the first 21st-century decade and that it will certainly threaten the viability of the current pension system and, more generally, the long-term sustainability of public finances. As regards the introduction of funded schemes, Law 3029/2002 (Article 7) has set the legal framework for a second “pillar” in the pension system, allowing for the creation, at the industry or enterprise level, of fully funded “occupational funds” operating as private entities. Efforts to exploit this possibility have started slowly, with only three such funds established thus far. The dialogue on the “social insurance issue” of bank employees provides an opportunity for the necessary measures to be taken so as to promote and fully develop the pension system’s second pillar.

Given the system’s serious actuarial imbalance – which will be exacerbated by the pressures of population ageing on healthcare costs – Greece cannot afford the luxury of delaying any further its pension system reform. There is a pressing need to limit incentives for early retirement, especially in the public sector. Without early structural reforms, onerous increases of taxation or of social security contributions to cover future pension expenditures will become inevitable over the long run, with additional adverse consequences for international competitiveness and growth.

The reforms of the health system implemented so far have not been sufficient. As already mentioned, Greece’s health expenditure-to-GDP ratio, one of the highest among OECD countries,³ is projected to further increase appreciably on account of population ageing. Hence, the need to reform this sector is urgent. In this regard, it is encouraging that the government – as noted also in the Updated Stability and Growth Programme – is preparing a healthcare system reform plan in order to ensure the system’s economic viability (by containing expenditure) and to address some of its specific weaknesses, while also ensuring a satisfactory level of services.⁴ In addition, the restructuring and settlement of debt incurred by hospitals to their suppliers is currently in progress,⁵ while measures are

1 See A. Börsch-Supan and P. Tinios, “The Greek pension system: strategic framework for reform” in *Greece’s Economic Performance and Prospects*, Bank of Greece and the Brookings Institution, 2002. See also IMF, *Greece: Selected Issue – An overview of pension reform*, March 2002, as well as F. Zervou, *The financing of the Greek pension system 1981-2000*, Centre of Planning and Economic Research (KEPE) 2004.

2 The importance of contribution evasion is highlighted – along with other problems of the pension system – in the recent *Actuarial study for the IKA-ETEAM: basic conclusions and proposals* carried out by the GSEE/ADEDY Labour Institute (April 2005).

3 OECD, *Towards High-performing Health Systems: Policy Studies*, 2004.

4 This reform includes Law 3329/2005 (“National Health and Social Security System”) that was passed last March.

5 Law 3301 that was passed in late 2004 pertains to this.

being prepared (e.g. implementation of “business resource planning” throughout the National Health System (ESY), reliance on public-private partnerships to provide hospitalisation services as well as to construct public hospitals) in order to prevent the re-emergence of this problem.

9.4 Economic reforms to enhance Greece’s growth potential

In order to converge with the average living standard of the 15 more advanced countries of the EU within a reasonable time period, Greece needs higher and sustained growth for a number of years. This requires urgently the development of a growth-oriented economic strategy aiming at raising both labour utilisation and labour productivity, always within a framework of sound, stability-oriented macroeconomic policies. It was already stressed that the policy priorities for improving macroeconomic conditions call for correction of the fiscal imbalance and securing low inflation. In addition, structural reforms are also needed to strengthen the Greek economy’s growth potential. The reforms discussed in this section focus, on the one hand, on improving the functioning of the labour market and the quality of human resources and, on the other hand, on accelerating productivity growth and increasing business dynamism. The reinvigoration of the Lisbon Strategy, with the re-prioritisation of its targets by the European Council last March, offers Greece a vital opportunity to address these challenges, so as to bring its economy back on the path to long-term prosperity through higher and sustainable rates of growth.

9.4.1 The convergence process so far

In 2004, economic expansion in Greece continued for the eleventh consecutive year. In the last five years (2000-2004) the average annual rate of growth was particularly high (4.3%), exceeding by 2.4 percentage points the EU-15 growth rate. Thus, as the average annual rates of population growth in Greece and the EU-15 were not much different (0.3% and 0.4% respectively), GDP *per capita* in Greece (in PPPs) grew faster than in the EU-15, although from a much lower base. Therefore, in 2004 Greece’s GDP *per capita* was still just under 76% of that of the EU-15 countries.

The reasons for which the Greek GDP *per capita* is 24% lower than the EU-15 average are well-known: Total employment rate (the employed as a percentage of total population) in Greece in 2004 was about 39% (compared with 44% in the EU-15) or 11%¹ lower than in the EU-15. In addition, labour productivity (GDP per employee)

¹ Refers to the percentage difference of the employment rates, not their difference in percentage points.

was 13% lower than in the EU-15.¹ However, it should be noted that, if employment is measured in total hours worked, there is no gap between Greece and the EU-15 average in total labour utilisation as the *average working time* is significantly higher in Greece than in the EU-15,² thus overcompensating for the lower *number of employees* as a percentage of the population. On this basis (hours worked), the gap between Greece and the EU-15 in GDP *per capita* is therefore totally attributable to differences in productivity (GDP per hour worked).

The average annual rate of increase in productivity per employee has picked up considerably,³ from 0.8% in 1980-1989 and 0.4% in 1990-1995, to 2.7% in the 1996-2004 period.⁴ Therefore, following a long period of weaker productivity growth in Greece than in the EU-15, the country's efforts to catch up have led to an improvement.⁵

As already mentioned, productivity improvement contributes decisively to long-term economic growth and to enhanced living standards. In this respect, a question arises as to which were the factors behind the acceleration of productivity growth in Greece in recent years. Although it should be noted that productivity growth in Greece has not yet been thoroughly studied, the available data allow a number of clear conclusions to be drawn.⁶ A decomposition of the sources of growth of labour productivity suggests that the stronger rates of productivity growth in Greece since the mid-1990s reflect, on the one hand, the higher rate of capital deepening over the 1996-2004 period and, on the other hand, the faster rates of growth in "total factor productivity". The first factor can be associated with the recovery of business investment, which rose at an average annual rate of 10.5% in that period, or, as a percentage of GDP,⁷ from 10.5% in 1995 to 14.7% in 2000 and 16.5% in 2004. Thus, total fixed capital formation reached 25.5% of GDP in 2004, from 18.6% in 1995 and 23.6% in 2000, a development also attributable to larger public investment, which led to improved infrastructures. The second factor can be attributed to the use of more efficient processes of production – e.g. Information and Communication Technologies (ICT) – in certain sectors, such as transport and communications, trade, as well as financial and other business services, all of which recorded substantial productivity gains in Greece in recent

1 Greek GDP and population data from the latest available national accounts, but employment data derived from the recently updated Labour Force Survey for the 1998-2004 period, not yet taken into consideration by the NSSG National Accounts Service. It should be noted that the employment ratio in 2004 according to the other commonly used definition (employed persons *aged 14-65* as a percentage of the population *of the same age*) was 59.4% in Greece, as opposed to roughly 65% in the EU-15 (see also Section 3.2).

2 The higher average working time in Greece reflects both the higher average real working hours of full-time employment and the lower share of part-time employment.

3 Not cyclically adjusted.

4 In the 1996-2004 period, the average annual rate of increase in GDP was 3.8%, which reflects an average annual growth rate of 2.7% in productivity per employee and of 1.1% in the number of employees.

5 The average annual growth rate in productivity per employee in the EU-15 was only 1.1% in the 1996-2004 period.

6 The overall assessment that there has been an increase in productivity growth is independent of whether labour productivity is measured per employee or per hour worked.

7 At current prices.

years.¹ The evidence presented in this section shows that special emphasis should be placed both on policies directly affecting the determinants of productivity and on measures to increase the employment and labour force participation rates.

9.4.2 Economic reforms to raise productivity growth

As mentioned in the previous section, the acceleration of labour productivity growth since the mid-1990s is mainly due to capital deepening and higher total factor productivity growth. This evidence – along with the fact that Greece still lags behind the more advanced EU economies as regards its *levels* of capital deepening and total productivity – illustrates the need for enterprises to exhibit even more dynamism and undertake more investment. This can be achieved through the implementation of a reform strategy aimed at improving the business climate by (i) promoting competition, simplifying the regulatory – particularly the tax – environment, providing incentives for and eliminating obstacles to entrepreneurship – particularly to the formation of new enterprises – and (ii) facilitating transition to a knowledge-based economy, encouraging the use of ICT and boosting investment in human capital and R&D.

Certain policy measures aimed towards these objectives were included in legislation regarding taxation (Law 3296/2004) and development (Law 3299/2004) passed at the end of the previous year. These two laws reduce significantly the tax burden on enterprises² and encourage private investment,³ job creation (in the private sector)⁴ and per-

1 The higher contributions to the average annual rate of GDP growth in the 1996-2004 period (3.8%) came from retail and wholesale trade/transport and communications/hotels and restaurants (1.7 percentage points), financial and other business services (0.6 percentage point) and education/health/public administration/other services (0.6 percentage point).

2 The tax rate on profits is gradually reduced from 35% in 2004 to 25% in 2007 for Sociétés Anonymes and Limited Liability Companies and from 25% in 2004 to 20% in 2007 for General Partnerships and Limited Partnerships.

3 The new law provides for four kinds of financial backing (subvention, leasing subsidy, tax exemption, subsidy of the payroll cost of the jobs created by the investment plan). For investments that fall under this law, the investor's own minimum participation required is reduced from 40% to 25% of the investment's value. The hitherto distinction between "old" and "new" enterprises is lifted so that all enterprises can access all four kinds of financial backing. The law also establishes the possibility of an additional subvention of SMEs, ranging from 5% to 15% of the investment's value. Moreover, it increases by 10 percentage points on average the subvention of investments in all sorts of tourist ventures. It considerably broadens the scope of financially-backed business activities oriented towards the tertiary sector. In addition, it provides for considerable changes in the investment's assessment, approval and supervision procedures. It makes the whole process simpler, shortens the time required for the assessment of the investment plan and the preparation of the supervision report and reduces the number of the subvention's instalment payments (and the respective audits) from 4 to 2. Furthermore, it enhances the role of private institutions in the assessment of investment plans and the supervision of their implementation. On the other hand, this law entails the creation and operation of numerous committees, which does not help in limiting bureaucracy.

4 While eligibility for subvention is henceforth dissociated from the obligation to create new jobs (which in some cases hampered high-technology or capital-intensive investments in the past), the number of new jobs created remains a key criterion in order for investments to fall under the provisions of this law. Part of the payroll cost of every new job created thanks to the investment is subsidised for 2 years (and within 3 years from its completion).

sonnel training,¹ R&D,² and decentralisation of economic activity. They represent significant steps in the right direction, which however are not sufficient by themselves to increase investment and attract foreign direct investment in Greece.

As regards entrepreneurship, according to a recent IOBE survey,³ the share of the population of employment age that was starting a business venture in 2003 was not lower in Greece compared with other developed countries. However, in contrast to most of these countries, Greece recorded a high rate of “*forced entrepreneurship*”, i.e. recourse to a business activity in the absence of other means of earning a living. Moreover, only 16% of these ventures could be characterised as being of “*high potential*”, i.e. conducive to market expansion, creating jobs and strengthening the export orientation of the economy. Finally, Greece ranked very low as regards the innovativeness of existing enterprises (mainly SMEs).

The strengthening of competition in the product markets can contribute directly to higher total factor productivity by inducing managers to improve efficiency and introduce more innovation. Experience from structural reforms in our country thus far shows that in the deregulated industries (e.g. the financial sector, telecommunications, post services) there have been clear benefits for the consumers and the economy. Despite this progress, there is room for strengthening competition further, not only in the aforementioned sectors but also in other sectors with public utilities (e.g. power supply, natural gas supply, water supply, oil refinement) in which competition is still limited. The absence or inadequacy of competition in these sectors is attributable to *deficiencies* in the structural framework (e.g. in power supply) but also to incomplete alignment with community directives (e.g. in telecommunications).⁴ In addition, greater progress in privatisation is needed. As mentioned in the Stability and Growth Programme, the privatisation programme for 2005 amounts to €1,010 million.⁵ The benefits of privatisation will be even greater if the state relinquishes its ability to control commercial policies in public utilities and withdraws completely from activities that properly belong in the private sector.

More generally, the country’s business environment presents serious deficiencies, as also evidenced by the results of a recent OECD survey covering the years 1998 to 2003.⁶ According to the OECD, business activity in Greece is heavily encumbered by state control, manifold regulatory interventions (e.g. price monitoring, plethora of administrative

1 Enterprise personnel training costs are recognised for tax return purposes.

2 Allows for a *further 50%* of the enterprises’ outlays for scientific and technological research to be deducted from their net income, in addition to the deduction of *total* such outlays from their gross income.

3 Since 2003 the Foundation for Economic and Industrial Research (IOBE) participates in an entrepreneurship survey carried out under the international research programme of the Global Entrepreneurship Monitor (GEM). The first annual report on this international programme was presented on 21 October 2004.

4 See Bank of Greece, *Monetary Policy 2004-2005*, February 2005, Appendix to Chapter III.

5 In the course of 2004 the government proceeded to the sale of Hellenic Petroleum and National Bank of Greece shares (with proceeds amounting to €192 million and €562 million respectively).

6 See OECD, *International Regulation Database*, as well as P. Conway, V. Janod, G. Nicoletti, “Product market regulation in OECD countries: 1998 to 2003”, OECD Economics Department Working Paper No. 419, 2005.

controls, etc.) and bureaucracy. The bureaucratic interference is readily attested by the cost, in terms of both time and money, of establishing new enterprises, be it personal companies or corporations – although some progress has been made in recent years as regards enterprise licensing procedures.¹ Impediments to business activity are also created by the markets' lack of sufficient information concerning the regulations and laws in effect (as for example in the case of unauthorised construction). A particular problem arises from the absence of a stable legal framework as regards urban planning regulations – particularly as to the use of land – and from inadequate zone planning. Moreover, the complexity of the bankruptcy legislation and the extremely time-consuming legal procedures that (e.g.) a bank must follow in order to collect a loan in the case of a borrower's bankruptcy may be leading banks to require their customers to provide considerably high collateral, thus in effect hindering access to financing. A review of the data used by the OECD to assess the regulatory framework shows that inadequate competition in the Greek economy is not due to the existence of legal hindrances as regards the entry of enterprises, but to the existence of administrative impediments to starting a business activity and the instability and complexity of the regulatory environment. This environment seems to favour collusions and harmonisation of practices among already existing enterprises.²

This is precisely why the role of the Competition Commission should be further reinforced. The proposed legislation that amends, replaces and complements Law 703/1977 on “Control of monopolies and oligopolies and protection of free competition”³ seeks to modernise the institutional framework on competition and align it with the recent EU Regulation 1/2003,⁴ as well as to upgrade the Competition Commission, in terms of its institutional entrenchment and independence as well as of its competencies, inspection powers and regulatory interventions. In fact, the provision of Article 5 grants to the Competition Commission the possibility of taking properly justified regulatory or corrective measures as needed to strengthen competition, particularly in certain markets. International experience and comparative studies that have been undertaken⁵ show that there is no single model for the legislative strengthening of competition and for the set-

1 Law 2941/2001 was passed in 2001 to simplify the procedure for the formation of sociétés anonymes, while Law 3325/2005 was recently passed to simplify the institutional framework for the authorisation of manufacturing firms.

2 Pertinent examples have been described in detail in a previous Bank of Greece Annual Report. See footnote 4 on page 59.

3 The bill was presented by the Ministry of Development on 16 March 2005 following deliberations with institutional agents such as the European Competition Committee, the Greek Economic and Social Commission, the Greek Competition Commission, etc.

4 European Council Regulation No. 1/2003 of 16 December 2002 on the implementation of the competition rules provided for by Articles 81 and 82 of the Treaty, which came into effect as of 1 May 2004. The new regulatory framework aspires to the maximum possible integration of the legal framework applicable throughout the EU, while placing greater emphasis on economic analysis so that the assessment of competition policies be mainly focused on economic results and seek the rationalisation, transparency and simplification of the competition rule implementation procedures. See also “A far-sighted competition policy for a competitive Europe”, European Commission Announcement, 20 April 2004.

5 See, for example, OECD, *Report on Regulatory Reform*, 1997, and *Global Competition Review* 6(6), June 2003.

ting up of the Competition Authority. Nevertheless, making best use of more general principles, such as the independence of the Competition Commission, the transparency in the decision-making process, the cultivation of a competitive spirit in business practices and the constant review of the regulatory provisions, can contribute to the establishment of a competitive climate in the economy. In the case of Greece, it appears that the legislation governing competition and the independence of its Competition Commission, once the proposed bill is passed, will be on a par with that of the other European countries. A more active attitude by the Competition Commission, based on the possibilities offered by the proposed legislation, is expected to expedite developments in the field. Still, as is also noted in an international comparative survey,¹ there are indications that competition policy does not enjoy full support in our country. In an economy with a history of (i) extensive state entrepreneurship and (ii) private entrepreneurship linked to the public sector, the establishment of a competitive spirit and the acceptance of a competitive mentality by economic and social institutions may be a long-term process.

As regards expenditure on R&D as a percentage of GDP, Greece ranks last among the 15 more advanced EU countries (with only 0.64% in 2001, as opposed to 1.99% in the EU-15 in 2002).² Therefore, stimulating business R&D spending remains a top priority for Greece. Moreover, the country is still a latecomer in the field of ICT use, although investment in ICT and the use of PCs and the internet has increased considerably over the past fifteen years. In particular, expenditure on information technology (IT) media as a percentage of GDP has remained practically unchanged over the 2001-2004 period.³ This means that, despite the constantly increasing number of IT media used in the economy (as GDP grows), the rate at which enterprises are being modernised has neither accelerated nor decelerated. It is therefore necessary to encourage the use of ICTs, as this tends to act as an important driver of labour productivity.

At the same time, policies for development should also aim at improving human capital. Given the rapid technological changes, the skills of the workers have to be frequently adapted throughout their working life. Moreover, measures promoting the development of human capital will also create the conditions for the introduction of innovations, which today remain limited,⁴ especially in cutting-edge technology fields, despite the increased proportion of technology-oriented university graduates in the total number of new graduates. It is a positive development that a large number of programmes promoting the transition to a knowledge-based economy have already been adopted at the EU level. These include (i) European Technological Platforms, which are created by the European Commission and bring in contact public- and private-sector institutions with a

1 Conducted in 2002 by *Global Competition Review* with the participation of competition policy “users”, such as enterprise groups, business executives, legislators, economists, and consumer associations.

2 Eurostat, “R&D expenditure in the EU”, *Statistics in Focus*, 2/2005.

3 Eurostat, New Cronos database. IT expenditure includes outlays for equipment, software and other IT services.

4 See Ministry of Development, Department of Competitiveness, *Investigation of the competition indicators and assessment of the cost of the Greek economy's lack of competition*, March 2005.

view to mapping out a strategy for the development and use of new technologies in Europe, and (ii) the Action Plan for Investment in Research, which aims at improving Europe's performance as regards R&D through a series of measures covering a wide variety of fields, such as research, innovations, financial markets and human capital. Moreover, education and professional training have been selected as key priority domains. The community Directive for the mutual recognition of professional skills will facilitate the mobility of specialised personnel across EU countries. In addition, enterprises can benefit from measures aimed at better recording skill shortages, as well as from closer cooperation with third-level education institutions for the educational system to be better suited to the needs of the enterprises.

The modernisation of public administration so that it becomes more friendly for citizens in general and for – both Greek and foreign – enterprises and employees in particular can contribute to growth decisively. Recent international as well as Greek experience with one-stop shops shows how modern technology can allow and foster faster intra-governmental communication, thereby expediting the provision of services to the user or citizen. On the contrary, time-consuming procedures not only raise the cost of transactions but also foster corruption and often lead to the perpetuation of centralised control solely on the pretext of combatting corruption. However, a more effective method of curbing corruption is through providing *information* and ensuring total *transparency* as to the progress in the procedures and the management of projects. Simplified and reduced bureaucratic formalities are also essential for strengthening citizen confidence in public administration, eliminating mistrust and ensuring an equal footing for all. That is why cooperation between social partners and business institutions would be valuable in identifying the major shortcomings and obstacles to the enhancement of economic activity, productive investment and employment, linked to public administration. At the current juncture, administrative reorganisation should preferably start from economically productive sectors of activity. Experience from the nearly 1,000 Citizen Service Centres (KEPs) now operating throughout the country shows how – by means of appropriate *non-bureaucratic* measures – constructive changes can be advanced. KEPs not only provide a valuable service to the public (relieving the citizens from time-consuming procedures and thus contributing to productivity growth) but also help public administration itself (allowing it to identify problems).

Of course, the extent and complexity of the required reorganisation of the state mechanism necessitates a gradual approach of “small steps” and measures focused on the top priority domains, something that may not only prove to be effective but also produce multiplicative positive results. Such domains include the provision of services to the public (Social Insurance Institute, pensions, health, education) and, over and above, to entrepreneurs. The serious problems that exist in the relationship of the public administration with the citizens and the enterprises are well known and collectively produce an *unfriendly* climate that often deters foreign or domestic investors and businessmen. Indeed, the malfunctions caused by the plethora of inspections and procedures required for the licensing

and the establishment of sociétés anonymes are well-reported. Simplifying them would not only encourage investment, but would also help curb corruption, which is fuelled by red tape. A gradual improvement in the functioning of public administration, especially vis-à-vis enterprises, can be achieved through the creation of “efficiency islets” that will have a beneficial effect on their surrounding areas. The task of such units (high-level Service Centres) can be two-fold: on the one hand to solve specific problems and cover specific needs of the users or citizens and on the other hand to study the weaknesses they record and suggest solutions. An effort in this direction has started with the Hellenic Centre for Investment (ELKE), the Investor Reception Centres (KYE) and the Technological Development Centres (EKTA). In striving to modernise the relationship of the administration with the citizens, enterprises and employees, priority must be given to sectors of activity that directly and decisively affect quality of life and growth, the facilitation of all business investments, the construction of public works and utility projects, the problems of zoning and urban planning, the public revenue collection and audit procedures (especially the tax audit system, which tends to deter foreign enterprises) and, finally, the employment issues and conditions that concern both Greek and immigrant employees in our country.

9.4.3 Economic reforms to raise employment and labour force participation rates

As mentioned already, if employment is measured in total hours worked, there is no gap in total labour utilisation between Greece and the EU-15. Nevertheless, given that the employment rates of youths, women and older workers are relatively low, while the working hours of full-time employees are long and part-time employment is low, there still remains much scope for higher labour force utilisation and improved quality of human resources – i.e. developments that would not only raise the Greek GDP *per capita*, but would also contribute substantially to sounder pension finances, lead to a more equitable income distribution and help tackle social exclusion.

The specific policies aimed at raising labour quality and labour utilisation can be grouped into those related directly to the labour market and those that are implemented in other markets or sectors but nevertheless have an effect on employment. Some of the policies mentioned in the previous sections – particularly those fostering a knowledge-based society and improving job-specific skills – can lead to increased employment and labour productivity. Furthermore, policies that encourage the creation of new businesses – by simplifying the administrative procedures and the regulatory framework governing the formation of companies – and, in general, policies that seek to prop up investment consequentially lead to increased employment as well.

