BANK OF GREECE

MONETARY POLICY

INTERIM REPORT 2004

OCTOBER 2004

BANK OF GREECE
21, E. Venizelos Avenue
GR-102 50 Athens

www.bankofgreece.gr

Economic Research Department - Secretariat
Tel. +30 210 320 2392
Fax +30 210 323 3025

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

ISSN 1108 - 2690

BANK OF GREECE

MONETARY POLICY

INTERIM REPORT 2004

OCTOBER 2004

To the Greek Parliament and
the Council of Ministers

This Interim Report on Monetary Policy, submitted to the Greek Parliament and the Council of Ministers in accordance with the Statute of the Bank of Greece, reviews economic developments in the euro area and Greece during the current year – the fourth since our country adopted the euro and the single monetary policy. The Report is summarised in Chapter I.

Chapter II examines the international economic environment of the euro area in 2004 and presents estimates for the year as a whole. In addition, it analyses monetary developments and the course of inflation and economic activity in the euro area. As regards the international environment, it is pointed out that conditions in the world economy have improved further in 2004, while at the same time economic growth has accelerated in all major economies despite the existence of considerable geopolitical and economic uncertainties. With respect to the euro area, economic recovery continues —albeit rather slowly— and prospects for 2005 are favourable. Inflation in the euro area, after reaching a four-year low in the first quarter of 2004, climbed above 2% in the last few months affected by the rise in oil prices, but is expected to decline in 2005. The European Central Bank has kept its key interest rates unchanged since June 2003, judging that the overall economic prospects —despite the risks mentioned in Chapter II.3— remain in line with price stability over the medium term and that the historically low level of interest rates lends support to economic activity. Nevertheless, the ECB will remain vigilant with regard to all developments that could imply risks to price stability over the medium term.

Chapter III discusses developments in inflation, economic activity, the balance of payments and employment in Greece. Inflation in Greece has slowed down, but only on account of temporary exogenous factors (mainly the big fall in fresh fruit and vegetable prices). In contrast, core inflation remains at high levels and has trended upwards since the second half of 2003. Real GDP is expected to grow at a quick pace (by around 4%) in 2004, for the eighth successive year. The current account deficit as a percentage of GDP is expected to narrow to some extent, remaining however relatively large. Employment continues to rise this year, but the rate of unemployment is still very high. Chapter IV examines in detail the evolution of the key fiscal aggregates in the light of the recent revisions of relevant data and the further relaxation of fiscal policy. Chapter V discusses developments in the money, credit and capital markets in Greece.

With a view to providing fuller information to the Greek Parliament and the Council of Ministers, the Report includes special presentations concerning the role of fiscal policy in a monetary union, the indicators of the fiscal policy stance and the growth of consumer credit in Greece.

The last chapter sums up the conclusions. The Report notes that the Greek economy has continued to grow strongly in 2004 for the eighth consecutive year. However, considerable fiscal imbalances and unfavourable developments in unit labour costs are strengthening inflationary pressures and eroding external competitiveness. Thus, if not addressed in time, they could threaten medium-term growth prospects. The Report stresses that the sustainability of high economic growth rates over the medium term —which is also a condition for dealing with the serious problem of unemployment and ensuring real convergence—

necessitates above all that fiscal imbalances are decisively and effectively tackled. The Greek government's aim to reduce the general government deficit to 2.8% of GDP in 2005 is satisfactory and implies a substantial immediate correction of fiscal imbalances. Obviously, for this to be achieved, the fiscal policy measures that have been announced must be concretised and implemented decisively and coherently. Furthermore, as it has been repeatedly stressed by the Bank of Greece in the past, it is necessary to speed up structural reforms in a wide range of economic sectors. This will increase the productive potential of the economy and the effectiveness of macroeconomic policy and will bolster investor confidence, with positive effects on growth and employment. At the same time, the social partners must contribute to higher productivity and continued wage moderation so as to help reduce unit labour cost growth and inflation, thereby enhancing the country's international competitiveness.

Nicholas C. Garganas
Governor

Athens, October 2004

Monetary Policy Council of the Bank of Greece

Chairman

Nicholas C. Garganas

Members

Panayotis A. Thomopoulos

Nicholas D. Paleocrassas

Vassilis S. Droucopoulos

Antonis G. Mantzavinos

Georgios E. Oikonomou

Contents

Charts

Tables

Tables - Charts of Appendix to Chapter V

Boxes

I. Summary

In the first three quarters of 2004, which was the fourth year since Greece adopted the euro and the single monetary policy, the Governing Council of the European Central Bank (ECB) kept key ECB interest rates unchanged at the levels to which they had been lowered on 6 June 2003.[1] Specifically, taking into account that the economic recovery is gradual and making the assesment that inflationary pressures from rising oil prices are likely to be temporary, the Governing Council considers that, although some upside risks to price stability exist (as discussed in Chapter II.3 below), the overall prospects remain in line with price stability over the medium term and that the historically low level of interest rates lends support to economic activity. The ECB will, however, remain vigilant with regard to all developments that could imply risks to price stability over the medium term.

Money market interest rates in the *euro area* have remained quite low, in line with the evolution of key ECB interest rates. Specifically, interest rates at shorter maturities remained virtually unchanged in the first three quarters of 2004, while interest rates at the longer end of the maturity spectrum, in spite of a temporary increase in the second quarter of 2004, stood at close to end-2003 levels in September. Euro area government bond yields followed a similar course, reflecting market expectations of an economic recovery in the euro area. Finally, the deposit and lending rates of Monetary Financial Institutions (MFIs) in the euro area fluctuated slightly, but remained at historically low levels.

The annual growth rate of euro area M3 continued to slow down in the period under review, as a

1 On 6 June 2003, the minimum bid rate on the main refinancing operations and the interest rates on the marginal lending facility and the deposit facility were lowered to 2%, 3% and 1% respectively.

result of gradual portfolio shifts towards longer-term assets wich reflected the improvement in financial market conditions. The annual growth rate of loans to the private sector, which account for the bulk of total credit expansion, accelerated to 5.5-6% in the first eight months of the year, reflecting improved conditions in the loan market and in the overall economic environment in the euro area. The ECB continues to consider that there remains substantially more liquidity in the euro area than is needed to finance non-inflationary growth and that this could have an upward impact on inflation. The Governing Council of the ECB is thus monitoring these developments carefully.

In *Greece*, the main components of the Greek contribution to euro area M3[2] (excluding currency in circulation) grew, as a whole, during the first half of 2004 at roughly the same pace as in the last quarter of 2003, and then at a slightly quicker pace in July and August. Throughout these eight months, however, their growth rate was higher in Greece than in the euro area, reflecting private (non-financial sector) portfolio shifts away from assets not included in M3 (e.g. government securities) towards deposits, whereas amongst euro area investors the opposite trend prevailed.

The annual growth rate of deposits included in M3 picked up slightly in the first half of the year, but moderated somewhat in July and August (August 2004: 11.1%, fourth quarter of 2003: 12.2%). Specifically, the relatively low opportunity cost of holding money (due to low interest rates on deposits), combined with expectations of a future increase in euro area interest rates, contributed to a significant acceleration in the growth of short-term (overnight) deposits. In contrast, the growth rate of time deposits with an agreed maturity of up to two years slackened significantly, as investors refrained from tying up their funds over relatively long time periods. An important slowdown was also recorded in the growth rate of money market fund shares/units, while the rate of decline in repo holdings weakened considerably.

The year-on-year growth rate of total credit extended by Monetary Financial Institutions (MFIs – i.e. banks and money market funds) strengthened considerably in the first eight months of 2004, rising to 7.8% in August 2004 from 3.2% in the fourth quarter of 2003. This acceleration is attributed to developments in MFI financing to general government, which continued to decrease in the first eight months of 2004, though at a much slower pace than in 2003 (August 2004: –5.6%, fourth quarter of 2003: –15.9%). In contrast, the annual rate of credit expansion to non-financial enterprises and households eased somewhat during the period under review (August 2004: 15.0%, fourth quarter of 2003: 17.1%), but still remains high.