However, increasing the rates of employment and labour force participation also requires policies geared more directly to attracting more people into the labour market and improving the market’s flexibility. Therefore, the main priorities of labour market policy include:

– Removing the impediments to the entry of the young into the labour market, through better tailoring the education and professional training systems to the labour market requirements.¹

– Attracting more women, as well as older people, into employment (e.g. by improving child-care systems, promoting equal treatment and opportunities and limiting early retirement).

– Encouraging the social integration of certain population groups, by converting the informal/undeclared labour (e.g. of immigrants) to legal employment.

– Improving the effectiveness of active labour market policies, as well as the operation of public and private institutions² that facilitate the match between labour supply and demand.

– Reducing the tax disincentives to working longer hours and reviewing the employment protection legislation, to ensure that they provide a sufficient level of flexibility as much for firms as for workers, especially in periods of economic changes. New forms of labour organisation and a greater variety of contractual arrangements for employees and enterprises can be useful in this respect, provided that they combine flexibility with security.³

– More generally, eliminating the impediments to labour mobility and increasing the employees' ability to respond to the requirements of new technologies (e.g. by promoting lifelong learning).

10. SUMMARY AND CONCLUSIONS

Greece has achieved strong growth in recent years, which continued into 2004, averaging about 4.3% during the past five years, well over double the euro area average. The main factor lying behind this sustained expansion was increasing domestic demand, underpinned by a monetary stimulus associated with the adoption of the euro and – more recently – the fact that real interest rates have remained at historical lows, as the European Central Bank has not changed its key rates since their last cut in June 2003. Another factor was an expansionary fiscal stance, which was not sustainable. These drew

1 An earlier NSSG survey (*Transition from education to the labour market - 2000, 2003*) showed that an average period of 35 months elapses between completion of the “basic continuous education” and employment in the first major job. Compared to other European countries it appears that Greece, along with Italy and Spain, presents one of the longest education-to-labour time spells. In addition, a recent NSSG sampling survey of mainly manufacturing firms, recorded tightness in some specialty occupations requiring tertiary education (according to 48% of the firms) and in some specialty occupations requiring lower-level education (according to 60% of the firms). See Federation of Greek Industries (SEV), *Survey on the needs of enterprises in leading-edge specialties in the three-year period 2005-2007*, June 2004.

2 That is, the Manpower Employment Organisation (OAED) and the Employment Promotion Centres, as well as Offices for the Information of Unemployed and Offices for the Information of Enterprises, Temporary Employment Firms and Private Offices of Labour Consultants.

3 See also Brussels European Council, 22-23 March 2005, Presidency Conclusions, paragraphs 30-33.

a strong private sector response, which, however, also reflected to some extent an improvement in business confidence ahead of the then-forthcoming Olympic Games. Total private investment (notably business investment) rose and strong personal income increases have spurred private consumption.

However, strong demand has contributed to relatively high inflation vis-à-vis the euro area. As a result, competitiveness weakened, causing a considerable loss in Greek export market shares and keeping the external balance in substantial deficit. Despite strong economic growth, employment growth has been modest and structural unemployment remains high. Greece's weak fiscal position has deteriorated further and the public debt-to-GDP ratio remains high.

The outlook for 2005 is for slower growth, given (i) the waning of the monetary stimulus provided by euro area entry; (ii) the necessary adjustment of fiscal policy to a more sustainable path; and (iii) the recent international oil price increases. Whether this slowdown will prove to be a temporary pause or a transition to a period of slower growth will depend on several factors. Foremost, it will depend on whether the Greek economy can be transformed from the one of the past several years, in which domestic demand provided the dynamics for growth, to an economy in which the supply side becomes more responsive to economic conditions and is increasingly able to compete successfully in global markets, so that the external sector becomes a key driver of growth. The thesis of this Report is that such a transformation is both necessary and achievable, and a roadmap that can lead to a new dynamic, competitive economy is presented. Many of the factors that have underpinned growth in the past several years – including the large infrastructure projects – have helped provide a foundation for sustainable growth. It is now time to build on that foundation.

Beyond 2005, prospects depend critically on credible policies to strengthen public finances and improve product and labour market performance so as to lay the groundwork for high and sustained GDP growth. The most pressing priority is to put public finances on a sustainable footing. The revised Updated Stability and Growth Programme recently submitted by the government is a welcome start to the required medium- and long-term fiscal adjustment. In addition, a substantial programme of structural reforms is needed across a broad range of areas.

Important progress has been made in recent years in reforming the Greek economy, especially since the launch of the Lisbon strategy in 2000. Action has been taken to reform product and financial markets, privatise state-owned enterprises, open up markets to the rigours of external competition and improve the functioning of the labour market.

Specifically, the financial sector in Greece has been fully liberalised and its efficiency has improved considerably since the early 1990s, while its stability has been ensured. As pointed out in Section 7, the banks' high capital adequacy safeguards the stability of the banking system in the current circumstances. However, account should be taken of the impact on own funds from the implementation of the International Accounting Standards (IAS) and of the new capital adequacy framework ("Basel II") as

from 31 December 2006, the overall magnitude of which cannot be estimated yet. Given these uncertainties, the Bank of Greece has recommended that banks should increase their own funds. Furthermore, as strong credit expansion to households under the pressure of competition may lead to increased credit risk in the future, notably if there is a slowdown in economic activity, the Bank of Greece raised the provisioning ratios for consumer loans with considerable arrears and has pointed out that banks should take into account this factor when they grant loans, so as to reduce credit risk. At the same time, households should evaluate carefully their income prospects before borrowing, in order to avoid undertaking excessive liabilities.

* * *

Notwithstanding the above, it is a fact that the scale of reform is not sufficient to match the challenges facing the Greek economy.

The global economy is in the midst of radical transformation, with far-reaching and fundamental changes occurring in technology, production and trading patterns. Moreover, the increasing integration of emerging markets into the global economy is placing Europe and particularly Greece under sustained and intensifying international competitive pressure.

Along with globalisation, Greece, more than any other European country, also faces a major demographic challenge. Greece's population is ageing, its birth rate is falling and its workforce shrinking; as a result, fewer people of working age will have to support growing numbers of above working age. An ageing population has profound implications for long-term growth in Greece and urgent action is needed to address this challenge.

As discussed in Section 9.3.3. above, demographic trends also have significant implications for age-related public spending programmes, such as pensions and healthcare provision. In spite of the legislative changes made in 1992 and in 2002, the current Greek pension system remains unable to absorb the forthcoming demographic changes. Without structural reform in the near future, a substantial tax hike or a further increase in workers' social security contributions to cover future pension expenditure will become virtually inevitable over the long run if the third option, i.e. that of reducing average annual public pensions in coming decades, is to be avoided. More determined reforms to improve the efficiency of the health care system are also needed.

The long-standing challenge for Greek economic policy is to bridge the sizeable gap with the average EU living standards. High growth in Greece during the past ten years has helped narrow the gap in living standards between Greece and the EU-15 average. However, as shown in Section 9.4.1, in 2004 the Greek *per capita* GDP was still 76% of that of the EU-15 average.

To achieve Greece's strategic goal of stronger economic growth, further action is required to improve Greece's international competitiveness in the years ahead, through reforms to strengthen the key drivers of economic growth, i.e. productivity and employment growth.

With respect to *productivity*, bolder action is needed to strengthen the key factors that drive its growth, including by creating a favourable environment for entrepreneurship and innovation; enhancing product market competition; reducing regulatory barriers; providing incentives and eliminating barriers to entrepreneurship; providing incentives to encourage the transition to a knowledge-based and growth-supportive economy; diffusing and utilising new technologies; and boosting investment in human capital and research and development.

As regards *employment*, tackling the causes of unemployment and low labour market participation is also central in the strategy of improving Greece's growth performance. Section 9.4.3 describes the priorities for reform. The need for action is pressing. Demographic changes make the need for faster growth in employment urgent, while increased international competition and technological change call for greater labour market flexibility. The main objective of labour market reform is to facilitate the re-employment of those employed in declining sectors that are losing market shares as a result of international competition in new and growing sectors, where Greece has a competitive advantage. In this context, it should be ensured that workers have access to the training opportunities they need to upgrade their skills. At the same time, to minimise any adverse consequences from international competition, a policy is needed for providing equal opportunities for all and security for the most vulnerable. As pointed out in Section 9.1 above, the poverty rate is relatively high and unequal income distribution is higher than in the EU-15. Therefore, an active welfare policy is needed to support the weaker and this should be a concern in the implementation of fiscal adjustment.

The renewed Lisbon Strategy imposes an obligation on – and at the same time offers an opportunity to – Greece and the other EU countries to adopt a national action programme for growth and jobs, based on the European Commission's recent proposals which were approved by the Brussels European Council in March 2005. This programme should set out the reform actions and targets appropriate to the conditions prevailing in Greece. It should be tailor-made to cater for Greece's reform requirements and should involve both Parliament and the social partners. The role of the social partners is vital, because their support will be crucial in the area of labour market reform. A balanced reform programme must take into account important social concerns. Adjustment costs are often painful, although experience shows that these costs can be reduced or absorbed if reform is accompanied by supportive policies, including active labour market policies. Reform is often difficult and opposed by vested interests. Hence, transparent and informed public dialogue on the benefits and costs of reform is necessary for building and maintaining broad public support for reform.

The current state of affairs is not sustainable. The world today is radically different from past decades as a result of a synergy of several factors, including technology, international trade, globalisation, EU enlargement and demographic changes. Greece must adapt to the new conditions dynamically. In order to achieve sustainable economic growth, further improvement of living standards and full employment, there is no choice other than reform.

APPENDIX I

1. CHRONOLOGY OF MAIN MONETARY POLICY MEASURES OF THE EUROSISTEM

8 January 2004

The Governing Council of the ECB decides that the minimum bid rate on the main refinancing operations and the interest rates on the marginal lending facility and the deposit facility will remain unchanged at 2.0%, 3.0% and 1.0% respectively.

12 January 2004

The Governing Council of the ECB decides to increase the allotment amount for each of the longer-term refinancing operations to be conducted in the year 2004 from €15 billion to €25 billion. This increased amount takes into consideration the higher liquidity needs of the euro area banking system anticipated for the year 2004. The Eurosystem will, however, continue to provide the bulk of liquidity through its main refinancing operations. The Governing Council may decide to adjust the allotment amount again at the beginning of 2005.

5 February, 4 March, 1 April, 6 May, 3 June, 1 July, 5 August, 2 September, 7 October, 4 November, 2 December 2004 and 13 January 2005

The Governing Council of the ECB decides that the minimum bid rate on the main refinancing operations and the interest rates on the marginal lending facility and the deposit facility will remain unchanged at 2.0%, 3.0% and 1.0% respectively.

14 January 2005

The Governing Council of the ECB decides to increase the allotment amount for each of the longer-term refinancing operations to be conducted in the year 2005 from €25 billion to €30 billion. This increased amount takes into consideration the higher liquidity needs of the euro area banking system anticipated in 2005. The Eurosystem will however continue to provide the bulk of liquidity through its main refinancing operations. The Governing Council may decide to adjust the allotment amount again at the beginning of 2006.

3 February, 3 March, 7 April 2005

The Governing Council of the ECB decides that the minimum bid rate on the main refinancing operations and the interest rates on the marginal lending facility and the deposit facility will remain unchanged at 2.0%, 3.0% and 1.0% respectively.

2. BANK OF GREECE DECISIONS CONCERNING THE ESTABLISHMENT AND OPERATION OF CREDIT INSTITUTIONS AND THE SUPERVISION OF THE FINANCIAL SYSTEM

16 January 2004

The Bank of Greece approves the merger of the Investment Bank of Greece and Marfin Hellenic Securities S.A. (through the absorption of the latter by the former).

20 January 2004

In implementation of ECB decisions, the Bank of Greece sets a framework for the reproduction of euro banknotes.

21 January 2004

The rules governing credit institutions' statistical reporting to the Bank of Greece of all transactions (capital movements and current transactions) in euro and foreign exchange between Greek residents and non-residents are amended and codified into a single text.

4 February 2004

Under authorisation by Law 3148/2003, the Bank of Greece specifies the terms and conditions for granting authorisation to, and the rules for the supervision of, money transfer intermediaries.

11 February 2004

With a view to providing more thorough information to the Bank of Greece for compiling the balance of payments and the international investment position, credit institutions shall submit, on a monthly basis, detailed lists of the securities they either hold for their own account or keep in custody/manage on behalf of their customers.

27 February 2004

- In the framework of Law 3066/2002 establishing the “Credit Guarantee Fund for Small and Very Small Enterprises SA” (TEMPME), the Bank of Greece lays down supervisory rules governing TEMPME's capital adequacy, liquidity and investment of its funds.
- The provisions relating to the authorisation of bureaux de change in Greece and the rules for their supervision by the Bank of Greece are codified into a single text and updated.

– The bank “Société Générale S.A.” is authorised to acquire the majority of the share capital of General (Geniki) Bank.

23 March 2004

The Tirana-based “American Bank of Albania” is authorised to establish and operate a branch in Greece.

18 June 2004

Credit institutions are required to report to the Bank of Greece quarterly data on their open positions in foreign exchange on both an individual and a consolidated basis. Thus, the frequency of reporting is harmonised with that for overall capital adequacy data.

23 June 2004

The ceiling on borrowing from credit institutions and members of the Athens Exchange for conducting stock exchange transactions is raised from €150,000 per customer to €1,000,000, following a proposal by the Hellenic Capital Market Commission, in accordance with the provisions of Law 2843/2000.

19 July 2004

– Credit institutions which are not members of the Athens Exchange are allowed to finance legal persons for conducting stock exchange transactions.

– To achieve correct and consistent implementation of the relevant provisions, the Bank of Greece clarifies some of its decisions referring to the interest rates charged by credit institutions and to the information provided to credit institution customers.

– The “Christoforos K. Varvias & Associates S.A. – Financial Services” is authorised to operate as a money transfer intermediary.

– The “Advanced Chronocash Financial – Electronic Fund Transfer S.A.” is authorised to operate as a money transfer intermediary.

– Ceilings are set on the amount of hybrid securities issued by credit institutions that may be included in their core (Tier I) capital.

27 July 2004

The Bank of Greece withdraws the authorisation of the “Arab Bank plc” branch operating in Greece.

4 August 2004

- “CBN Greece S.A.” is authorised to operate as a money transfer intermediary.
- “Manilink – S.A.” is authorised to operate as a money transfer intermediary.

9 September 2004

- The Bank of Greece approves the merger of “Emporiki Bank” with several of its subsidiaries (“Emporiki Investment Bank” inclusive) of the financial sector. The merger will be effected through absorption of the above firms by “Emporiki Bank”.
- “Smith & Smith Hellas S.A.” is authorised to operate as a money transfer intermediary.

10 November 2004

“Athens Tourism Enterprises S.A.” is authorised to operate as a money transfer intermediary.

23 November 2004

Piraeus Bank is authorised to establish and operate seven new branches in Bulgaria.

21 December 2004

The ceiling on Postal Savings Bank (PSB) financing of natural persons for the purchase of goods and for covering other personal needs is set at 15% of PSB’s own funds, on condition that its provisions for doubtful loans will at least equal the amount provided for by Law 2238/94 (1% of the amounts lent).

19 January 2005

Alpha Bank is authorised to acquire 100% of the share capital of the Belgrade-based “Jubanka a.d. Beograd”.

26 January 2005

– The provisioning ratios on claims (i) from non-performing consumer loans one year past due or in permanent arrears and (ii) from doubtful consumer loans are increased, respectively, from 70% to 90% and from 84% to 100%. At the same time, the provisioning ratio on performing loans backed by residential mortgages is lowered from 0.7% to 0.5%, provided that the amount of the loan does not exceed 70% of the objective value of the residential property.

– The provisioning ratios applying to the part of the outstanding guarantees of the Credit Guarantee Fund for Small and Very Small Enterprises that is secured by the European Investment Fund are set at 20% of the respective general minimum provisioning ratios.

25 February 2005

- The National Bank of Greece is authorised to establish and operate 15 new branches in Serbia-Montenegro.
- Alpha Bank is authorised to establish and operate one new branch in Albania.

11 March 2005

- The operating framework and the assessment criteria concerning credit institutions' internal audit systems are amended and specified, while the powers of the bodies responsible for internal audit are defined.
- Piraeus Bank is authorised to acquire the majority of the share capital of the Sofia-based "Eurobank a.d."

23 March 2005

"Famanet Hellas S.A. Financial Information Services" is authorised to operate as a money transfer intermediary.

1 April 2005

The Bank of Greece supervisory framework for the liquidity adequacy of credit institutions is amended and minimum compulsory ratios are set.

APPENDIX II

TABLES AND CHARTS	PAGE
TABLES	
1. Gross expenditure of the economy and gross domestic product	77
2. Dwelling price index	78
3. Gross value added at basic prices	79
4. Industrial production	80
5. Population, labour force and employment	81
6. Inflation indicators	82
7. Earnings, unit labour costs and productivity (1997-2004)	83
8. Greek contribution to the key monetary aggregates of the euro area	84
9. Total credit expansion in Greece	85
10. Breakdown of MFI credit to enterprises and households in Greece	86
11. Bank interest rates on new deposits and loans in the euro area and Greece	87
12. Breakdown of Greek government paper issues	88
13. Stock market aggregates	89
14. General and central government deficits	90
15. Net borrowing requirement of central government on a cash basis	91
16. Sources of financing the borrowing requirement of central government	92
17. Consolidated debt of general government	93
18. Balance of payments	94
19. Breakdown of Greece's non-oil external trade by product category	95
20. Breakdown of Greece's external trade by geographical area	96
21. Balances on services, income and transfers	97
22. Financial account balance	98
23. International investment position	99
24. Breakdown of Greece-China trade by product category	100
25. Greece-China trade in services	101
26. Key macroeconomic aggregates relating to shipping receipts	102
27. Greece, EU-15 and USA: selected structural indicators (2000-2003)	103
28. Banks' balance sheet key aggregates	104
29. Structure of the Greek credit system	105
30. Greek commercial banks' and banking groups' income statements	106
31. Transactions through the HERMES and the TARGET systems	107
CHARTS	
1. The coincident indicator of economic activity compiled by the Bank of Greece ...	108
2. Consumer demand	109
3. Main indicators of investment activity	110

4. Indicators of industrial production	111
5. Total unemployment rate (1998-2004)	112
6. Business forecasts for employment	113
7. Consumer price index and core inflation in Greece	114
8. A. The output gap of the Greek economy: level	
B. The output gap of the Greek economy: changes	115
9. Inflation differentials between Greece and the euro area (selected sub-indices) ..	116
10. Greece: credit expansion to enterprises and households	117
11. Bank interest rates on new deposits from households in Greece and in the euro area (January 2003-February 2005)	118
12. Interest rates on new bank lending in Greece	119
13. Interest rates on new bank deposits and loans: differentials between Greece and the euro area	120
14. Yield on Greek 10-year government bond and yield differential over the corresponding German bond	121
15. Mutual funds: number and assets	122
16. Primary surplus of government budget as a percentage of GDP	123
17. Composition of outlays under the ordinary budget	124
18. Interest payments on central government debt	125
19. Greek-flag fleet as a percentage of the world fleet	126
20. Non-performing bank loans by category of loan granted by Greek commercial banks	127
21. Provisions to non-performing bank loans ratio, and net non-performing loans (less provisions) as a percentage of total bank lending	128
22. Greek commercial banks' total capital adequacy	129

TABLE 1
GROSS EXPENDITURE OF THE ECONOMY AND GROSS DOMESTIC PRODUCT
(Constant prices of 1995)

	Million euro	Annual percentage changes			
		1995	2001	2002	2003	2004
1. Private consumption	58,405.3	3.0	3.1	4.0	3.3
2. Public consumption	12,249.7	-3.2	8.3	-2.3	6.5
3. Gross fixed capital formation	14,867.2	6.5	5.7	13.7	4.9
3.1.a By investor: general government	2,538.0	2.4	-5.4	17.3	8.0
3.1.b other sectors	12,329.2	7.4	7.9	13.1	4.4
3.2.a By type: construction	9,422.0	6.9	3.7	10.9	4.0
3.2.b equipment	4,680.0	4.9	6.9	18.3	5.8
3.2.c other investment	765.2	20.1	21.0	3.4	7.4
4. Change in stocks and statistical discrepancy (percentage of GDP)	251.4	0.1	0.0	0.1	0.2
5. Domestic final demand	85,773.7	2.3	4.3	5.4	4.2
6. Exports of goods and services	14,087.0	-1.0	-7.7	1.0	10.0
6.1 Exports of goods	8,343.9	-1.6	-7.1	4.2	-1.3
6.2 Exports of services	5,743.1	-0.7	-8.1	-1.3	18.4
7. Final demand	99,860.7	1.7	2.1	4.7	5.1
8. Imports of goods and services	19,933.7	-5.2	-2.9	4.8	8.2
8.1 Imports of goods	18,084.2	-6.3	3.2	6.6	8.1
8.2 Imports of services	1,849.4	-0.4	-26.5	-5.2	8.8
9. Balance of goods and services	5,846.7	...	...	...	...
GDP at market prices	79,927.0	4.3	3.8	4.7	4.2

	Contribution to GDP growth (percentage points)			
	2001	2002	2003	2004
1. Private consumption	2.1	2.2	2.8	2.3
2. Public consumption	-0.5	1.2	-0.4	0.9
3. Gross fixed capital formation	1.6	1.4	3.4	1.3
3.1.a By investor: general government	0.1	-0.2	0.6	0.3
3.1.b other sectors	1.5	1.6	2.8	1.0
3.2.a By type: construction	0.9	0.5	1.4	0.6
3.2.b equipment	0.5	0.7	2.0	0.7
3.2.c other investment	0.2	0.2	0.0	0.1
4. Change in stocks and statistical discrepancy	-0.5	-0.1	0.1	0.1
5. Domestic final demand	2.6	4.7	6.0	4.6
6. Exports of goods and services	-0.3	-1.9	0.2	2.1
6.1 Exports of goods	-0.2	-0.7	0.4	-0.1
6.2 Exports of services	-0.1	-1.2	-0.2	2.3
7. Final demand	2.3	2.8	6.2	6.8
8. Imports of goods and services	1.9	1.0	-1.5	-2.6
8.1 Imports of goods	1.9	-0.9	-1.8	-2.2
8.2 Imports of services	0.0	1.8	0.3	-0.4
9. Balance of goods and services	1.7	-0.9	-1.3	-0.5
GDP at market prices	4.3	3.8	4.7	4.2

Sources: NSSG/National Accounts, March 2005 (for 2001 to 2004, provisional estimates).