In more detail, the annual growth rate of loans to enterprises fell to 6.9% in August 2004 from 11% in the fourth quarter of 2003, owing to a considerable slowdown in credit expansion to industry and, particularly, the "other sectors" of the economy, including construction firms. To a certain extent, this development is also due to launching by several enterprises of bond issues, which were not sold to the wider public, but remained in credit institutions' portfolios. The annual rate of credit expansion to households once again persisted at high levels in the first eight months of 2004 (August 2004: 28.4%, fourth quarter of 2003: 28.2%). This development was the net result of a considerable slowdown in the growth rate of housing loans (August 2004: 23.1%, fourth quarter of 2003: 27.1%) and the high and accelerating growth rate of consumer loans (August 2004:

2 See Chapter V.1 for details on why only developments in the main components of Greek M3 (excluding currency in circulation) are discussed.

38.4%, fourth quarter of 2003: 24.8%). It should, however, be noted that the slowdown in housing credit growth is associated with the securitisation of loans under this category. If securitisation effects are not taken into consideration, the year-on-year rate of increase in housing loans stood at 27.0% in August 2004, i.e. at roughly the same level as in the fourth quarter of 2003 (27.1%).

Interest rates on bank deposits fluctuated marginally in the first eight months of the year, as ECB rates were kept unchanged and euro area money market rates changed only marginally over that period. Specifically, with regard to new deposits by households, the interest rate on overnight deposits remained almost unchanged, while the rate on deposits with an agreed maturity of up to one year increased slightly. As euro area interest rates on the corresponding deposits remained broadly stable, they continue to stand at lower levels than in Greece.

Interest rates on bank loans registered stronger movements, though not always in the same direction. The rates on bank lending to households fluctuated during the first eight months of the year, with consumer loan rates marking a slight increase and housing loan rates remaining unchanged. With regard to bank lending to non-financial corporations, the rates on loans with a defined maturity fell, whereas the rates on those without a defined maturity increased.

The spread between the average rate on total new bank loans and the corresponding rate on deposits remained almost the same over the first eight months of the year (August 2004: 4.83 percentage points), reflecting the broad stability of both average deposit and lending rates.

The yields on Greek government bonds declined sharply in the first quarter of 2004, reflecting similar developments in the yields of comparable euro area securities, before rebounding appreciably in the second quarter. These developments were initially associated with uncertainty about the recovery of the global economy and repercussions from the appreciation of the euro, but at a later stage reflected the upward revisions of market expectations of growth. Bond yields decreased gradually in the third quarter, amid concerns from European market investors about the potential impact of mounting oil prices on economic recovery. In total for the first three quarters of 2004, Greek government bond yields declined across the whole maturity spectrum, with the exception of the twelve-month maturity. Specifically, the yield on the ten-year Greek government bond fell to 4.19% at end-September 2004 (from 4.42% at end-December 2003). Meanwhile, the volume of transactions in these securities on the secondary market rose substantially in the first three quarters of 2004. Developments in the primary market for government securities were marked by an increase in the amount of funds raised and the continued attractiveness of Greek government bonds for domestic and foreign investors.

Share prices in the Greek stock market rose from the beginning of 2004 until early March, mainly on account of the visible improvement in corporate profitability in 2003. In the ensuing period, however, in spite of the increased profitability of firms listed on the Athens Exchange (Athex) in the first half of the year, stock prices followed a broadly downward course until late August 2004, owing at first to the terrorist attack in Madrid and later to investor concerns about the impact of rising oil prices on economic activity and corporate profitability. Stock prices recovered slightly in September. The course of stock prices also affected stock exchange transactions, which increased only moderately in value during the period under review. In contrast, the amount of funds raised from the stock market in the first three quarters of 2004 increased significantly.