TABLE 2
DWELLING PRICE INDEX

	Urban areas – total				Athens				Other urban areas				
	Index	Percentage changes	Index	Percentage changes	Index	Percentage changes	Index	Percentage changes	Index	Percentage changes	Index	Percentage changes	
	1997=100	Over previous period	1997=100	Over corresponding period of previous year	1997=100	Over previous period	Q4 1993=100	Over previous period	1997=100	Over corresponding period of previous year	Q4 1993=100	Over previous period	Over corresponding period of previous year
1994	76.1	8.5	73.4	9.5	73.4	9.5	106.0	7.8	73.4	9.5	106.0	7.8	7.8
1995	82.6	8.5	80.1	9.2	80.1	9.2	114.3	10.0	80.1	9.2	114.3	10.0	10.0
1996	91.2	10.5	88.9	11.0	88.9	11.0	125.7	7.1	88.9	11.0	125.7	7.1	7.1
1997	100.0	9.7	100.0	12.5	100.0	12.5	134.7	13.3	100.0	12.5	134.7	13.3	13.3
1998	114.4	14.4	115.5	15.5	115.5	15.5	152.6	5.8	114.4	14.4	152.6	5.8	5.8
1999	124.5	8.9	129.6	12.2	129.6	12.2	161.5	6.0	124.5	8.9	161.5	6.0	6.0
2000	137.6	10.5	149.1	15.1	149.1	15.1	171.2	11.3	137.6	10.5	171.2	11.3	11.3
2001	157.7	14.6	175.4	17.6	175.4	17.6	190.6	9.5	157.7	14.6	190.6	9.5	9.5
2002	178.2	13.0	203.8	16.2	203.8	16.2	208.8	7.9	178.2	13.0	208.8	7.9	7.9
2003	188.4	5.7	211.9	4.0	211.9	4.0	225.2	5.4	188.4	5.7	225.2	5.4	5.4
2004	...	...	...	...	...	...	237.3	...	...	...	237.3	...	...
2003 Q1	187.2	2.3	214.6	3.1	214.6	3.1	219.0	1.4	187.2	2.3	219.0	1.4	1.4
2003 Q2	186.9	-0.2	210.6	4.5	210.6	4.5	223.0	1.8	186.9	-0.2	223.0	1.8	8.6
2003 Q3	188.6	0.9	210.6	5.1	210.6	5.1	227.1	1.9	188.6	0.9	227.1	1.9	8.2
2003 Q4	190.8	1.2	211.5	4.2	211.5	4.2	231.7	2.0	190.8	1.2	231.7	2.0	7.3
2004 Q1	190.7	0.0	209.7	1.8	209.7	1.8	233.8	0.9	190.7	0.0	233.8	0.9	6.8
2004 Q2	191.1	0.2	209.4	2.2	209.4	2.2	235.3	0.6	191.1	0.2	235.3	0.6	5.5
2004 Q3	193.4	1.2	211.1	2.6	211.1	2.6	239.1	1.6	193.4	1.2	239.1	1.6	5.3
2004 Q4	...	...	...	...	...	...	241.1	0.8	...	...	241.1	0.8	4.0
2003 June	...	...	...	...	...	...	...	...	...	...	...	...	...
2003 July	...	...	207.6	0.0	207.6	0.0	...	...	...	...	...	...	...
2003 Aug.	...	...	208.6	0.5	208.6	0.5	...	...	...	...	...	...	...
2003 Sept.	...	...	211.9	1.6	211.9	1.6	...	...	...	...	...	...	...
2003 Oct.	...	...	211.5	-0.2	211.5	-0.2	...	...	...	...	...	...	...
2003 Nov.	...	...	210.7	-0.4	210.7	-0.4	...	...	...	...	...	...	...
2003 Dec.	...	...	211.2	0.3	211.2	0.3	...	...	...	...	...	...	...
2004 Jan.	...	...	212.7	0.7	212.7	0.7	...	...	...	...	...	...	...
2004 Feb.	...	...	212.7	0.0	212.7	0.0	...	...	...	...	...	...	...
2004 March	...	...	207.1	-2.6	207.1	-2.6	...	...	...	...	...	...	...
2004 Apr.	...	...	209.5	1.1	209.5	1.1	...	...	...	...	...	...	...
2004 May	...	...	208.0	-0.7	208.0	-0.7	...	...	...	...	...	...	...
2004 June	...	...	211.5	1.7	211.5	1.7	...	...	...	...	...	...	...
2004 July	...	...	208.5	-1.4	208.5	-1.4	...	...	...	...	...	...	...
2004 Aug.	...	...	208.8	0.1	208.8	0.1	...	...	...	...	...	...	...
2004 Sept.	...	...	212.4	1.7	212.4	1.7	...	...	...	...	...	...	...
2004 Oct.	...	...	212.1	-0.1	212.1	-0.1	...	...	...	...	...	...	...

Sources: For the other urban areas: Bank of Greece. For Athens: calculations based on data from "Property Ltd.". For the total of urban areas: weighted index based on the housing stock in Athens and the other urban areas.

TABLE 3
GROSS VALUE ADDED AT BASIC PRICES

	Million euro	Annual percentage changes (constant prices of 1995)				
		1995	2000	2001	2002	2003	2004
1. Primary sector (agriculture)	7,277	-4.2	-4.1	-1.3	-4.2	10.8
2. Secondary sector	16,550	5.4	6.4	2.2	5.9	0.6
2.a Mining and quarrying	476	23.2	2.2	8.5	-4.8	...
2.b Manufacturing	9,572	4.6	3.3	2.4	2.4	...
2.c Electricity - natural gas - water supply	1,751	4.8	1.3	1.8	6.3	...
2.d Construction	4,751	5.7	14.4	1.4	12.3	4.9
3. Tertiary sector	50,031	5.1	5.2	3.7	6.0	...
3.a Trade	10,018	3.1	11.4	1.2	11.1	...
3.b Hotels - restaurants	4,821	5.4	6.2	5.2	6.9	...
3.c Transport - communications	4,978	16.2	1.3	5.9	6.3	...
3.d Financial intermediaries	3,112	10.0	5.9	-5.2	8.9	...
3.e Real estate management and related activities	12,577	3.5	3.5	1.8	2.9	...
3.f Public administration - security	5,308	-2.8	1.0	8.4	-4.3	...
3.g Education	3,298	1.6	-1.2	12.2	12.4	...
3.h Health	3,855	3.0	2.6	6.5	4.9	...
3.i Other activities	2,064	7.6	15.2	6.9	5.7	...
4. Gross value added at basic prices	73,858	4.4	4.8	3.1	5.2	4.4
5. Financial intermediation services indirectly measured (FISIM)	2,175	13.7	12.1	-9.3	12.8	6.0
6. Gross value added at basic prices (excl. FISIM)	71,682	4.1	4.5	3.6	4.9	4.4

Source: NSSG/National Accounts, March 2005 (provisional estimates for the period 2000-2004).

TABLE 4
INDUSTRIAL PRODUCTION (2000=100)

	Weights (2000)		Average annual percentage changes				2004 level (2000=100)
			2001	2002	2003	2004	
TOTAL	100.0		-1.8	0.8	0.3	1.2	100.4
1. Mining and quarrying	5.9	100.0	2.4	9.7	-5.2	0.3	106.8
Coal and lignite extraction		48.3	4.5	6.5	-3.4	1.6	109.1
Oil wells and extraction of natural gas		5.2	-25.9	-7.3	-24.5	3.0	53.4
Ore extraction		11.5	13.2	20.7	-22.7	-2.5	102.8
Other extraction and quarrying activities		35.1	0.3	12.1	1.0	-0.7	112.7
2. Manufacturing	77.5	100.0	-2.5	-0.1	-0.4	1.2	98.1
3. Electricity - natural gas - water supply	16.6	100.0	-0.1	1.8	5.8	1.4	109.1
Electricity		80.9	-0.9	1.5	6.8	0.8	108.2
Natural gas		5.3	0.4	4.7	13.2	9.9	130.9
Water supply		13.8	4.4	2.8	-2.8	1.6	106.0
TOTAL	100.0		-1.8	0.8	0.3	1.2	100.4
Main industrial groupings							
Energy		28.5	-0.3	2.3	2.9	0.3	105.3
Intermediate goods		31.1	-0.5	1.6	-0.4	1.0	101.7
Capital goods		10.6	-13.0	-7.2	0.8	-0.5	81.0
Consumer durables		2.5	-14.4	-15.4	-3.6	1.8	71.1
Consumer non-durables		27.3	0.7	2.3	-1.4	2.7	104.2

Source: NSSG.

TABLE 5
POPULATION, LABOUR FORCE AND EMPLOYMENT

	2004 (thous. persons)	Annual percentage changes				
		2000	2001	2002	2003	2004 ⁹
Population						
aged 15 and over ¹	9,057	0.9	0.8	0.7	0.6	...
Population aged 15-64 ¹	7,127	0.5	0.3	0.2	0.1	...
Labour force ¹	4,823	0.7	-0.8	1.5	1.6	...
Employment: ¹	4,330	1.4	0.1	2.1	2.3	...
- Primary sector ¹	546	1.2	-7.2	-2.0	1.1	...
- Secondary sector ¹	974	-0.2	2.0	1.0	1.2	...
- Tertiary sector ¹	2,811	2.1	1.5	3.6	3.0	...
Rate of participation in the labour force ^{1,2}	4,742	63.9	63.2	64.2	65.1	66.5
Employment rate ^{1,3}	4,250	56.6	56.5	57.7	58.9	59.6
Unemployment (as a percentage of the labour force) ¹	493	11.2	10.4	9.9	9.3	10.2
Employment in:						
- Manufacturing ¹	570	-1.0	1.5	-0.2	-2.5	...
- Construction ¹	350	2.9	4.1	3.4	8.6	...
- Banks ⁴	62	2.3	-1.0	1.4	0.1	-3.0
- Civil service ⁵	464 ⁶	1.9	1.1	2.2	0.8	1.6
- Public enterprises and entities ⁷	79 ⁸	-4.6	-4.4	-3.8	-2.2	-1.8 ¹⁰

1 NSSG, Labour Force Surveys. *Changes from second quarter to second quarter*. New revised data 1999-2003 published in January 2005. New sample as from 2004.

2 Labour force participation rate of population aged 15-64.

3 Employed persons aged 15-64 as a percentage of population aged 15-64.

4 Data obtained from banks: December-on-December changes. Including the Bank of Greece.

5 Ministry of Economy and Finance: December-on-December changes. The increase in average annual employment was 1.8% in 2000 (counting in public hospital personnel and smoothing out fluctuations in the number of secondary school substitute teachers), 0.6% in 2001, 4.0% in 2002, 1.8% in 2003 and 1.2% in 2004.

6 Including public hospital personnel.

7 Ministry of Economy and Finance: December-on-December changes. The decrease in average annual employment was 4.2% in 2000, 4.6% in 2001, 4.7% in 2002, 1.9% in 2003 and 2.1% in 2004 (first 9 months).

8 Excluding the Hellenic Telecommunications Organisation (OTE).

9 Labour Force Survey data for 2004 are not fully comparable with those for the previous years.

10 September-on-September changes.

TABLE 6
INFLATION INDICATORS
(Annual percentage changes)

Year or quarter	Consumer Price Index										Wholesale Price Index						
	Sub-indices										Sub-indices						
	General index	Goods	Services	CPI excluding fuel & fresh fruit and vegetables	CPI excluding food & fuel	Food and non-alcoholic beverages	Fresh fruit and vegetables	Fuel	General index	Primary	Industrial	Industrial excluding fuel	Exported products	Imported products			
1998	4.8	3.9	6.2	5.3	5.7	4.4	7.0	-5.9	3.8	5.9	3.3	4.2	2.3	5.4			
1999	2.6	1.7	4.0	2.9	3.0	2.4	1.8	-1.7	1.8	2.2	2.8	2.6	0.5	0.6			
2000	3.2	3.4	2.8	2.0	2.0	1.9	1.4	26.8	6.6	1.5	5.2	3.3	12.3	6.4			
2001	3.4	3.2	3.7	3.8	3.7	5.1	9.2	-4.8	2.3	10.0	2.7	3.4	0.7	1.9			
2002	3.6	3.2	4.3	3.6	3.6	5.3	13.8	-1.7	2.4	11.2	2.6	3.0	1.9	0.4			
2003	3.5	3.1	4.2	3.2	3.1	5.0	10.7	3.9	2.1	8.6	2.7	2.9	0.1	1.1			
2004	2.9	2.3	3.8	3.3	3.2	0.5	-11.9	7.5	2.4	-1.7	4.5	4.1	3.4	0.5			
2001	Q1	3.3	2.9	3.8	3.8	1.9	-5.7	3.4	3.1	-2.0	3.8	3.9	3.7	4.0			
	Q2	3.7	3.7	3.7	3.8	4.6	7.4	2.4	3.6	8.8	4.0	3.8	3.4	2.8			
	Q3	3.8	3.9	3.6	4.0	6.2	14.0	-4.4	2.2	12.2	2.9	3.5	0.0	1.8			
	Q4	2.7	2.2	3.6	3.6	7.8	23.7	-18.7	0.2	22.2	0.3	2.4	-4.0	-0.8			
2002	Q1	4.0	4.0	3.9	3.3	3.4	43.2	-7.4	4.3	34.7	2.6	3.3	2.4	0.6			
	Q2	3.5	3.0	4.4	3.9	3.9	9.0	-4.9	1.7	6.9	2.2	3.0	1.2	0.2			
	Q3	3.5	2.7	4.6	3.7	4.0	4.5	-0.4	1.6	4.8	2.4	2.9	1.3	0.2			
	Q4	3.6	3.0	4.5	3.5	2.9	1.0	6.7	2.0	0.6	3.1	2.7	2.7	0.6			
2003	Q1	3.8	3.4	4.5	3.6	3.4	-5.4	15.9	1.7	-2.5	3.6	2.8	1.1	1.5			
	Q2	3.7	3.4	4.1	3.1	3.0	27.6	-2.4	2.2	19.6	1.9	2.6	-2.0	0.9			
	Q3	3.4	2.9	4.1	3.0	6.1	19.2	0.9	2.2	12.2	2.4	2.8	0.2	1.0			
	Q4	3.2	2.5	4.3	3.2	3.3	4.6	1.9	2.2	7.1	3.1	3.5	1.0	0.8			
2004	Q1	2.7	1.8	4.0	3.3	3.2	2.6	-5.7	1.8	4.6	2.8	3.7	1.6	0.0			
	Q2	2.9	2.3	3.9	3.3	3.2	-16.3	11.6	2.6	-8.1	5.4	4.8	5.6	0.6			
	Q3	2.8	2.1	3.9	3.4	3.4	-22.8	9.6	2.4	-6.0	4.9	4.2	4.1	0.5			
	Q4	3.2	2.9	3.5	3.0	2.9	-11.3	15.5	2.8	3.1	4.7	3.7	2.5	0.9			
2005	Q1	3.3	3.1	3.6	3.3	3.5	-11.5	15.1									

Source: NSSG.

TABLE 7
EARNINGS, UNIT LABOUR COSTS AND PRODUCTIVITY (1997 - 2004)
(Annual percentage changes)

	1997	1998	1999	2000	2001	2002	2003	2004
WHOLE ECONOMY								
– Average gross earnings ¹ (nominal)	10.5	6.3	4.5	6.1	4.8	6.6	5.3	7.3
– Average gross earnings ¹ (real)	4.7	1.4	1.9	2.8	1.4	2.9	1.7	4.3
– Net income of an employee with average earnings (nominal)	10.7	5.7	3.6	8.1	3.5	6.3	6.0	5.4
– Net income of an employee with average earnings (real)	4.9	0.9	1.0	4.7	0.1	2.6	2.4	2.4
– Total compensation of employees ^{1,2}	10.7	7.7	6.8	9.0	8.4	9.2	8.0	8.9
– Compensation (earnings and employer contributions) per employee	10.1	6.8	4.5	5.9	4.9	6.0	5.3	7.6
– Unit labour costs ^{1,3}	6.9	4.2	3.3	4.3	3.9	5.2	3.2	4.5
– Consumer price index ⁴	5.5	4.8	2.6	3.2	3.4	3.6	3.5	2.9
– Gross domestic product ⁵	3.6	3.4	3.4	4.5	4.3	3.8	4.7	4.2
BUSINESS SECTOR ⁶								
– Total compensation of employees ¹	9.4	6.8	7.1	9.2	9.4	8.6	8.3	7.2
– Unit labour costs ¹	5.6	3.3	3.6	4.5	4.9	4.6	3.5	2.9
CIVIL SERVICE ⁷								
– Average gross earnings of employees	13.5	9.2	3.5	7.1	5.5	7.3	5.9	10.5
– Total outlays for salaries and pensions	13.3	9.9	6.1	8.5	6.3	10.5	7.4	12.6
– Total outlays for salaries (excluding pensions)	14.7	8.0	5.7	9.0	6.1	11.6	7.8	11.8
PUBLIC ENTERPRISES								
– Average gross earnings of employees ⁸	11.0	5.7	5.1	13.7	8.2	11.2	7.0	7.8
– Total compensation of employees ⁸	9.7	2.1	3.1	8.9	3.2	5.5	5.1	5.5
– Monthly earnings of white-collar workers in electricity-water supply ⁴	9.9	8.9	...	...	...	...	...	...
– Hourly earnings of blue-collar workers in electricity-water supply ⁴	10.4	11.4	...	...	...	...	...	...
BANKS								
– Average gross earnings of employees ¹	9.7	4.0	13.1	6.8	6.4	2.9	3.1	8.0
– Total outlays for salaries ⁹	10.8	5.9	14.3	9.3	5.3	4.3	3.2	6.5
– Total compensation of employees ⁹	9.8	6.6	12.7	9.4	6.4	3.6	3.1	7.3
– Monthly earnings of employees ^{4,10}	9.4	8.6	...	...	...	...	...	...
NON-BANK PRIVATE SECTOR								
– Minimum earnings ¹¹ (nominal)	8.0	5.4	3.5	4.2	3.5	5.4	5.1	4.8
– Minimum earnings ¹¹ (real)	2.4	0.6	0.9	1.0	0.1	1.7	1.5	1.8
– Average contractual earnings ¹²	8.2	5.7	3.9	4.2	4.2	5.7	5.1	5.0
– Average gross earnings ¹	8.8	5.8	4.4	5.0	5.3	6.5	5.8	5.8
– Total compensation of employees ¹	9.3	7.6	6.2	9.2	10.7	9.6	9.4	7.5
– Hourly earnings of blue-collar workers in manufacturing ⁴	8.9	4.7	4.4*	5.5*	5.5*	6.4*	5.9*	5.8*
– Monthly earnings of white-collar workers in manufacturing ⁴	9.8	5.9	...	...	...	...	...	...
– Output per hour worked (manufacturing) ⁴	4.4	4.4	0.6*	2.0*	-0.6*	0.6*	1.2*	1.2*
– Unit labour costs (manufacturing) ⁴	4.4	0.2	3.8*	3.4*	6.1*	5.3*	4.7*	4.5*
– Weekly earnings of blue-collar workers in mining ⁴	12.2	5.2	...	...	...	...	...	...
– Monthly earnings of white-collar workers in mining ⁴	14.3	13.7	...	...	...	...	...	...
– Monthly earnings of employees in retail trade ⁴	12.0	9.6	...	...	...	...	...	...
– Monthly earnings of employees in wholesale trade ⁴	10.5	6.3	...	...	...	...	...	...

1 Bank of Greece estimates.

2 NSSG and Ministry of Economy and Finance estimates on the growth in total compensation of employees (March 2005): 1997: 13.6%, 1998: 10.4%, 1999: 8.9%, 2000: 6.8%, 2001: 7.0%, 2002: 8.2%, 2003: 6.4%, 2004: 10.9%.

3 NSSG and Ministry of Economy and Finance estimates on the rate of increase in unit labour costs (as defined by the Ministry of Economy and Finance): 1997: 9.1%, 1998: 6.1%, 1999: 3.0%, 2000: 1.3%, 2001: 0.8%, 2002: 5.7%, 2003: 0.8%, 2004: 4.4%.

4 Calculations based on NSSG survey data.

5 NSSG estimates (March 2005).

6 The business sector comprises public enterprises, banks and the non-bank private sector.

7 Estimates based on data from the Ministry of Economy and Finance, and Introductory Reports on the Budget. Data for 1997 have been adjusted for comparability purposes. In calculating expenditure growth from 1998 onwards, healthcare outlays were not taken into account.

8 Calculations based on Ministry of Economy and Finance data and estimates. For comparability purposes, public enterprises include OTE for the entire period.

9 Data from annual profit and loss accounts (1996-2004).

10 October-on-October rates of change.

11 National General Collective Labour Agreement.

12 Calculations based on data from collective labour agreements at branch and occupational level.

* Estimates.

TABLE 8
GREEK CONTRIBUTION TO THE KEY MONETARY AGGREGATES OF THE EURO AREA
(Not seasonally adjusted data)

	Outstanding balances on 31.12.04 (million euro)	Annual percentage changes ¹										
		2001		2002		2003		2004				2005
		Q4 ²	Q4 ²	Q4 ²	Q4 ²	Q1 ²	Q2 ²	Q3 ²	Q4 ²	December ³	February ³	
1. Overnight deposits	91,695	11.1	8.9	6.8	11.7	13.4	15.5	16.8	15.5	15.5	15.6	
1.1 Sight deposits and current account deposits	20,697	5.3	5.7	17.7	19.3	18.0	11.8	19.1	17.8	17.8	20.1	
1.2 Savings deposits	70,998	12.5	9.8	4.1	9.7	12.2	16.5	16.1	14.7	14.7	14.2	
2. Time deposits with an agreed maturity of up to 2 years	33,408	-9.3	10.1	29.3	19.9	14.8	5.1	5.3	6.0	6.0	25.4	
3. Deposits redeemable at notice of up to 3 months ⁴	1,939	19.7	8.1	1.5	2.8	1.6	3.9	2.8	0.3	0.3	-2.4	
4. Total deposits (1+2+3)	127,042	5.1	9.3	12.2	13.4	13.1	11.8	12.6	11.8	11.8	17.2	
5. Repurchase agreements (repos)	9,529	38.3	-19.0	-47.7	-45.9	-41.3	-23.8	-12.6	-12.1	-12.1	-57.7	
6. Money market fund units	15,227	-38.4	-3.7	68.0	24.6	7.5	0.1	-1.9	-2.9	-2.9	-4.3	
7. Bank bonds with a maturity of up to 2 years ⁵	466	...	...	...	...	...	...	...	...	...	...

1 Annual rates of change in the corresponding index, which is compiled on the basis of outstanding stocks for December 2001 and cumulative monthly flows, adjusted for exchange rate variations, reclassifications etc.

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

3 Annual rates of change on the basis of the corresponding index at the end of the month.

4 Including savings deposits in currencies other than the euro.

5 Rates of change are not shown because, owing to the low calculation base, they are very high.

Sources: Bank of Greece and ECB.