* * *

With regard to the *international economic environment*, global economic conditions improved further in 2004, as growth accelerated concurrently in all of the large economies. According to the International Monetary Fund, global economic growth is projected to reach 5.0% this year, from 3.9% in 2003, while the volume of world trade in goods and services should grow by 8.8% (compared with 5.1% in 2003). Nevertheless, there are still a number of important geopolitical and economic uncertainties relating to (i) the effects that the continued escalation in international oil prices (in US dollars) to record-high levels from the third quarter of 2003 onwards is likely to have on economic activity and inflation; (ii) the large twin deficits (fiscal and current account) of the United States and, more importantly, the manner in which the adjustment of these deficits to sustainable levels will take place; and (iii) the response of global financial markets to international political and economic developments.

In the *euro area*, economic recovery is continuing, albeit at the rather modest pace of around 2%. The strengthening of euro area GDP growth was driven in the first half of 2004 by private consumption and exports, while in the second quarter public consumption was also a contributing factor. Investment, on the other hand, essentially remained unchanged relative to the last quarter of 2003, rising only slightly year-on-year. The prospects for economic activity in the remainder of 2004 and in 2005 are positive. More specifically, the continuing growth of the world economy should bolster euro area exports. In addition, the improved external environment, favourable financing conditions and increased profitability are expected to stimulate investment growth, while the rise in real disposable income and higher employment should underpin a further recovery of private consumption.

Euro area inflation fell to a four-year low in the first quarter of 2004, but due to mounting oil prices has returned to levels above 2% in recent months. According to flash estimates, inflation slowed slightly in September to 2.2%, while core inflation in recent months has remained at 2.1-2.2%. The annual rate of inflation is expected to fall below 2% in the course of 2005. This forecast is largely based on the assumption that the rise in oil prices will not have second-round effects on wages.

The *Greek economy* continued to grow at a robust pace for the eighth consecutive year. Real GDP growth, though projected to decline to 4% in 2004, from 4.5% in 2003, will nonetheless remain considerably above the average euro area growth rate. Growth continues to be driven by private consumption, reflecting rising real disposable household income, continued consumer credit expansion and increased household wealth in recent years. Public consumption is also rising at a fast pace. Total investment has continued to grow in 2004, albeit at a lower rate than in 2003, due to the completion of construction projects associated with the 2004 Olympic Games and the halt in private residential investment. The real external balance will once again make a negative contribution to GDP growth in 2004, approximately of the same size as in 2003. Nevertheless, the current account deficit (as compiled by the Bank of Greece) is expected to decline in relation to GDP, but to remain relatively high in 2004 at 5% of GDP. The widening, this year, of the trade deficit is projected to be more than offset by higher surpluses in the services and transfers accounts. Estimates show that employment is growing, possibly faster than in 2003. However, the unemployment rate remains particularly high. (The Bank of Greece will present its forecasts for 2005 in the next Report on Monetary Policy, taking the new government budget into account. In any event, the Bank of Greece does not consider a slowdown in economic growth to be inevitable, so long as certain conditions related to economic policy are met, as detailed in Chapter III.2).

Meanwhile, inflationary pressures in Greece are on the rise. Average annual inflation (based on both the CPI and the HICP) is projected to fall below last year's levels, but this stems exclusively from temporary exogenous factors (mainly the drop in fresh fruit and vegetable prices). Core inflation (i.e. the HICP excluding energy and unprocessed food) has trended upwards since mid-2003, rising from 2.8% in the second quarter of 2003 to an estimated 3.7% in the third quarter of 2004. On an average annual basis, core inflation is expected to rise to 3.6% in 2004 from 3.1% in 2003, thus causing the core inflation differential vis-a-vis the euro area to widen. As analysed in Chapter III.1, the persistently high levels of core inflation are attributable to macroeconomic (both demand-side and cost-side) factors, as well as to inadequately competitive conditions in certain markets, which do not operate efficiently.