TABLE 9
TOTAL CREDIT EXPANSION IN GREECE
(Annual percentage changes)

	2001		2002		2003		2004			2005		
	Q4 ¹		Q4 ¹		Q4 ¹		Q1 ¹	Q2 ¹	Q3 ¹	Q4 ¹	December ²	February ²
1. Total credit expansion	8.9		7.1		3.2		3.8	8.6	9.3	8.6	7.7	8.6
2. Credit expansion to general government	-2.4		-5.2		-15.9		-15.5	-6.2	-2.8	-5.6	-8.0	-3.4
3. Credit expansion to enterprises and households	23.2		18.3		17.1		16.9	17.4	15.7	16.1	15.8	14.4
3.1 Credit expansion to enterprises	16.7		11.4		11.0		10.9	10.5	8.2	8.6	7.5	5.0
3.2 Credit expansion to households	40.0		33.1		28.2		27.5	28.9	28.2	28.0	28.5	28.6
<i>of which:</i>												
3.2.1 Housing loans	36.7		35.4		27.1		24.5	24.7	22.9	23.8	24.8	25.4
3.2.2 Consumer loans	44.3		27.4		24.8		29.2	34.5	38.2	37.9	37.4	35.0

1 The quarterly average is derived from monthly averages (which are calculated as arithmetic means of two successive end-of-month figures) and is not the three-month average of end-of-month annual growth rates (see the "Technical Notes" in the ECB *Monthly Bulletin*).

2 Annual rate of change at the end of the month.

Source: Bank of Greece.

TABLE 10
BREAKDOWN OF MFI CREDIT TO ENTERPRISES AND HOUSEHOLDS IN GREECE

	Outstanding balances on 31.12.04 (million euro)	Annual percentage changes											
		2001		2002		2003		2004				2005	
		Q4 ¹	Q4 ¹	Q4 ¹	Q4 ¹	Q4 ¹	Q4 ¹	Q1 ¹	Q2 ¹	Q3 ¹	Q4 ¹	December ²	February ²
A. Enterprises	65,566	16.7	11.4	11.0	10.9	10.5	8.2	8.6	7.5	5.0			
1. Agriculture	3,248	-2.6	-14.0	3.3	2.6	5.5	9.1	7.8	5.4	3.9			
2. Industry ³	15,676	10.2	11.5	10.4	10.2	7.5	1.8	1.1	-1.2	-2.0			
3. Trade	18,821	20.3	7.8	4.0	4.5	7.6	10.2	12.7	14.0	12.0			
4. Tourism	4,040	14.2	33.7	24.4	18.6	19.4	18.9	17.6	15.8	15.1			
5. Shipping	4,495	7.8	5.5	2.3	4.0	7.0	4.0	3.0	4.1	5.2			
6. Non-monetary financial institutions	2,693	141.8	72.5	-3.2	-2.2	6.0	2.9	9.5	-2.7	-31.7			
7. Other	16,593	24.6	14.3	26.5	25.6	18.5	12.6	11.7	11.0	9.0			
B. Households	51,636	40.0	33.1	28.2	27.5	28.9	28.2	28.0	28.5	28.6			
1. Housing loans	33,127	36.7	35.4	27.1	24.5	24.7	22.9	23.8	24.8	25.4			
2. Consumer loans	17,054	44.3	27.4	24.8	29.2	34.5	38.2	37.9	37.4	35.0			
– Credit cards	7,665	62.1	37.1	27.8	24.8	23.3	23.0	23.4	23.2	21.4			
– Other consumer loans ⁴	9,389	31.8	19.2	21.8	33.9	46.9	54.9	53.1	51.7	48.4			
3. Other	1,455	165.5	62.6	135.7	119.2	87.5	47.6	18.8	15.9	29.7			
TOTAL	117,202	23.2	18.3	17.1	16.9	17.4	15.7	16.1	15.8	14.4			
– In euro	111,951	35.2	21.9	19.8	19.1	18.7	17.2	17.6	17.0	15.5			
– In other currencies	5,251	-28.6	-12.3	-14.1	-11.1	-2.5	-6.3	-7.2	-5.0	-3.6			

1 The quarterly average is derived from monthly averages (which are calculated as arithmetic means of two successive end-of-month figures) and is not the three-month average of end-of-month annual growth rates (see the "Technical Notes" in the ECB *Monthly Bulletin*).

2 Annual rate of change at the end of the month.

3 Comprising manufacturing and mining/quarrying

4 Including personal loans and loans against supporting documents.

Source: Bank of Greece.

TABLE 11
BANK INTEREST RATES ON NEW DEPOSITS AND LOANS
IN THE EURO AREA AND GREECE
(Percentages per annum)

	December 2003	February 2005	Change Feb. 2005/ Dec. 2003
A. Deposits			
A.1 Overnight from households¹			
Weighted average interest rate in the euro area	0.70	0.74	0.04
Maximum interest rate	1.20	1.20	0.00
Minimum interest rate	0.12	0.12	0.00
Interest rate in Greece	0.87	0.95	0.08
A.2 With an agreed maturity of up to one year from households²			
Weighted average interest rate in the euro area	1.89	1.94	0.05
Maximum interest rate	2.38	2.24	-0.14
Minimum interest rate	1.47	1.51	0.04
Interest rate in Greece	2.22	2.19	-0.03
B. Loans with a floating rate or an initial rate fixation of up to one year²			
B.1 Loans up to €1 million to non-financial corporations			
Weighted average interest rate in the euro area	4.06	3.91	-0.15
Maximum interest rate	5.63	5.91	0.28
Minimum interest rate	3.21	3.44	0.23
Interest rate in Greece	5.13	5.08	-0.05
B.2 Loans of more than €1 million to non-financial corporations			
Weighted average interest rate in the euro area	3.12	3.02	-0.10
Maximum interest rate	4.33	4.21	-0.12
Minimum interest rate	2.90	2.71	-0.19
Interest rate in Greece	3.78	3.53	-0.25
B.3 Housing loans			
Weighted average interest rate in the euro area	3.62	3.40	-0.22
Maximum interest rate	4.63	4.35	-0.28
Minimum interest rate	3.29	3.12	-0.17
Interest rate in Greece	4.31	4.20	-0.11
B.4 Consumer loans			
Weighted average interest rate in the euro area	7.17	6.20	-0.97
Maximum interest rate	10.87	10.56	-0.31
Minimum interest rate	4.96	4.45	-0.51
Interest rate in Greece	9.60	8.99	-0.61
C. Loans with an initial rate fixation of 1-5 years			
C.1 Consumer loans			
Weighted average interest rate in the euro area	6.54	6.84	0.30
Maximum interest rate	10.03	10.84	0.81
Minimum interest rate	4.34	4.24	-0.10
Interest rate in Greece	10.03	9.53	-0.50

1 Interest rate at the end of the month.

2 Monthly average rate.

Sources: ECB and euro area NCBs.

TABLE 12
BREAKDOWN OF GREEK GOVERNMENT PAPER ISSUES

Type	2002		2003		2004	
Treasury bills	4.7		4.8		5.7	
Bonds	95.3		95.2		94.3	
1-year	0.0		7.4		17.5	
3-year	22.7		22.5		21.2	
5-year	24.1		25.9		30.3	
7-year	5.0		0.5		0.2	
10-year	29.1		28.0		23.7	
12-year	-		-		0.9	
15-year	0.0		1.9		-	
20-year	19.1		10.2		0.7	
23-year	0.0		3.6		5.5	
Total	100.0	100.0	100.0	100.0	100.0	100.0
Total value (million euro)	32,069		36,521		43,361	

Note: By initial (not residual) maturity as regards the re-opening of past issues.

Source: Bank of Greece.

TABLE 13
STOCK MARKET AGGREGATES

Year	Share price indices ¹ (1980 = 100)		Average daily value of transactions ² (million euro)	Market capitalisation ¹ (million euro)			Market capitalisation (percentage of GDP)			Funds raised through the Athens Exchange (ATHEX) ⁴ (million euro)		
	Composite	Banks		Shares	Bonds ³	Total	Shares	Bonds	Total	Listed companies	New companies	Total
2001	2,591.6	4,788.1	166.1	96,950	81,180	178,130	74	62	136	367	470	836
2002	1,748.4	2,688.2	100.2	65,760	114,570	180,330	46	81	127	267	86	353
2003	2,263.6	4,246.9	141.1	84,547	135,219	219,766	55	88	143	317	61	378
2004	2,786.2	6,129.0	140.8	92,140	157,905	250,045	56	96	151	397	79	476

1 At year-end.

2 In shares. Excluding transactions in existing shares.

3 Comprising Greek Treasury bills and government bonds, bank bonds and corporate bonds.

4 Through capital increase and issuance of new shares. Subscriptions to new capital are entered on the last day of the subscription period.

Sources: ATHEX, Bank of Greece and (for GDP) Ministry of Economy and Finance.

T A B L E 14
GENERAL AND CENTRAL GOVERNMENT DEFICITS
(Percentage of GDP)

	2000	2001	2002	2003	2004*
<i>General government deficit</i> ¹ (national accounts data – convergence criterion)	-4.1	-3.6	-4.1	-5.2	-6.1
– <i>Central government</i>	-6.4	-5.3	-7.0	-8.1	-9.2
– Social security organisations and local authorities	2.3	1.7	2.9	2.9	3.1
<i>Central government deficit</i> ² (administrative data)	-4.3	-4.0	-3.8	-6.4	-7.7
<i>Central government deficit</i> ³ (cash basis)	-5.8	-5.9	-5.0	-6.9	-9.4

1 Ministry of Economy and Finance data, as submitted to the European Commission (Excessive Deficit Procedure).

2 General Accounting Office data published in the State budget.

3 Bank of Greece data. They regard only the borrowing requirement of central government on a cash basis. The borrowing requirement of public entities is now calculated by NSSG on the basis of detailed data collected directly from these entities through a special quarterly survey on their financial results (revenue-expenditure) and financial situation (borrowing, investment in securities, deposits, etc.), as data from the banking system are no longer adequate for reliable estimates.

* Provisional data.

Sources: Bank of Greece, Ministry of Economy and Finance, NSSG.

TABLE 15
NET BORROWING REQUIREMENT OF
CENTRAL GOVERNMENT ON A CASH BASIS^{1,2,3}
(Million euro)

	2002	2003	2004*
1. Central government	7,102	10,526	15,605
Percentage of GDP	5.0	6.9	9.4
– State budget	6,674	10,833	15,377
(Ordinary budget) ⁴	(2,128)	(4,106)	(8,841)
(Public investment budget)	(4,546)	(6,727)	(6,536)
– OPEKEPE ⁵	428	–307	228

1 See footnote 3 in Table 14.

2 As shown by the respective accounts with the Bank of Greece, the Agricultural Bank and commercial banks.

3 Excluding the repayment of government debt to the Social Insurance Institute (IKA) through bond issuance (L. 2972/2001, Article 51). The debt, totalling €3,927.9 million, was repaid in three instalments (2002: €1,467.4 million, 2003: €1,549.5 million and 2004: €911 million). The figure for 2004 includes the repayment, through the issuance of special-type bonds, of debt to social security organisations (€1,043 million) and the Agricultural Bank of Greece (€554 million).

4 Including movements in public debt management accounts.

5 Payment and Control Agency for Guidance and Guarantee Community Aid. It replaced DIDAGEP (Agricultural Markets Management Service) as from 3 September 2001.

* Provisional data.

Source: Bank of Greece.

T A B L E 16
SOURCES OF FINANCING THE BORROWING
REQUIREMENT OF CENTRAL GOVERNMENT
(Million euro)

	2002		2003		2004*	
	Amount	Percentage of total	Amount	Percentage of total	Amount	Percentage of total
Greek Treasury bills and government bonds ^{1,2}	11,929	168.0	13,378	127.1	16,829	107.8
Change in the balances of central government accounts kept with the banking system ³	90	1.3	-871	-8.3	-901	-5.8
External borrowing ⁴	-4,917	-69.2	-1,981	-18.8	-323	-2.0
Total borrowing	7,102	100.0	10,526	100.0	15,605	100.0

1 Including Treasury bills and government bonds issued in Greece, as well as privatisation certificates.

2 Excluding bonds issued by the Greek government for debt repayment to the Social Insurance Institute-IKA (Law 2972/2001, Article 51). The figure for 2004 includes the repayment, through the issuance of special-type bonds, of debt to social security organisations (€1,043 million) and the Agricultural Bank of Greece (€554 million). See also footnote 3 in Table 15.

3 Including changes in central government's accounts with the Bank of Greece and credit institutions, as well as the change in OPEKEPE's account.

4 Comprising borrowing abroad and securities issuance abroad. Excluding non-residents' holdings of bonds issued in Greece. Also including the change in government deposits with foreign banks.

* Provisional data.

Source: Bank of Greece.

TABLE 17
 CONSOLIDATED DEBT OF GENERAL GOVERNMENT*
 (Million euro)

	1999	2000	2001	2002	2003	2004*
Short-term liabilities	4,988	2,279	1,106	1,398	3,409	2,839
– securities	4,531	1,767	747	982	3,084	2,568
– loans	457	512	359	416	325	271
Long-term liabilities	121,415	136,302	149,391	156,972	163,859	179,342
– securities	99,843	109,923	117,442	126,514	134,394	156,969
– loans	21,572	26,379	31,949	30,458	29,465	22,373
Coin	155	178	198	515	454	521
Total	126,558	138,759	150,695	158,885	167,722	182,702
Percentage of GDP	112.3	114.0	114.8	112.2	109.3	110.5
– domestic debt ¹	96,643	105,431	142,195	154,188	164,340	180,199
(of which: debt to the Bank of Greece)	(12,290)	(12,472)	(10,985)	(9,561)	(9,018)	(8,488)
– external debt ¹	29,915	33,328	8,500	4,697	3,382	2,503

1 According to the definition in the Maastricht Treaty.

2 For 1999-2000, domestic debt includes euro-denominated securities held by non-residents, as well as Bank of Greece loans with a foreign currency clause. From 2001 onwards, domestic debt covers all liabilities in euro, and external debt all liabilities in currencies other than the euro.

* Provisional data.

Sources: State General Accounting Office and Bank of Greece.

T A B L E 18
BALANCE OF PAYMENTS
(Million euro)

	January – December			Percentage changes	
	2002	2003	2004*	2003/02	2004*/03
I. Current account balance (I.A+I.B+I.C+I.D)	-8,571.3	-8,646.3	-6,411.0		
I.A Trade balance (I.A.1 – I.A.2)	-22,708.7	-22,643.5	-25,435.7		
Non-oil trade balance	-19,203.7	-18,607.7	-20,960.8		
Oil trade balance	-3,505.0	-4,035.8	-4,475.0		
I.A.1 Exports of goods	10,433.6	11,113.6	12,653.3	6.5	13.9
I.A.2 Imports of goods	33,142.3	33,757.1	38,089.0	1.9	12.8
I.B Services balance (I.B.1 – I.B.2)	10,755.3	11,506.4	15,467.0		
I.B.1 Receipts	21,131.4	21,430.3	26,742.5	1.4	24.8
I.B.2 Payments	10,376.1	9,923.9	11,275.5	-4.4	13.6
I.C Income balance (I.C.1 – I.C.2)	-2,073.4	-2,597.4	-2,457.5		
I.C.1 Receipts	1,626.5	1,569.1	1,686.5	-3.5	7.5
I.C.2 Payments	3,699.9	4,166.5	4,144.0	12.6	-0.6
I.D Transfers balance (I.D.1 – I.D.2)	5,455.4	5,088.1	6,015.1		
I.D.1 Receipts	7,801.4	7,817.4	8,974.3	0.2	14.8
I.D.2 Payments	2,346.0	2,729.3	2,959.2	16.3	8.4
II. Financial account balance	10,310.4	9,663.7	7,834.0		
III. Errors and omissions	-1,739.0	-1,017.4	-1,423.0		
Reserve assets (end of period) ¹	9,014.0	4,605.0	1,994.0		

1 Since Greece entered the euro area in January 2001, reserve assets, as defined by the European Central Bank, include only monetary gold, the “reserve position” with the IMF, “Special Drawing Rights”, and Bank of Greece’s claims in foreign currency on residents of non-euro area countries. Conversely, reserve assets do not include claims in euro on residents of non-euro area countries, claims in foreign currency and in euro on residents of euro area countries, and the Bank of Greece participation in the capital and the reserve assets of the ECB.

* Provisional data.

Source: Bank of Greece.

TABLE 19
BREAKDOWN OF GREECE'S NON-OIL EXTERNAL TRADE
BY PRODUCT CATEGORY

A. Export receipts					
	Percentage share of each product category in total export receipts			Percentage change in export receipts	
	2002	2003	2004*	2003/2002	2004/2003
Agricultural products	19.3	22.0	17.1	20.0	-12.3
Chemicals, plastics ¹	11.0	12.4	11.6	19.3	5.7
Metallurgy	8.6	7.9	9.7	-3.3	38.7
Machinery, appliances	5.4	7.3	5.5	42.2	-14.9
Means of transport	0.7	3.7	13.7	445.1	323.2
Ships	0.4	3.0	12.4	702.7	369.8
Other manufacturing industries ¹	19.2	20.1	17.8	10.8	0.1
Unclassified goods ²	35.8	26.6	24.6	-21.4	4.4
Total	100.0	100.0	100.0	5.6	13.0
<i>Total (excluding ships)</i>				<i>2.9</i>	<i>2.0</i>
B. Import bill					
	Percentage share of each product category in total import bill			Percentage change in import bill	
	2002	2003	2004*	2003/2002	2004/2003*
Agricultural products	14.7	14.4	13.7	-2.6	7.7
Chemicals, plastics	16.7	15.8	14.2	-5.2	1.1
Metallurgy	8.1	8.8	9.2	8.5	18.0
Machinery, appliances	21.4	21.2	19.3	-1.4	2.5
Consumer durables	3.5	3.6	3.2	1.7	-0.9
Capital goods	13.0	13.2	11.7	1.6	0.0
PCs	2.3	1.9	2.0	-16.1	15.9
Fixed-voice and mobile telephony	2.6	2.4	2.4	-7.6	10.6
Means of transport	12.8	15.0	18.4	16.7	38.1
Passenger cars	6.2	7.1	7.9	14.2	24.8
Other manufacturing industries ¹	21.9	21.9	20.7	0.1	6.3
Other goods	0.4	0.3	0.4	-13.6	36.7
Unclassified goods ²	4.0	2.5	4.2	-37.2	84.8
Total	100.0	100.0	100.0	-0.3	12.8

1 Including raw materials used.

2 Products for which no code number has been reported.

* Provisional data.

Source: Bank of Greece.

TABLE 20
BREAKDOWN OF GREECE'S EXTERNAL TRADE BY GEOGRAPHICAL AREA

A. Exports							
	Percentage shares in total export value				Percentage change in export value		
	2001*	2002*	2003*	2004*	2002/01	2003/02	2004*/03
European Union-15	42.0	43.5	46.7	47.8	-3.3	16.4	6.3
Euro area	32.3	35.2	37.8	38.8	1.6	16.6	6.7
New Member States	9.5	8.8	8.5	7.6	-13.5	4.4	-7.2
OECD ²	12.9	12.3	14.3	13.3	-10.6	25.9	-3.1
USA	5.5	5.3	6.6	5.3	-9.3	33.1	-15.9
Balkan countries ³	18.4	16.6	16.4	17.0	-15.6	6.9	7.7
Commonwealth of Independent States	4.3	4.3	3.5	3.0	-5.8	-10.5	-12.3
Northern Africa & Middle East countries ⁴	6.7	7.1	5.5	6.4	-1.2	-16.0	20.9
China and Southeastern Asia ⁵	1.9	2.1	1.6	2.0	4.9	-20.1	32.1
Other countries	4.5	5.2	3.6	3.0	8.6	-25.1	-13.4
Total	100.0	100.0	100.0	100.0	-6.7	8.5	3.9
B. Imports							
	Percentage shares in total import value				Percentage change in import value		
	2001*	2002*	2003*	2004*	2002/01	2003/02	2004*/03
European Union-15	54.5	52.2	54.5	53.7	-0.5	25.6	5.1
Euro area	47.3	46.3	48.3	47.2	1.6	25.5	4.2
New Member States	2.0	2.0	1.8	2.1	4.0	9.1	19.3
OECD ²	13.8	17.9	18.9	15.9	35.1	26.9	-10.3
USA	3.5	4.7	5.0	4.4	40.3	28.2	-5.3
Balkan countries ³	3.6	2.7	2.7	3.1	-21.2	17.7	23.1
Commonwealth of Independent States	6.8	9.3	7.3	6.4	42.5	-6.1	-6.6
Northern Africa & Middle East countries ⁴	10.4	7.0	7.2	8.8	-30.6	24.0	30.6
China and Southeastern Asia ⁵	5.2	5.0	4.7	5.1	1.0	12.4	16.5
Other countries	3.7	3.8	2.8	5.0	7.7	-11.3	87.0
Total	100.0	100.0	100.0	100.0	3.9	20.1	6.8

1 Estonia, Latvia, Lithuania, Poland, Czech Republic, Slovakia, Hungary, Slovenia, Cyprus, Malta.

2 The OECD Member States not included in any other category.

3 Albania, Bulgaria, Romania and former Yugoslavia countries (Bosnia, Croatia, FYROM and New Yugoslavia).

4 Greece's major trading partners in Northern Africa and the Middle East.

5 Greece's major trading partners in Southeastern Asia.

* Provisional data.

Source: NSSG.

TABLE 21
BALANCES ON SERVICES, INCOME AND TRANSFERS
(Million euro)

	2002	2003	2004*	2003/2002	2004*/2003
Services balance	10,755.4	11,506.5	15,467.0	7.0	34.4
Receipts	21,131.4	21,430.3	26,742.5	1.4	24.8
Travel	10,284.7	9,495.3	10,347.8	-7.7	9.0
Transport	8,523.4	9,569.8	13,307.0	12.3	39.1
Other services	2,323.3	2,365.3	3,087.7	1.8	30.5
Payments	10,376.1	9,923.9	11,275.5	-4.4	13.6
Travel	2,548.7	2,136.0	2,310.4	-16.2	8.2
Transport	5,029.7	4,923.6	5,728.2	-2.1	16.3
Other services	2,797.7	2,864.3	3,236.9	2.4	13.0
Net receipts	10,755.4	11,506.5	15,467.0	7.0	34.4
Travel	7,736.0	7,359.3	8,037.4	-4.9	9.2
Transport	3,493.7	4,646.2	7,578.8	33.0	63.1
Other services	-474.4	-499.0	-149.2	5.2	-70.1
Income balance	-2,073.4	-2,597.4	-2,457.4	25.3	-5.4
Receipts	1,626.5	1,569.1	1,686.5	-3.5	7.5
Wages, salaries	509.6	337.2	280.0	-33.8	-17.0
Interest, dividends, profits	1,116.9	1,231.9	1,406.5	10.3	14.2
Payments	3,699.9	4,166.5	4,144.0	12.6	-0.5
Wages, salaries	240.4	169.9	188.9	-29.3	11.2
Interest, dividends, profits	3,459.5	3,996.6	3,955.1	15.5	-1.0
Transfers balance	5,455.4	5,088.1	6,015.1	-6.7	18.2
Receipts	7,801.4	7,817.4	8,974.3	0.2	14.8
General government (EU transfers)	5,458.0	5,375.0	6,544.2	-1.5	21.8
Other sectors (emigrants' remittances etc.)	2,343.4	2,442.4	2,430.1	4.2	-0.5
Payments	2,346.0	2,729.3	2,959.2	16.3	8.4
General government (mainly payments to the EU)	1,695.7	2,169.3	2,286.6	27.9	5.4
Other sectors	650.3	560.0	672.6	-13.9	20.1

* Provisional data.

Source: Bank of Greece.

T A B L E 22
FINANCIAL ACCOUNT BALANCE
(Million euro)

	2002	2003	2004*
Financial account balance (I+II+III+IV)	10,310.4	9,663.7	7,834.0
I. Direct investment	-643.0	544.7	599.6
Abroad by residents	-696.3	-41.2	-488.8
In Greece by non-residents	53.4	585.9	1,088.4
II. Portfolio investment	10,937.8	12,334.0	13,727.5
Assets	-2,230.0	-8,737.9	11,489.4
Liabilities	13,167.8	21,071.8	25,216.9
III. Other investment	1,998.6	-7,623.9	-9,104.1
Assets	-7,481.9	-4,034.5	-6,215.7
Liabilities	9,480.5	-3,589.4	-2,888.4
(General government borrowing)	-4,510.1	-2,618.4	-1,027.4
IV. Reserve asset changes	-1,983.0	4,409.0	2,611.0

* Provisional data.

Source: Bank of Greece.

TABLE 23
INTERNATIONAL INVESTMENT POSITION
(Million euro)

	2002*	2003*	2004**
1. Direct investment	-6,255	-8,159	-10,394
Abroad by residents	8,583	8,934	9,586
In Greece by non-residents	14,838	17,083	19,980
2. Portfolio investment	-57,738	-69,062	-84,767
Assets	17,139	27,685	38,504
Liabilities	74,877	96,747	123,271
3. Financial derivatives	300	258	603
4. Other investment	-21,639	-19,932	-17,787
Assets	45,056	47,734	50,095
Liabilities	66,695	67,666	67,882
5. Reserve assets¹	9,014	4,605	1,994
Net international investment position (1+2+3+4+5)	-76,318	-92,290	-110,351
GDP	141,669	153,472	165,280
% of GDP	-53.9	-60.1	-66.8

1 The decrease in reserve assets in 2003 and 2004 is largely associated with the restructuring of the Bank of Greece's portfolio.

* It should be noted that data for 2001 and 2002 have been revised and are thus not comparable with those in the previous *Annual Report*.

** Provisional estimates.

Source: Bank of Greece.

TABLE 24
 BREAKDOWN OF GREECE-CHINA TRADE BY PRODUCT CATEGORY
 (Percentage share by product category)

A. Exports										
	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Agricultural products	2.2	0.5	0.9	0.4	2.3	1.7	2.0	1.8	2.7	3.4
Raw materials (except fuel)	4.4	15.5	5.2	5.5	16.8	30.5	35.5	27.1	69.9	55.5
Fuel	3.5	0.4	1.0	5.1	1.6	2.8	1.0	0.4	0.3	1.5
Chemical products	73.0	56.0	72.9	33.6	44.1	44.6	23.7	19.1	10.5	3.3
Machinery and transport equipment	1.8	5.3	1.7	4.1	6.1	5.7	28.4	45.6	8.1	12.9
Miscellaneous industrial goods	15.2	22.3	18.3	51.0	28.8	14.7	9.3	6.0	8.2	23.4
	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
<i>China's percentage share in total Greek exports</i>	<i>0.2</i>	<i>0.4</i>	<i>0.5</i>	<i>0.2</i>	<i>0.2</i>	<i>0.3</i>	<i>0.4</i>	<i>0.6</i>	<i>0.5</i>	<i>0.5</i>
B. Imports										
	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Agricultural products	0.9	1.0	2.1	1.6	1.1	1.4	1.2	1.3	1.5	1.3
Raw materials (except fuel)	0.8	0.8	0.6	0.6	1.2	1.6	1.3	1.0	0.8	1.0
Fuel	0.0	0.0	0.0	0.1	0.9	0.6	1.3	0.1	0.0	0.4
Chemical products	3.1	2.1	2.1	2.3	2.3	2.1	1.9	2.6	2.5	2.3
Machinery and transport equipment	21.8	22.2	19.5	32.7	24.1	30.5	39.9	35.9	39.6	34.7
Miscellaneous industrial goods	73.5	73.9	75.8	62.7	70.4	63.9	54.4	59.0	55.6	60.4
	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
<i>China's percentage share in total Greek imports</i>	<i>1.3</i>	<i>1.6</i>	<i>1.8</i>	<i>2.0</i>	<i>1.8</i>	<i>2.1</i>	<i>3.0</i>	<i>3.1</i>	<i>3.1</i>	<i>3.5</i>

Source: NSSG.

TABLE 25
GREECE-CHINA TRADE IN SERVICES
(Percentage share in total trade with China)

A. Receipts						
	1999	2000	2001	2002	2003	2004
Sea transport	70.6	75.3	28.5	28.8	76.1	54.6
Travel services	23.7	4.2	27.8	65.3	9.6	20.8
Other services	5.7	20.6	43.7	5.8	14.4	24.6
	100.0	100.0	100.0	100.0	100.0	100.0
<i>China's percentage share in total Greek receipts from services exports</i>	<i>0.02</i>	<i>0.01</i>	<i>0.01</i>	<i>0.10</i>	<i>0.12</i>	<i>0.13</i>
B. Payments						
	1999	2000	2001	2002	2003	2004
Sea transport	56.2	88.0	87.5	80.1	68.9	72.0
Travel services	24.3	5.3	4.2	8.6	23.0	18.9
Other services	19.5	6.8	8.4	11.3	8.1	9.1
	100.0	100.0	100.0	100.0	100.0	100.0
<i>China's percentage share in total Greek import bill for services</i>	<i>0.13</i>	<i>0.22</i>	<i>0.26</i>	<i>0.36</i>	<i>0.59</i>	<i>0.69</i>

Source: Bank of Greece.

T A B L E 26
KEY MACROECONOMIC AGGREGATES RELATING TO SHIPPING RECEIPTS
(Million euro)

	2002	2003	2004
GDP (at current prices)	141,668.7	153,472.1	165,280.5
Trade balance	-22,708.7	-22,643.5	-25,435.8
<i>of which: sale of ships</i>	36.5	293.0	1,376.5
Services balance	10,755.3	11,506.5	15,467.0
Sea transport receipts	8,002.8	8,961.1	12,404.2
Sea transport bill	4,015.4	3,817.9	4,486.0
Net receipts from sea transports	3,987.4	5,143.3	7,918.3
– As a percentage of GDP	2.81	3.35	4.79
– As a percentage of the services balance	37.07	44.70	51.19
– As a percentage of the trade deficit	17.56	22.71	31.13
Annual percentage change in net receipts from sea transport	-3.21	28.99	53.95

Sources: Bank of Greece and Eurostat.

TABLE 27
GREECE, EU-15 AND USA: SELECTED STRUCTURAL INDICATORS (2000-2003)

	EU-15 2000	EU-15 2003	Greece ¹ 2000	Greece 2003	United States 2000	United States 2003
<i>Per capita</i> GDP in purchasing power standards (PPS)	70.8	70.9	46.7	52.7	100.0	100.0
Labour productivity per person employed (in PPS)	80.5	76.8	62.2	65.2	100.0	100.0
Employment rate, persons aged 15-64 (%)	63.4	64.4	56.5	58.7	74.1	71.2
Employment rate of women aged 15-64 (%)	54.1	56.1	41.7	44.3	67.8	65.7
Employment rate, persons aged 55-64 (%)	37.8	41.7	39.8	42.0	57.8	59.9
Long-term unemployed as a percentage of the labour force	3.5	3.3	6.4	5.5	0.2	0.7
Percentage of the population aged 20-24 with at least upper secondary education	73.6	73.8	80.5	81.7	...	...
R&D expenditure (% of GDP) ²	1.9	2.0	0.7	0.6	2.7	2.8
ICT expenditure (% of GDP) ³	6.1	6.1	5.2	4.8	8.2	9.4
Percentage of households with internet access ⁴	39.0	45.0	12.0	17.0	...	...
Penetration of broadband networks (connections per inhabitant) ⁴	2.3	7.6	0.0	0.2	...	...
Relative price levels of final consumption items (EU-15 = 100) ⁵	100.0	100.0	80.8	81.1	113.1	97.4
At-risk-of-poverty rate ⁶	15.0	16.0	20.0	20.0	...	...
Total greenhouse gas emissions (1990 = 100) ⁷	96.3	97.1	121.2	126.5	114.8	113.1
Energy intensity of the economy (gross inland consumption of energy divided by GDP at constant prices, in kilograms of oil equivalent per €1,000) ⁷	193.3	191.7	263.6	258.4	334.2	331.0
Volume of freight transport relative to GDP (1995 = 100)	102.6	100.6	...	...	91.5	90.6 ⁸

1 Indicators for Greece have been updated in the light of revised data from the Labour Force Survey of January 2005 referring to the 1998-2003 period; these data have not yet been taken into account by Eurostat.

2 Aggregate (public and private) Research and Development (R&D) expenditure. Figures for the EU-15 are Eurostat estimates and for 2003 are based on provisional data. The figure for Greece refers to 1999 and 2001.

3 Data on expenditure on information and communication technologies (ICT) comprise expenditure for hardware and software and refer to 2002 and 2004.

4 Data on internet access and broadband network penetration refer to 2002 and 2004.

5 Including indirect taxes. For 2003, Eurostat's flash estimate.

6 Defined as the share of persons with an equivalised disposable income (after social transfers) below the risk-of-poverty threshold, which is set at 60% of the national median equivalised disposable income. See also Table III in the main text. Figures refer to 1999 and 2000 income.

7 Data refer to 2000 and 2002.

8 Data refer to 2001.

Source: Eurostat, New Cronos Database.

T A B L E 28
BANKS' BALANCE SHEET KEY AGGREGATES
(Percentage changes over previous year)

	All banks		Greek commercial banks	
	2003	2004	2003	2004
Loans	14.2	17.0	14.9	17.9
Own funds	4.7	4.7	9.4	4.3
Deposits	9.6	14.0	9.5	12.0
Deposits and repos	3.9	10.5	2.9	8.0
Total assets	6.3	9.4	5.8	7.3
Off-balance sheet items	20.4	25.5	19.0	22.9

Sources: Bank of Greece (data from financial statements) and banks' balance sheets.

TABLE 29
STRUCTURE OF THE GREEK CREDIT SYSTEM

A. Market shares (%) in balance sheet key aggregates						
	Assets		Loans		Deposits	
	2003	2004	2003	2004	2003	2004
Greek commercial banks	82.1	80.9	84.5	85.1	82.6	81.8
Foreign banks	9.3	10.0	9.4	8.8	7.3	8.2
Cooperative banks	0.6	0.7	0.9	1.0	0.7	0.8
Specialised Credit Institutions	8.0	8.4	5.2	5.1	9.4	9.2
Total	100.0	100.0	100.0	100.0	100.0	100.0

B. Number of banks, branches and employees						
	Banks		Branches		Employees	
	2003	2004	2003	2004	2003	2004
Greek commercial banks	22	21	2,876	2,953	53,809	51,741
Foreign banks	20	23	205	223	4,851	5,133
Cooperative banks	15	16	80	87	681	781
Specialised Credit Institutions	2	2	139	140	1,733	1,682
Total	59	62	3,300	3,403	61,074	59,337

Source: Bank of Greece (data from financial statements).

T A B L E 30
 GREEK COMMERCIAL BANKS' AND BANKING GROUPS' INCOME STATEMENTS
 (Percentage of average assets)

	Banks		Banking groups	
	2003	2004	2003	2004
Interest income	4.9	4.9	5.1	5.2
Interest expenses	2.1	2.1	2.1	2.2
Net interest income	2.8	2.8	2.9	3.0
Non-interest income	1.0	0.9	1.3	1.4
Operating expenses	2.3	2.3	2.7	2.7
Net income	1.4	1.4	1.5	1.7
Provisions	0.5	0.6	0.5	0.7
Pre-tax profits (ROA)	0.9	0.7	1.0	1.0
<i>Pre-tax profits as a percentage of own funds (ROE)</i>	<i>13.0</i>	<i>10.8</i>	<i>16.5</i>	<i>16.1</i>

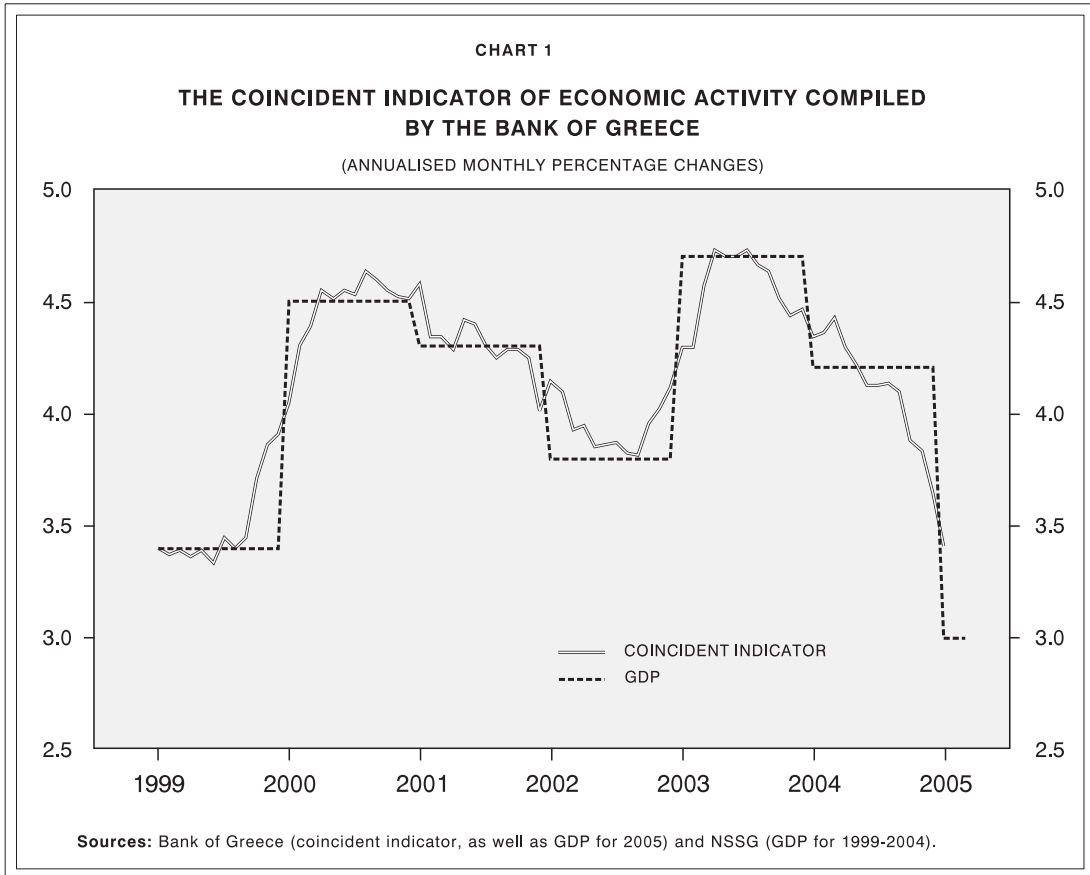
Source: Bank of Greece calculations based on income statement data.

TABLE 31
TRANSACTIONS THROUGH THE HERMES AND THE TARGET SYSTEMS

Payment orders	2003		2004	
	Number of transactions	Value of transactions (million euro)	Number of transactions	Value of transactions (million euro)
1. Domestic	984,492	1,723,429	1,024,108	1,675,300
– customer payments	651,953	387,639	695,493	331,823
– interbank payments ¹	332,539	1,335,790	328,615	1,343,477
2. Cross-border	340,330	1,620,873	340,427	2,021,865
– customer payments	218,414	8,560	213,135	10,196
– interbank payments	121,916	1,612,313	127,292	2,011,669
HERMES total	1,324,822	3,344,302	1,364,535	3,697,165
TARGET total	66,608,000	420,749,000	69,213,498	443,993,000

¹ They include the debiting of the following settlement systems: the Book-Entry Securities System, the Athens Clearing Office and DIAS S.A. (13,529 payment orders amounting to €321,085 million for 2003 and 13,415 orders amounting to €382,809 million for 2004).

Sources: Bank of Greece and ECB.



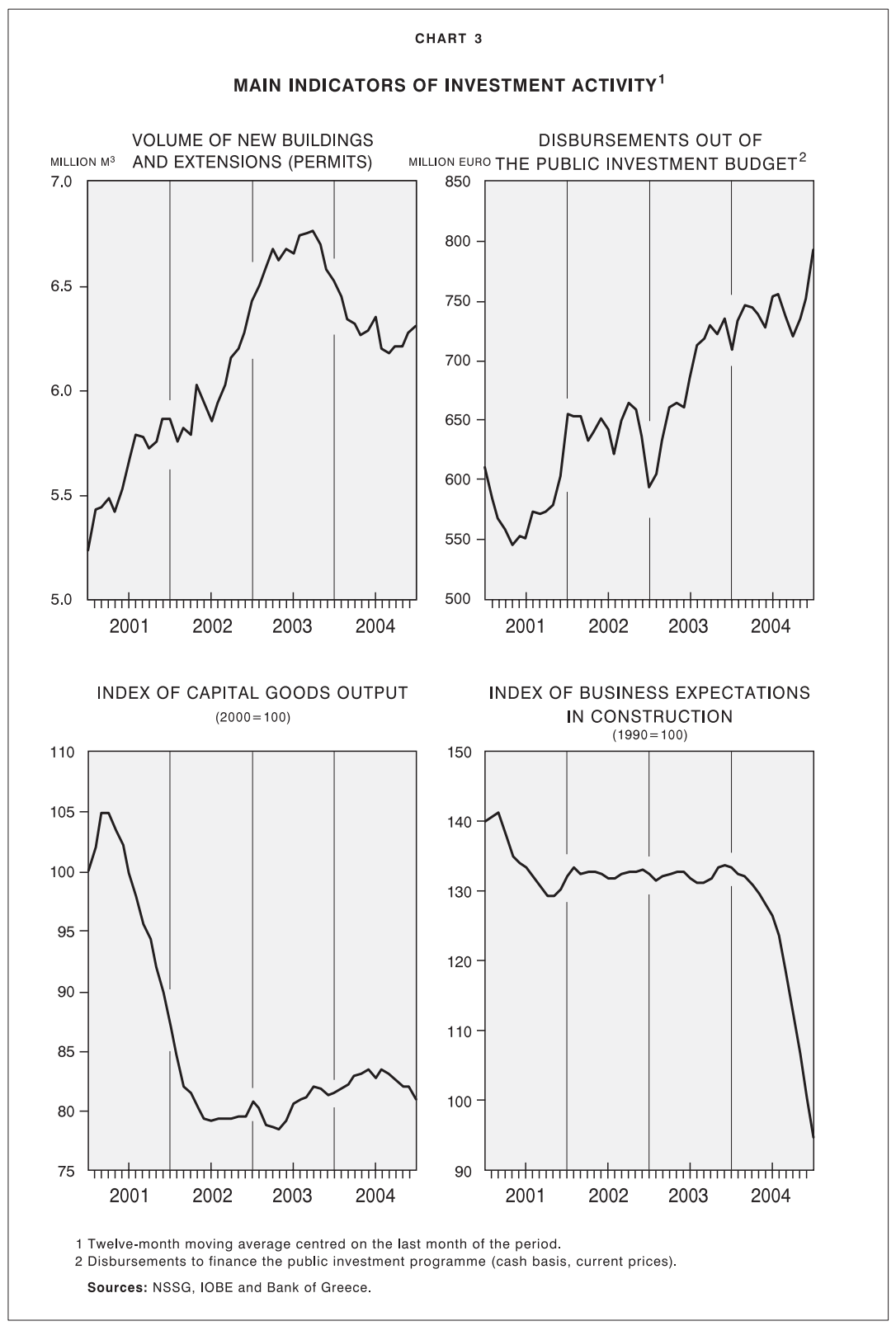
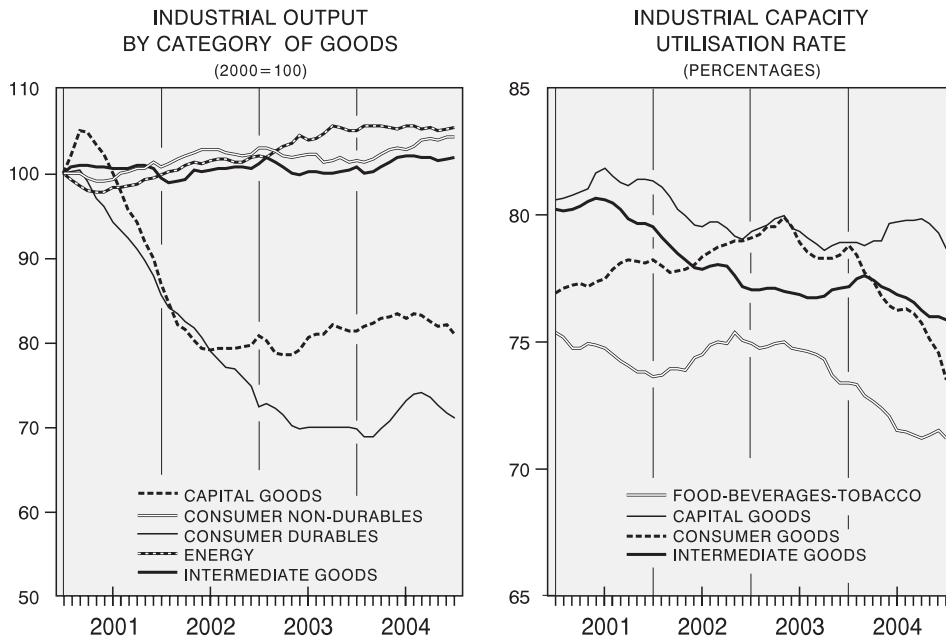


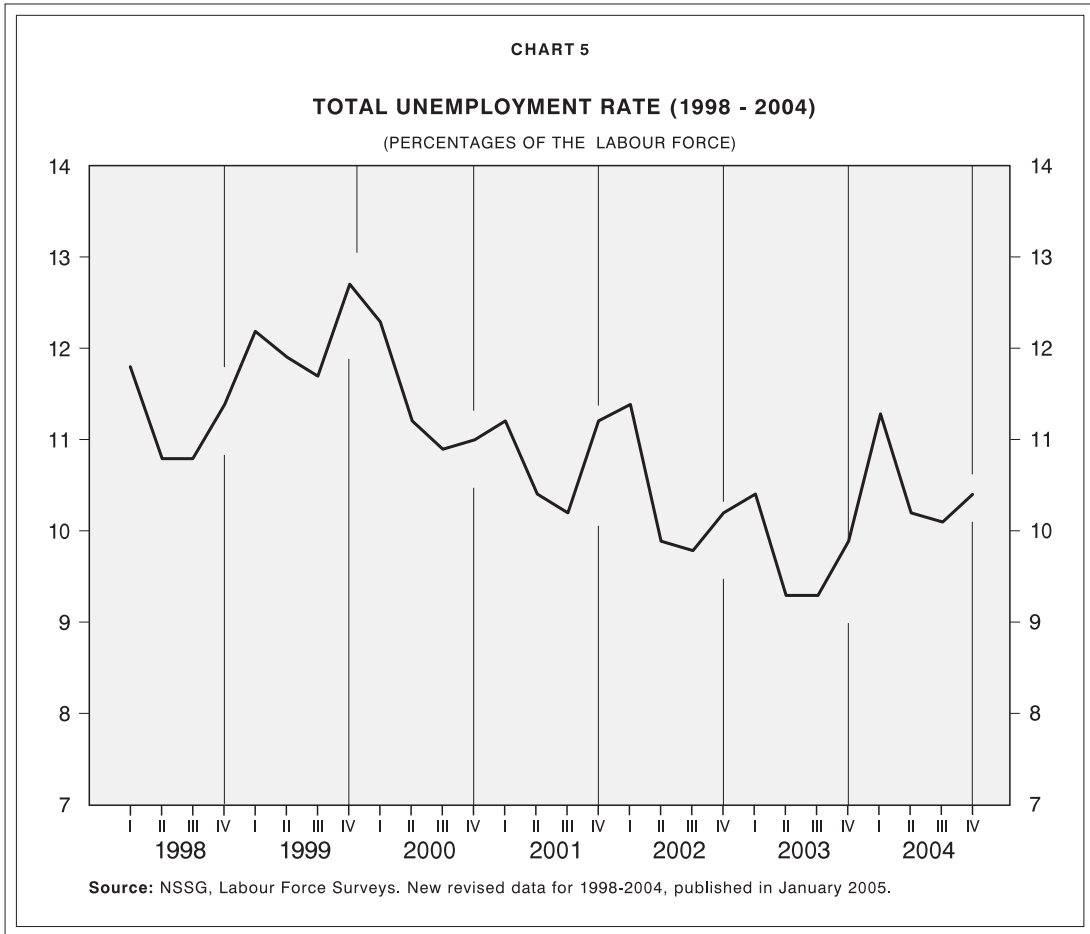
CHART 4

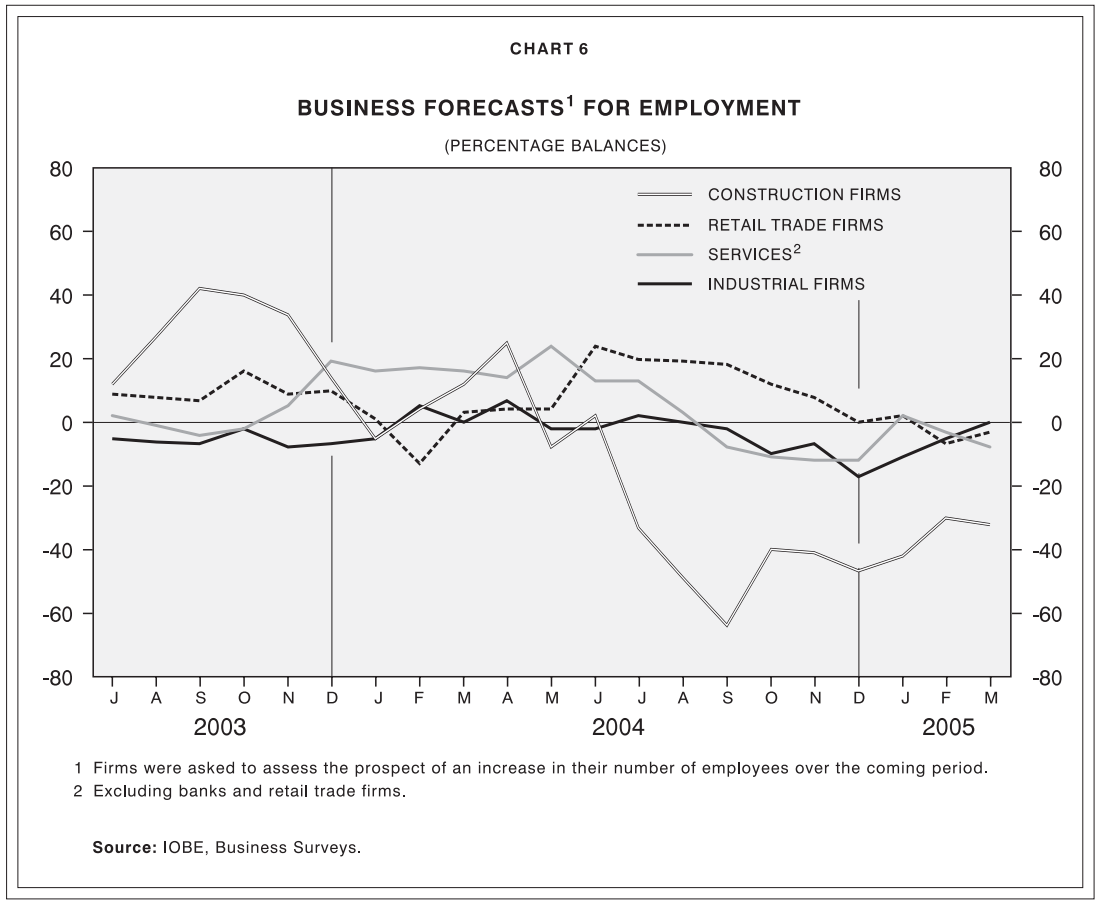
INDICATORS OF INDUSTRIAL PRODUCTION¹



¹ Twelve-month moving average centred on the last month of the period.

Sources: NSSG and IOBE.





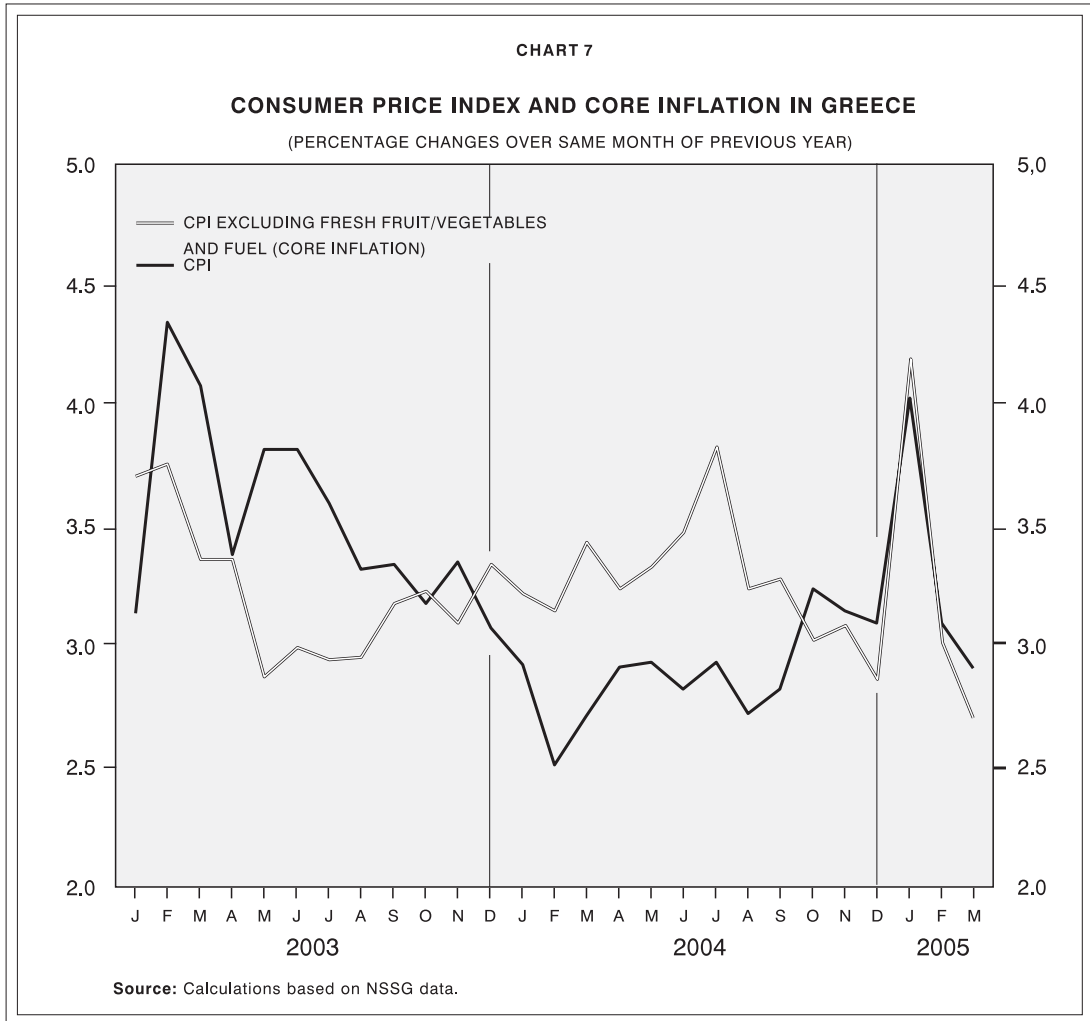
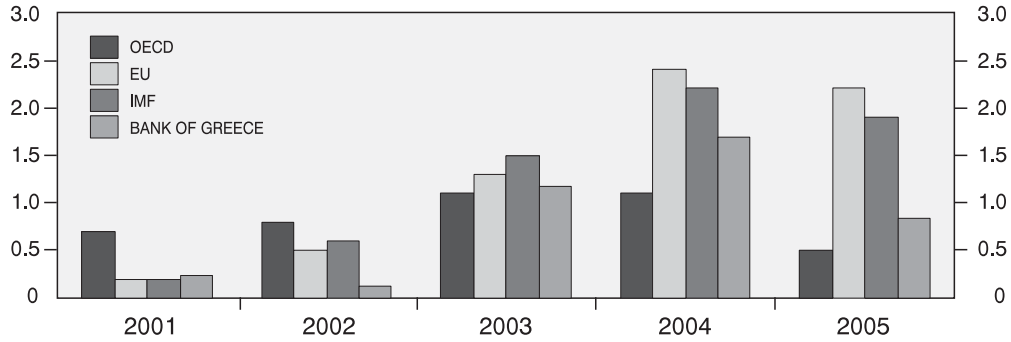


CHART 8

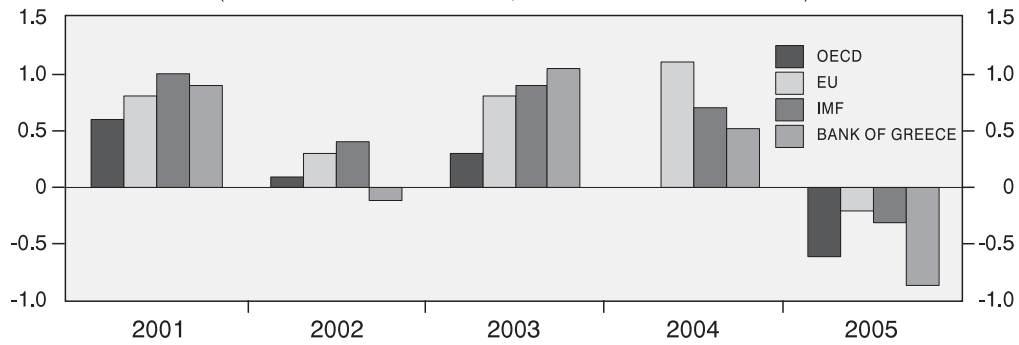
A. THE OUTPUT GAP OF THE GREEK ECONOMY: LEVEL

(PERCENTAGE OF POTENTIAL GDP)

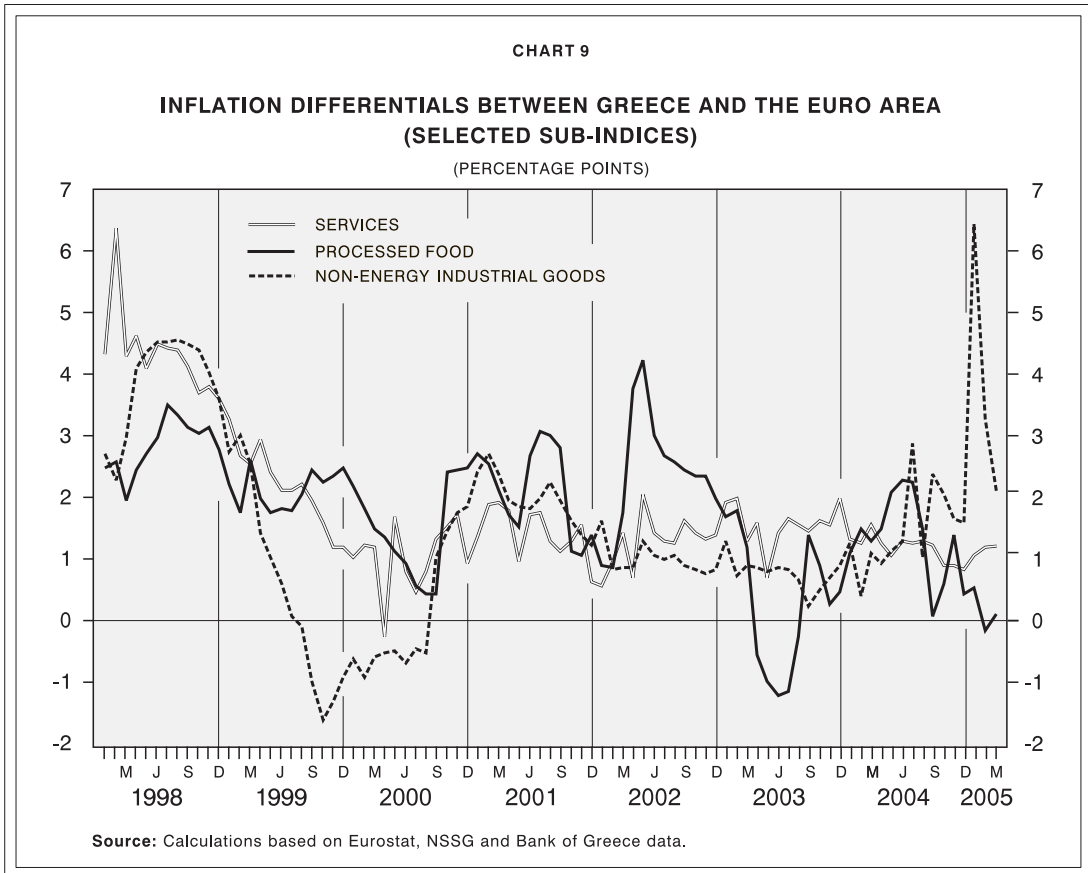


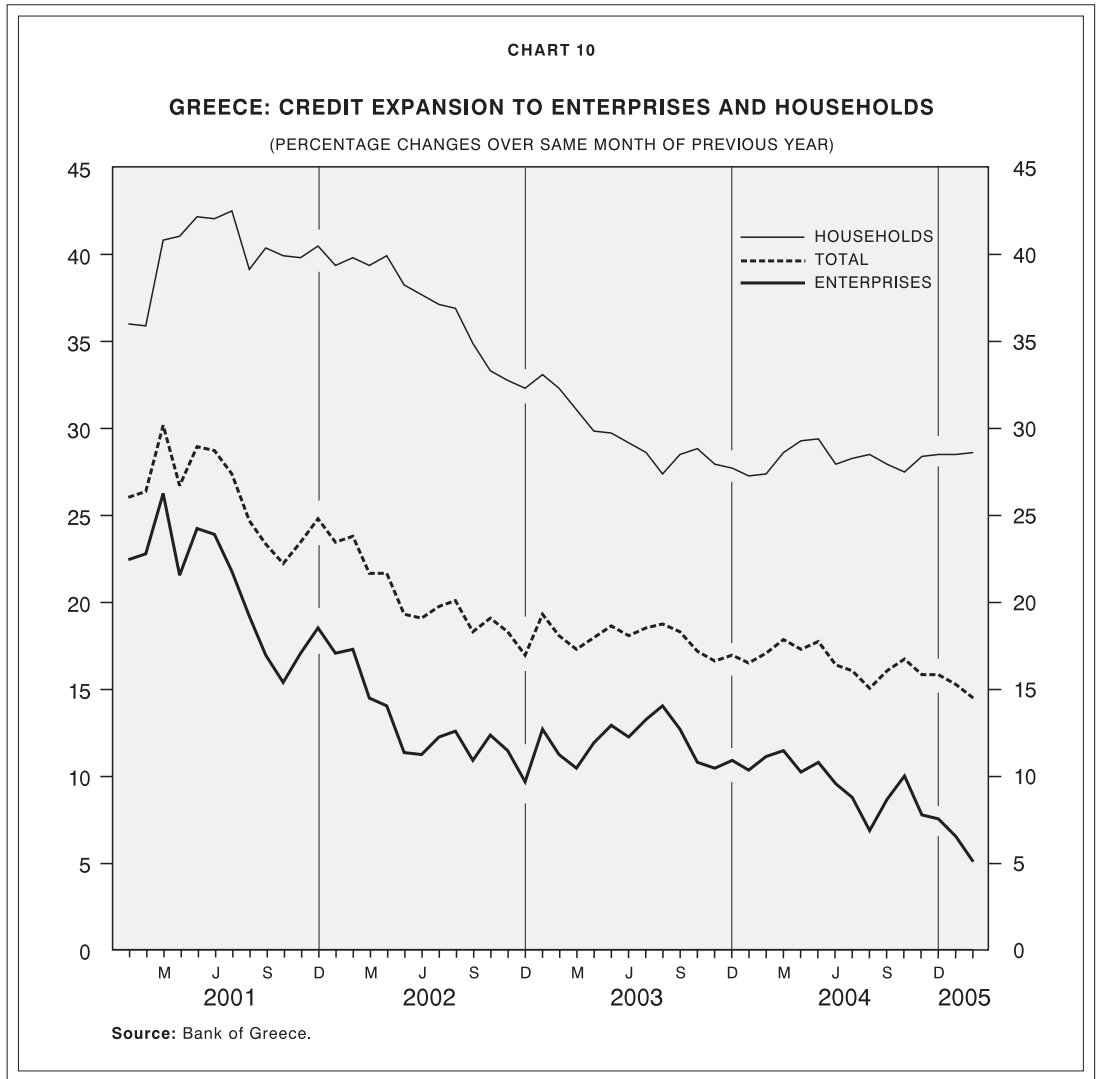
B. THE OUTPUT GAP OF THE GREEK ECONOMY: CHANGES

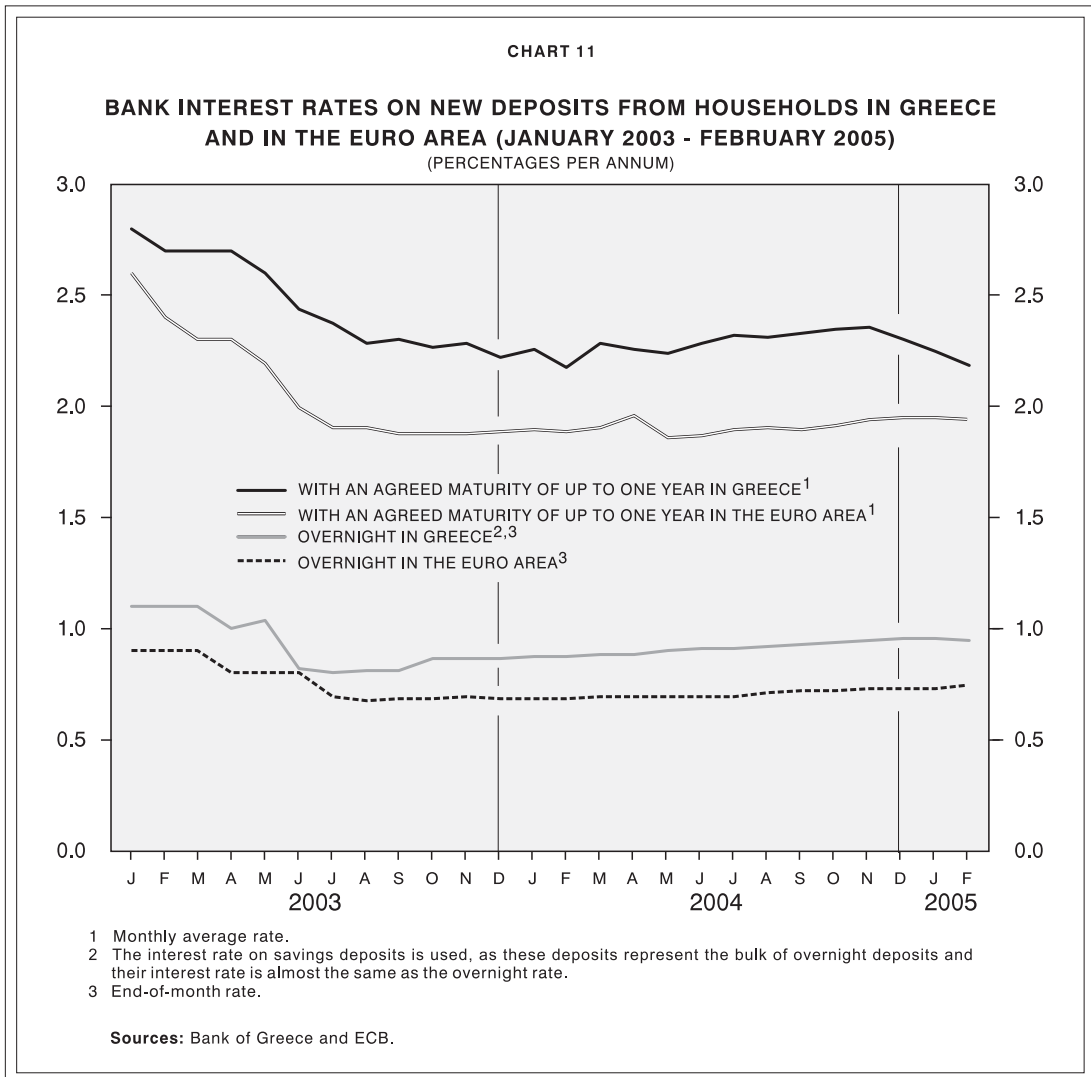
(PERCENTAGE OF POTENTIAL GDP, ANNUAL PERCENTAGE CHANGES)

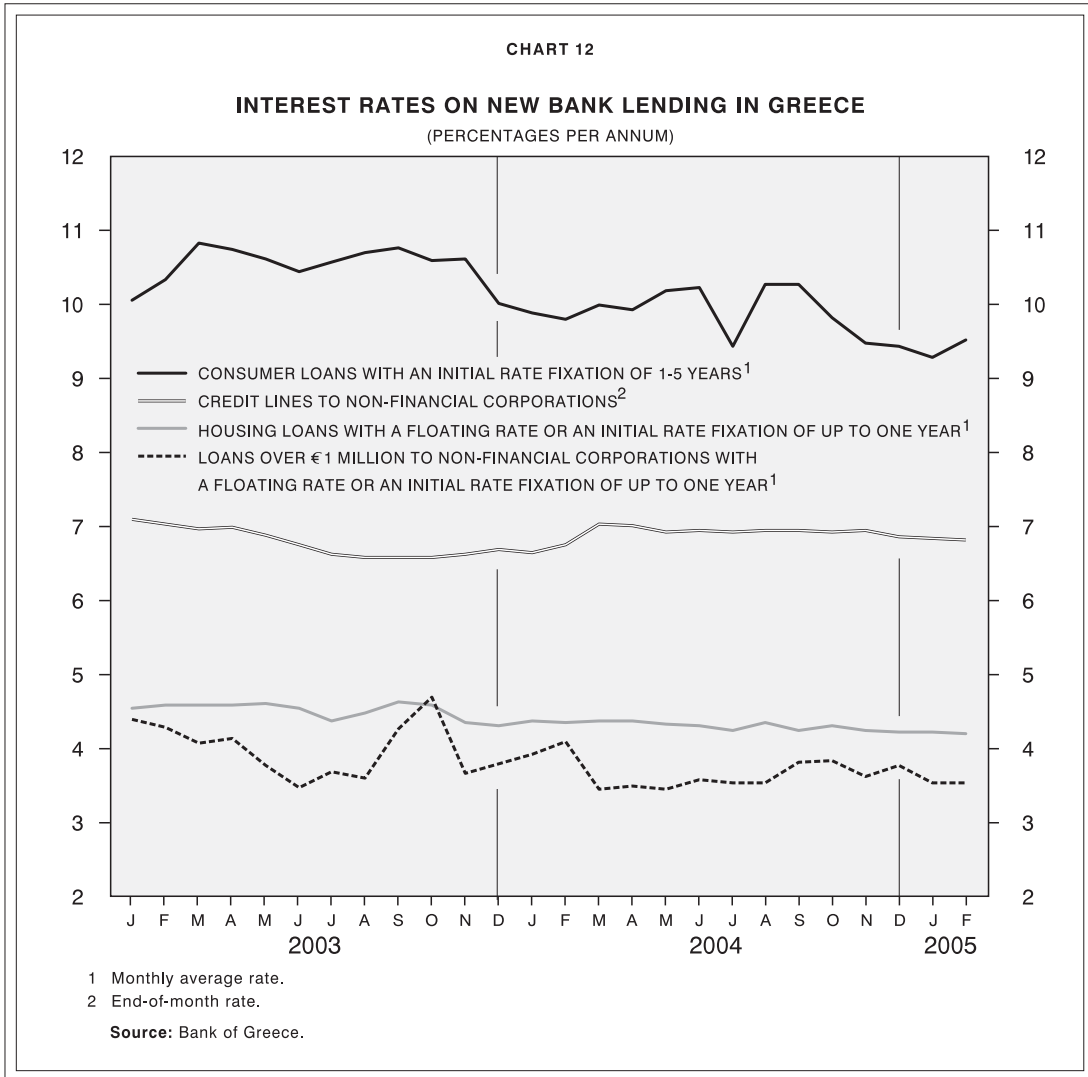


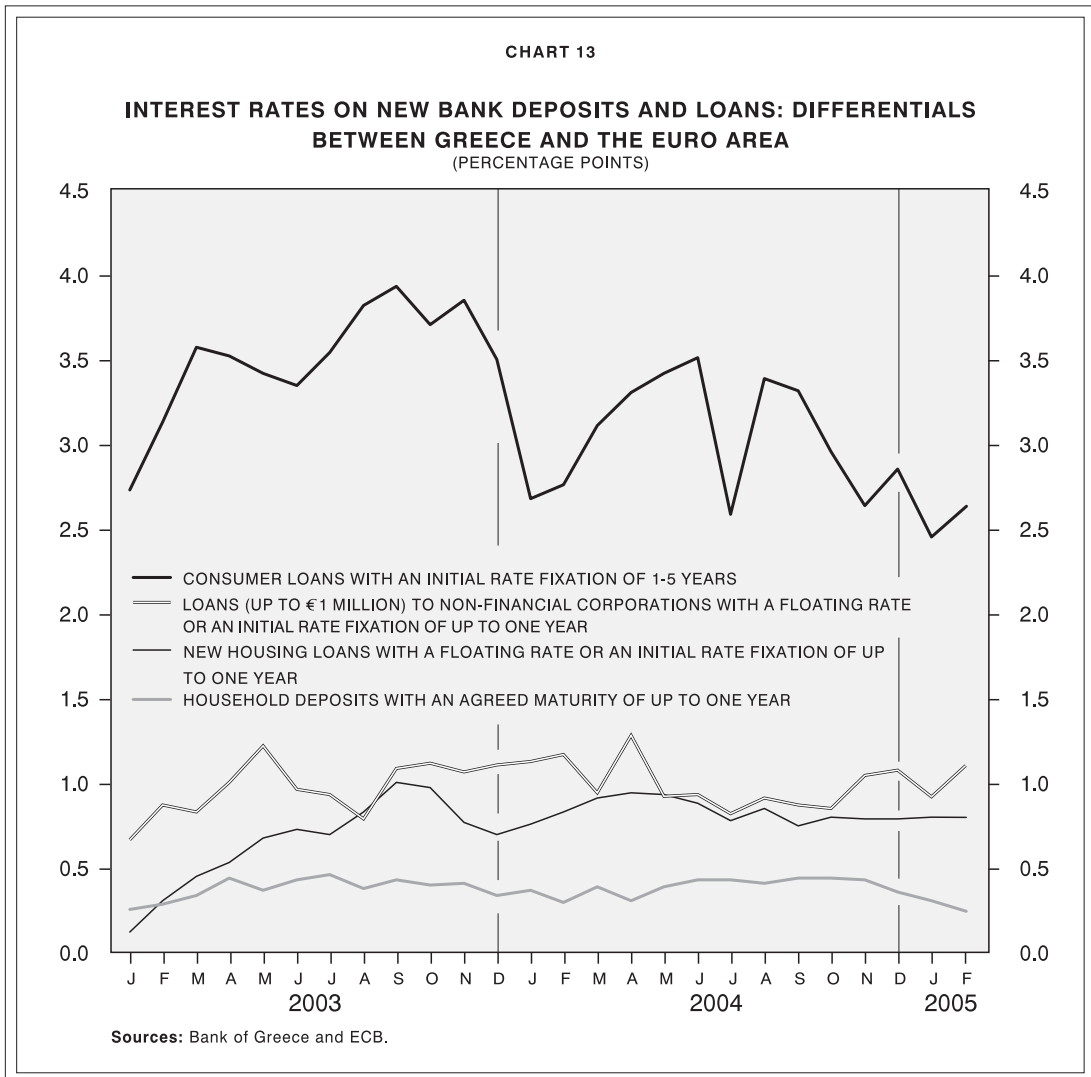
Sources: OECD, *Economic Outlook*, December 2004,
 European Commission, *Spring 2005 Economic Forecasts*,
 IMF, *Greece: 2004 Article IV Consultation - Staff Report*,
 Bank of Greece: Estimates of the Economic Research Department.

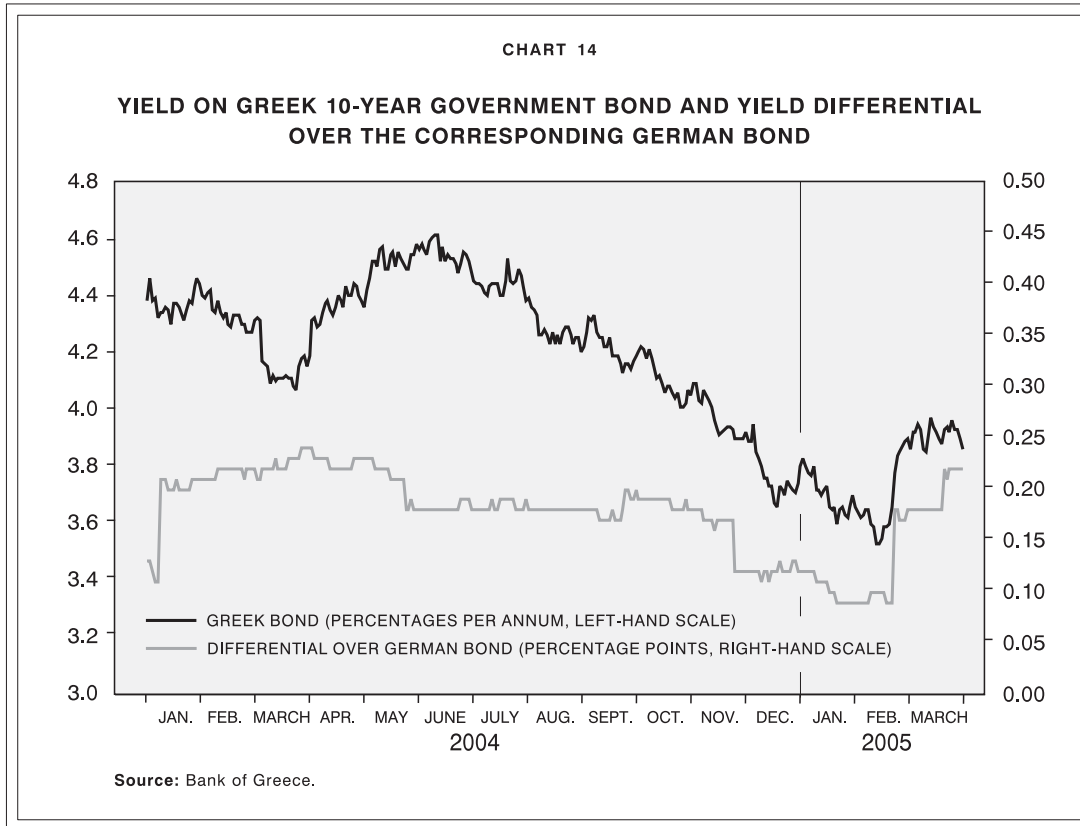


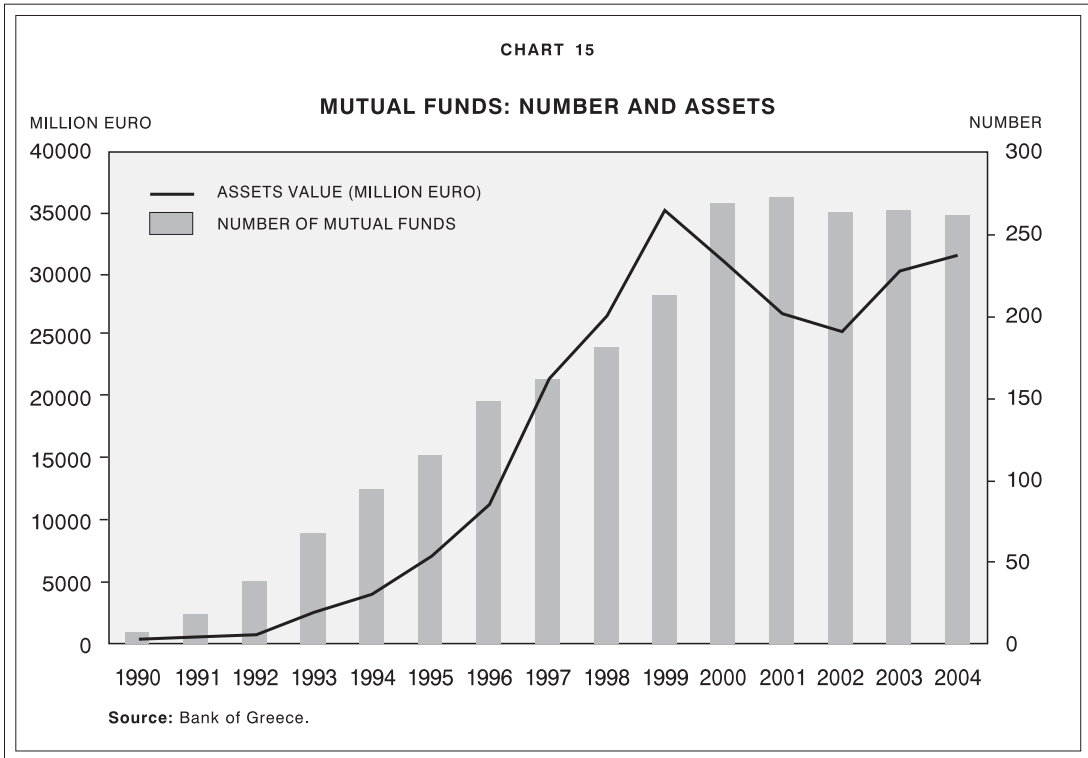












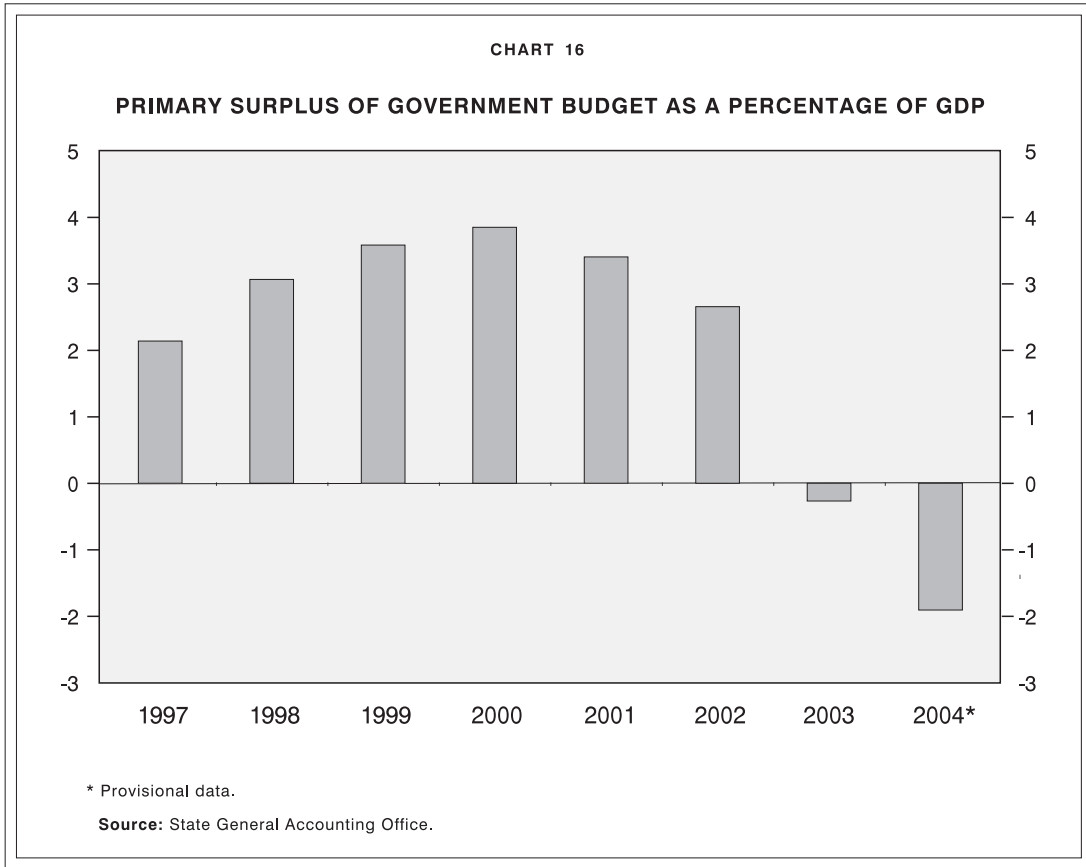
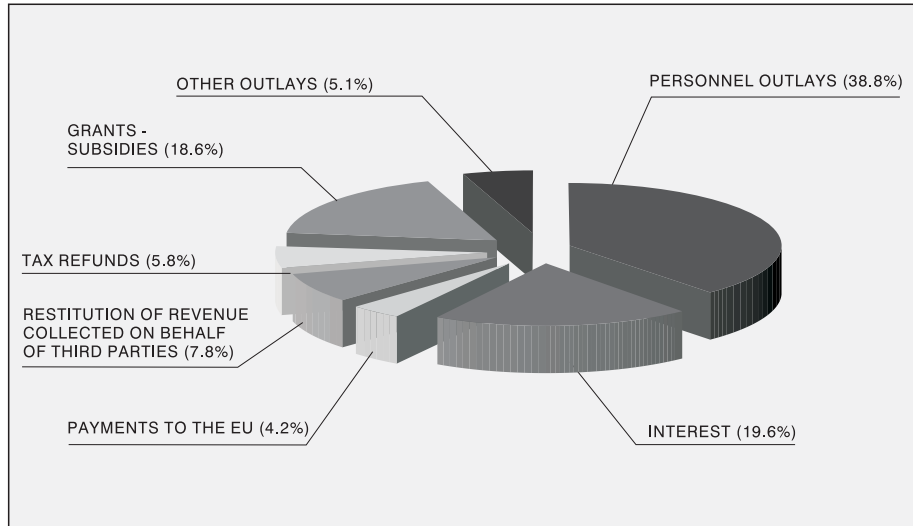


CHART 17

COMPOSITION OF OUTLAYS¹ UNDER THE ORDINARY BUDGET

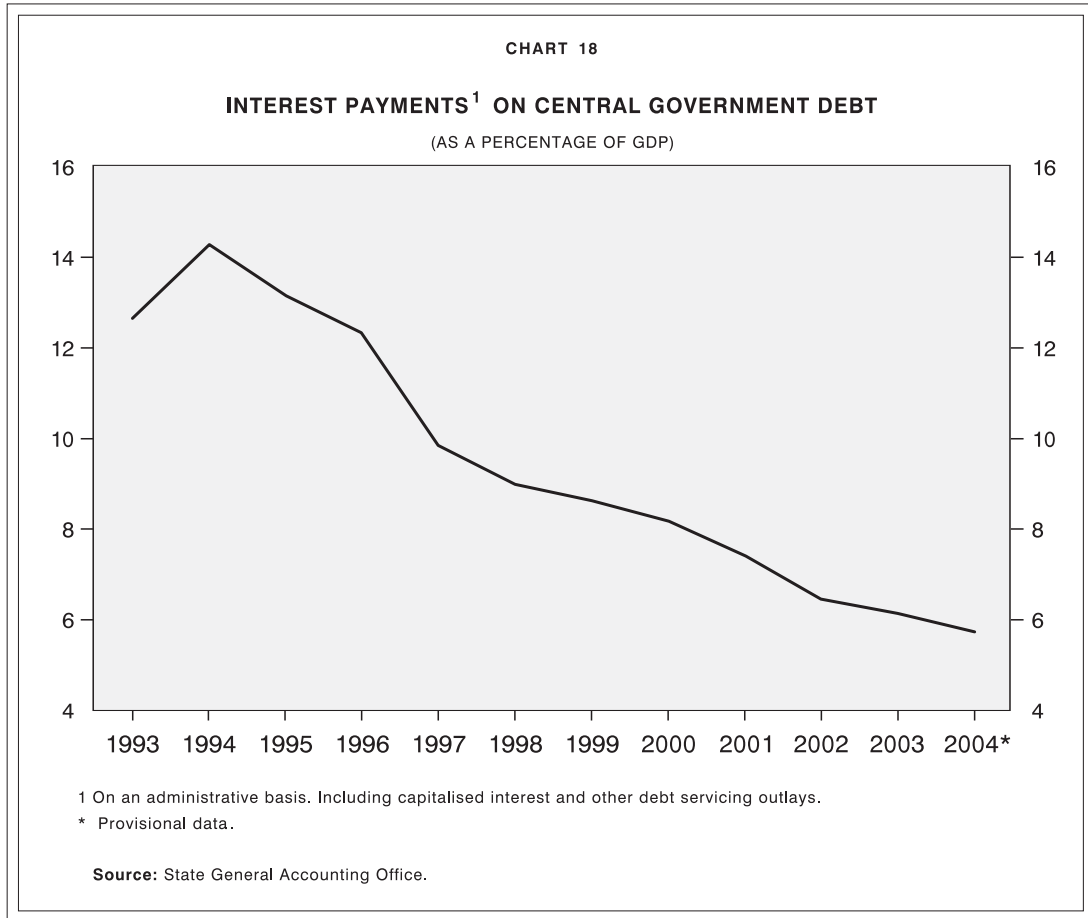
(YEAR 2004*)

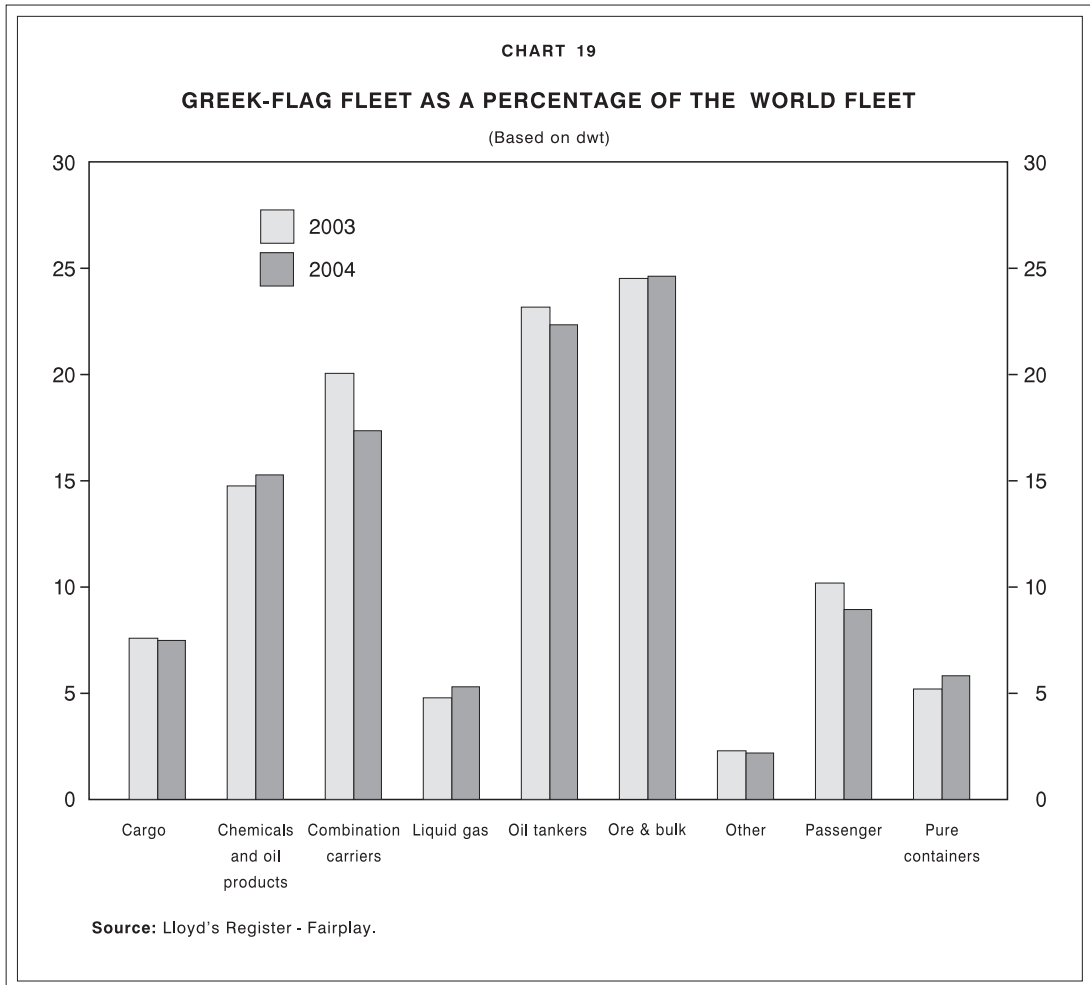


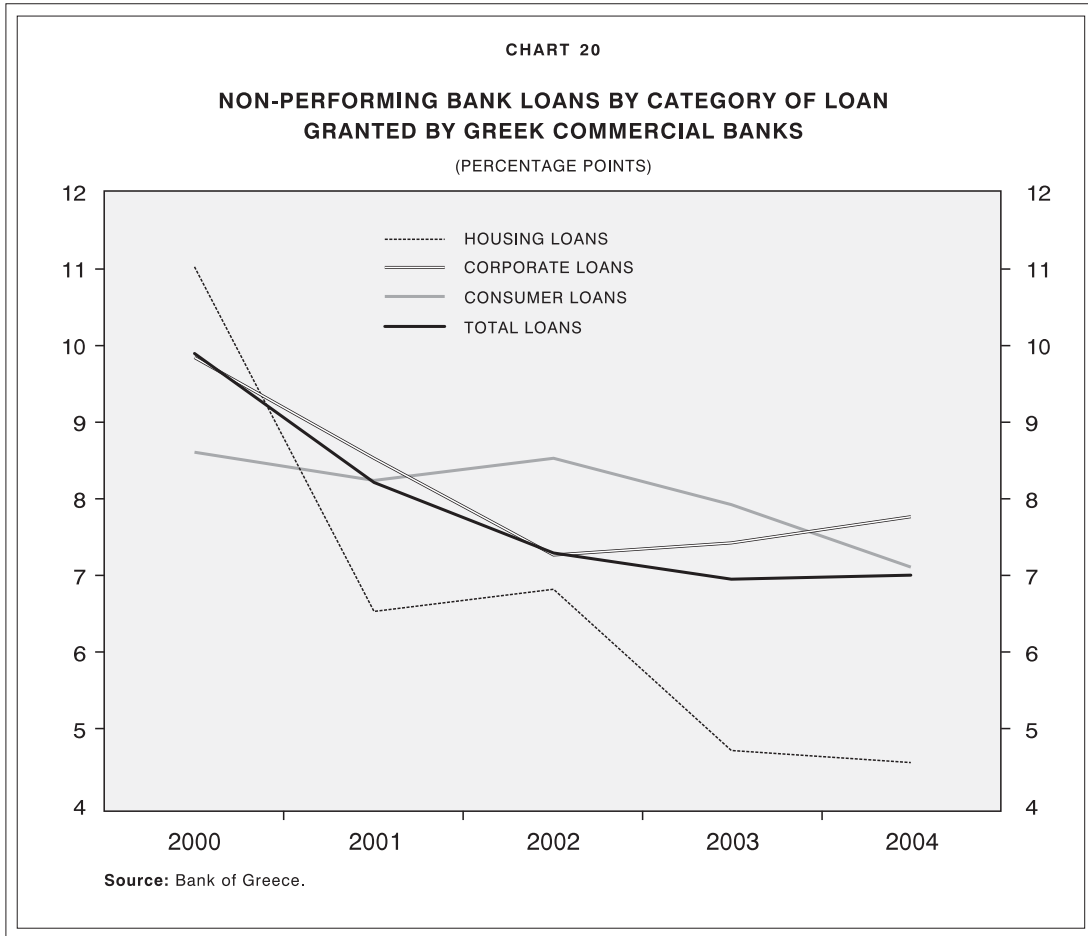
¹ Excluding amortisation payments.

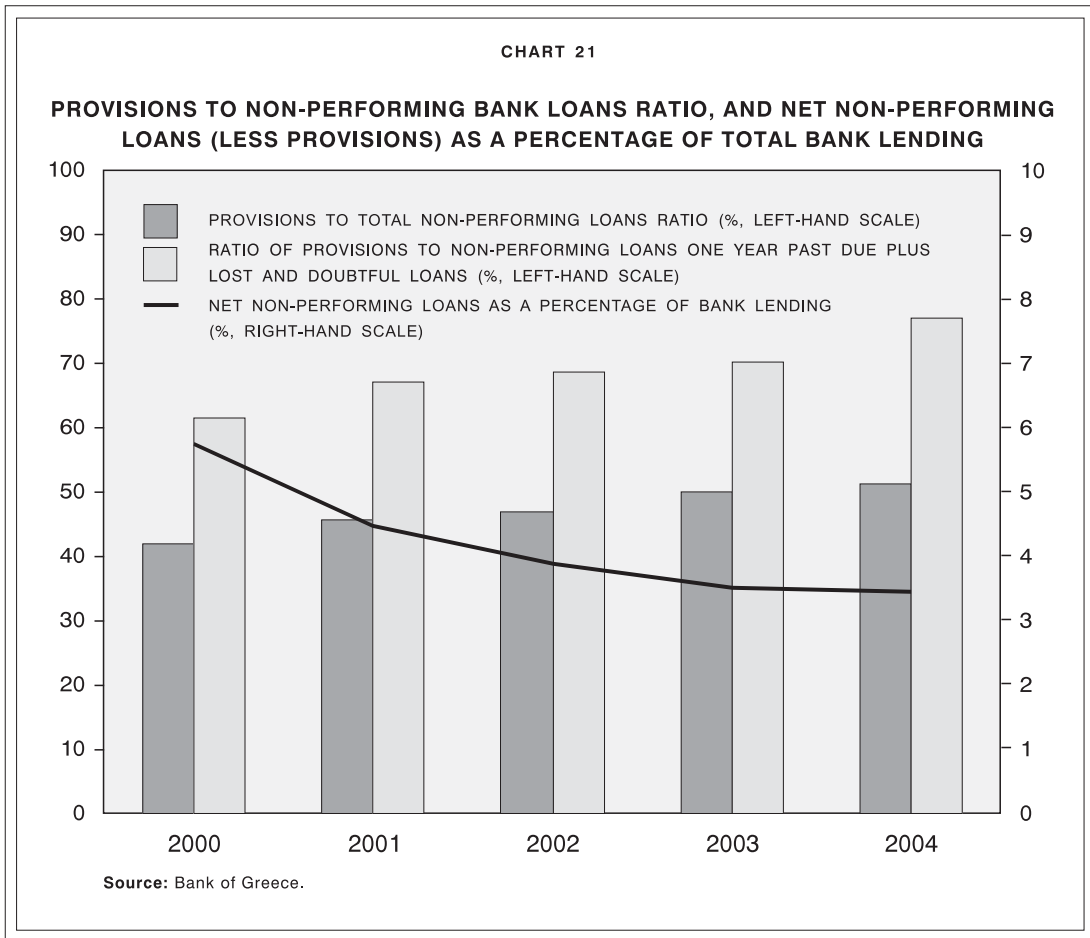
* Provisional data.

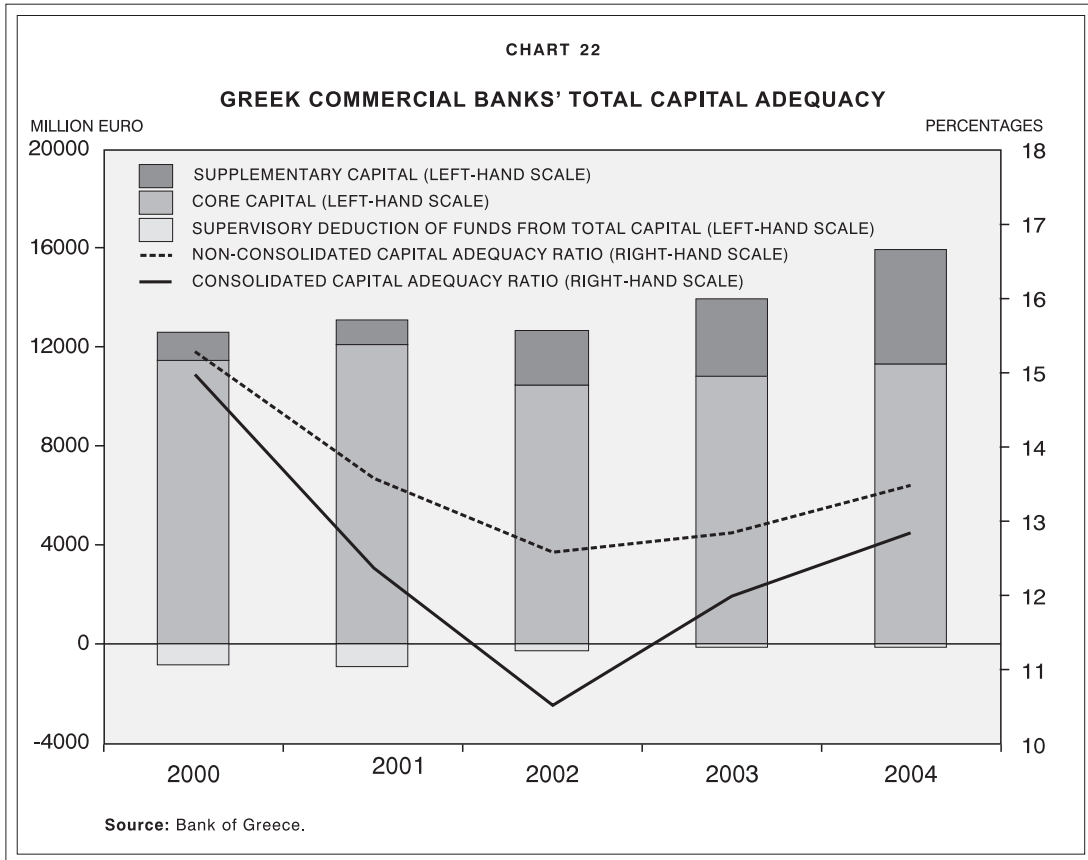
Source: State General Accounting Office.











**ANNUAL ACCOUNTS
OF THE BANK OF GREECE**

BALANCE SHEET AS AT

IN EURO

ASSETS	2 0 0 4	2 0 0 3
1. Gold and gold receivables	1,430,796,271	1,466,081,069
2. Claims on non-euro area residents denominated in foreign currency	902,461,999	3,441,044,109
2.1 Receivables from the IMF	334,351,329	421,272,697
2.2 Balances with banks and security investments, external loans and other external assets	568,110,670	3,019,771,412
3. Claims on euro area residents denominated in foreign currency	1,382,733,073	2,441,720,904
3.1 General government	1,224,358,075	1,313,176,558
3.2 Other claims	158,374,998	1,128,544,346
4. Claims on non-euro area residents denominated in euro	1,196,029,735	520,803,599
4.1 Balances with banks, security investments and loans	1,196,029,735	520,803,599
4.2 Claims arising from the credit facility under ERM II	0	0
5. Lending to euro area credit institutions related to monetary policy operations denominated in euro	201,368,044	4,342,500,000
5.1 Main refinancing operations	48,000,000	4,342,500,000
5.2 Longer-term refinancing operations	153,368,044	0
6. Other claims on euro area credit institutions denominated in euro	767,244,745	98,885,665
7. Securities of euro area residents denominated in euro	6,443,828,060	3,460,870,091
8. General government debt denominated in euro	9,254,374,380	9,848,680,442
8.1 Long-term debt	1,668,806,532	1,853,871,728
8.2 Loans for participation in the IMF	726,634,375	774,878,742
8.3 Long-term loans and securities in euro	6,858,933,473	7,219,929,972
9. Intra-Eurosystem claims	1,449,244,341	1,425,018,195
9.1 Participating interest in the ECB	393,403,998	388,614,874
9.2 Claims equivalent to the transfer of foreign reserves to the ECB	1,055,840,343	1,028,200,000
9.3 Claims related to promissory notes backing the issuance of ECB debt certificates	0	0
9.4 Net claims related to the allocation of euro banknotes within the Eurosystem	0	0
9.5 Net claims related to the TARGET account	0	0
9.6 Other claims within the Eurosystem (net)	0	8,203,321
10. Items in course of settlement	389,343	5,461,849
11. Other assets	6,618,040,175	5,758,944,185
11.1 Coins of euro area	33,287,864	36,198,747
11.2 Tangible and intangible fixed assets	758,842,518	264,620,992
11.3 Other financial assets	4,864,714,102	4,571,873,748
11.4 Accruals and prepaid expenses	577,929,305	535,044,528
11.5 Sundry	383,266,386	351,206,170
TOTAL ASSETS	<u>29,646,510,166</u>	<u>32,810,010,108</u>
OFF-BALANCE-SHEET ITEMS	2 0 0 4	2 0 0 3
1. Investment in Greek government securities on behalf of public entities (legal persons in public law, social security funds in public and private law)	15,218,519,470	12,388,376,153
2. Investment in Greek government securities and other debt securities on behalf of public entities, social security funds and private agents	8,723,342,399	7,824,960,029
3. Other off-balance-sheet items	2,606,875,223	6,830,752,773
TOTAL OFF-BALANCE-SHEET ITEMS	<u>26,548,737,092</u>	<u>27,044,088,955</u>
NOTES:		
1. Under Article 54A of the Bank's Statute, the balance sheet was drawn up in compliance with the rules and accounting practices determined by the European Central Bank (ECB) and applying to the members of the European System of Central Banks (ESCB).		
2. Claims/liabilities denominated in euro or foreign currencies are broken down into claims on/liabilities to euro area residents and non-euro area residents.		
3. Account balances related to monetary policy operations are shown under separate items.		
4. The value of gold has been calculated on the basis of the euro price of the gold ounce (€321.562), according to the ECB's foreign exchange rate list of 31 December 2004.		
5. Claims and liabilities in foreign currencies have been converted into euro on the basis of the exchange rates published in the ECB's foreign exchange rate list of 31 December 2004.		

LIABILITIES	2 0 0 4	2 0 0 3
1. Banknotes in circulation	12,238,189,655	10,079,150,900
2. Liabilities to euro area credit institutions related to monetary policy operations denominated in euro	5,234,280,080	2,403,901,409
2.1 Current accounts (covering the minimum reserve system)	5,233,450,080	2,399,726,409
2.2 Deposit facility	830,000	4,175,000
3. Other liabilities to euro area credit institutions denominated in euro	0	198,000
4. Liabilities to other euro area residents denominated in euro	1,211,444,873	367,598,758
4.1 General government	1,196,313,972	351,027,564
4.2 Other liabilities	15,130,901	16,571,194
5. Liabilities to non-euro area residents denominated in euro	648,506,465	604,726,683
6. Liabilities to euro area residents denominated in foreign currency	127,832,903	207,530,978
7. Liabilities to non-euro area residents denominated in foreign currency	536,364,014	551,060,434
7.1 Deposits and other liabilities	536,364,014	551,060,434
7.2 Liabilities arising from the credit facility under ERM II	0	0
8. Counterpart of special drawing rights allocated by the IMF	117,993,482	121,971,446
9. Intra-Eurosystem liabilities	6,966,258,551	16,069,321,621
9.1 Liabilities related to promissory notes backing the issuance of ECB debt certificates	0	0
9.2 Net liabilities related to the allocation of euro banknotes within the Eurosystem	416,930,960	716,252,165
9.3 Net liabilities related to the TARGET account	6,545,889,704	15,353,069,456
9.4 Other liabilities within the Eurosystem (net)	3,437,887	0
10. Items in course of settlement	20,769,508	30,810,822
11. Other liabilities	973,095,264	1,126,362,505
11.1 Accruals and income collected in advance	133,340,775	191,115,949
11.2 Sundry	839,754,489	935,246,556
12. Provisions	821,921,817	181,436,025
13. Revaluation accounts	123,871,662	374,327,194
14. Capital and reserves	625,981,892	691,613,333
14.1 Capital	66,746,019	66,746,019
14.2 Ordinary reserve	66,746,019	66,746,019
14.3 Special reserve from the revaluation of real estate under Law 3229/2004	492,267,534	0
14.4 Special reserves	222,320	558,121,295
TOTAL LIABILITIES	<u>29,646,510,166</u>	<u>32,810,010,108</u>

6. The value of securities has been calculated on the basis of their prices as at 31 December 2004, except for the securities included in asset item 11.3 "Other financial assets", which have been valued at cost. The Greek government debt securities and part of the debt securities of euro area countries, which are fixed investment to be held until their maturity date, have been transferred from asset item 7 "Securities of euro area residents denominated in euro" to the above item 11.3. To ensure comparability, the corresponding items of financial year 2003 have been reclassified accordingly.

7. In financial year 2004, the undepreciated value of the Bank's real estate was adjusted, under Article 15 of Law 3229/2004, at its fair (market) value, as determined by independent appraisers. The resulting surplus value of €492,267,534 was transferred to the "Special reserve from the revaluation of real estate under Law 3229/2004" item. In the previous years, real estate was valued at cost, as adjusted under Law 2065/92.

8. The subscription key of the Bank of Greece to the ECB's capital – following the two adjustments in 2004 – was set at 1.8974%, from 2.0564% in 2003, and the weighted subscription key of the Bank of Greece to the ECB's capital fully paid by the 12 national central banks of the Eurosystem was set at 2.65405%, from 2.53894% in 2003.

PROFIT AND LOSS ACCOUNT

IN EURO

DEBIT	2 0 0 4	2 0 0 3
STAFF COSTS	238,376,244	226,542,368
Wages and salaries	126,350,375	121,887,566
Employer's contributions and other levies		
To the Health Insurance Fund	12,246,167	11,208,669
To the Pension Fund	29,739,637	29,596,749
To the Supplementary Pension Fund	12,186,812	12,186,041
Contributions to other insurance funds and other charges	11,290,889	9,143,215
Pensions and benefits	46,562,364	42,520,128
ADMINISTRATIVE AND OTHER EXPENSES	37,552,145	43,131,840
DEPRECIATION OF TANGIBLE AND INTANGIBLE FIXED ASSETS	34,613,846	19,700,525
OPERATING PROVISIONS	82,476,430	21,716,267
Provision under Article 71 of the Statute	11,152,473	11,487,360
Provision for the Bank's future liabilities to the Personnel's		
Social Security Funds	35,000,000	10,000,000
Provision, against monetary income, for the Bank's participation		
in the coverage of the ECB's loss for financial year 2004	36,095,050	0
Sundry provisions	<u>228,907</u>	<u>228,907</u>
	393,018,665	311,091,000
NET PROFIT	<u>205,605,304</u>	<u>218,259,837</u>
	<u>598,623,969</u>	<u>529,350,837</u>

FOR THE YEAR 2004

SEVENTY-SEVENTH YEAR

CREDIT	2004	2003
NET INTEREST INCOME	325,922,104	270,809,782
NET RESULT OF FINANCIAL OPERATIONS	3,873,348	27,898,860
NET INCOME FROM FEES AND COMMISSIONS	141,630,119	117,786,711
INCOME FROM EQUITY SHARES AND PARTICIPATING INTERESTS	2,459,420	2,689,516
NET RESULT OF POOLING OF MONETARY INCOME	10,795,758	21,729,366
<u>OTHER INCOME</u>	<u>113,943,220</u>	<u>88,436,602</u>
	<u><u>598,623,969</u></u>	<u><u>529,350,837</u></u>

DISTRIBUTION OF NET PROFIT

(Article 71 of the Statute)

(in euro)

	2004	2003
Dividend on capital, euro 0.67 per share on 11,918,932 shares	7,985,684	7,985,684
Additional dividend, euro 2.18 per share on 11,918,932 shares*	25,983,272	21,811,646
Tax payment (Law 3296/2004, Article 6)	18,290,976	16,044,716
To the Government	<u>153,345,372</u>	<u>172,417,791</u>
	<u><u>205,605,304</u></u>	<u><u>218,259,837</u></u>

* The dividend on capital and the additional dividend for the year 2003 were euro 0.67 and euro 1.83 respectively per share (in total, euro 2.50)

Athens, 18 March 2005

THE GOVERNOR

THE DIRECTOR OF THE ACCOUNTS DEPARTMENT

NICHOLAS C. GARGANAS

DIMITRIOS E. MATSIMANIS

AUDITORS REPORT

FOR THE YEAR 2004

TO THE GENERAL MEETING OF SHAREHOLDERS
OF THE
BANK OF GREECE

We have audited the attached financial statements of “BANK OF GREECE S.A.” for the year ended 31 December 2004. The management of BANK OF GREECE S.A. is responsible for the preparation of the above financial statements. Our responsibility is to express an opinion upon these financial statements, based on our audit.

We conducted our audit in accordance with the audit procedures we considered appropriate on the basis of the auditing principles and rules promulgated by the Greek Institute of Certified Auditors – Accountants. These auditing principles require that we plan and perform our audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit, also, includes assessing the accounting principles used and significant estimations made by the Bank’s management as well as evaluating the overall Financial Statement Presentation. We believe that our audit provides a reasonable basis for our opinion.

Based on our audit we noted that in the year ended 31 December 2004 the Bank increased the provision for future liabilities to Employee Funds by €593 million, out of which €35 million were charged to the Income Statement and €558 million were transferred from transition reserves. Consequently, the recorded provision amounts to €660 million, but we cannot assess its adequacy.

In our opinion, except for the above finding, the attached Financial Statements give a true and fair view of the financial position of BANK OF GREECE S.A. as at 31 December 2004, and the results for the year then ended, on the basis of the accounting principles determined by the European Central Bank as they have been adopted by the Bank in Article 54A of its Statute and Codified Law 2190/1920, and are consis-

tent with those applied by the Bank in the preceding year, apart from note 7 made by the Bank.

Athens, 18 March 2005

The Auditors

ERNST & YOUNG S.A.

N. Moustakis
(ICPA Reg. No. 13971)

D. Xenaki

(ICPA Reg. No. 14161)

SOL S.A.

C. Stathakis
(ICPA Reg. No. 12251)

 **ERNST & YOUNG**