The size of the fiscal imbalances and the acceleration of unit labour cost growth in 2004 are particularly worrisome developments. The current year has so far been characterised by:

First, a further relaxation of fiscal policy, which —in conjunction with the revision of fiscal statistics— has pushed the fiscal deficit-to-GDP and public debt-to-GDP ratios up to very high levels. More specifically, the recent revision of Greece's fiscal statistics and further budgetary slippages in 2004 attributable to the "political cycle" and to Olympic Games-related expenditure, should, according to Ministry of Economy and Finance estimates, raise the general government deficit-to-GDP ratio to 5.3% in 2004, from 4.6% in 2003, and the general government debt-to-GDP ratio to 112.1% by end-2004, from 109.9% at end-2003. The widening of the deficit has occurred against the backdrop of strong economic growth. Thus, the cyclically adjusted deficit should increase by 1.0% of GDP in 2004, whereas the original aim had been to reduce it. The cyclically adjusted *primary* balance, a better indicator of the fiscal effort, is expected to worsen even more, declining by 1.5 percentage points of GDP in 2004.

Second, an acceleration in the growth of gross annual earnings in the whole economy from 5.5% in 2003 to 6.4% in 2004, driven mainly by wage developments in the public sector (where average gross earnings are expected to increase by 8.4% this year, compared with 6.0% in 2003). The acceleration in unit labour cost growth, both in the whole economy (to 4.8%, from 3.0% in 2003) and in the business sector (to 4.1%, from 3.0% in 2003), has contributed this year to the rise in core inflation and has added to the considerable cumulative loss of price competitiveness in recent years, with adverse effects on employment developments.

The year 2004 is thus marked by *serious challenges for the policy makers and the social partners*, which, if left unaddressed, could undermine medium-term growth prospects.

Specifically, sustaining relatively high growth rates over the medium term is a *sine qua non* if Greece wants to reduce its unemployment, raise its living standards and benefit from the stable macroeconomic environment made possible by full participation in Economic and Monetary Union. The gradual macroeconomic stabilisation since the early 1990s, as well as structural reforms, have obviously helped the Greek economy to attain strong growth rates. However, fiscal imbalances are very large and undermine macroeconomic stability, as they intensify inflationary pressures, erode external competitiveness and add to the excessively high public debt. In addition, unit labour cost developments are incompatible with the disinflation, competitiveness and employment objectives of the economy. Meanwhile, structural rigidities are constraining output growth, as indicated by the widening positive output gap and by mounting inflationary pressures.

It is therefore important for the government to address the fiscal imbalances and structural rigidities decisively, and for the social partners to show more moderation in settlements on wage increases. Specifically:

— *First*, rapid fiscal consolidation is not only required under the Stability and Growth Pact but is also urgently needed in order to address the existing macroeconomic imbalances and ensure longer-term fiscal sustainability. The government has already announced its aim to reduce the general government deficit to 2.8% of GDP in 2005. This aim is satisfactory and implies a substantial immediate correction of fiscal imbalances. For this to be achieved, however, the fiscal policy measures that have been announced must be concretised and implemented decisively and coherently. International experience suggests that durable progress in correcting fiscal imbalances requires current spending restraint, a curtailment of tax evasion and a widening of the tax base. This will allow adequate spending on infrastructure and a reduction in the tax burden through lower taxes and, ultimately, the achievement of small fiscal deficits.

— *Second*, as the Bank of Greece has repeatedly pointed out in the past, structural reforms need to be accelerated across a wide spectrum of economic sectors. Specifically, in order to enhance the productive potential of the economy, the business climate and the functioning of the labour and product markets must be further improved. Other measures of paramount importance include: cutting down on administrative burdens and red tape, enhancing effective competition in the electricity and the internal sea transport markets, liberalising the natural gas market and —more generally— further reducing the role of the State through continued privatisations. Furthermore, to address the high rate of unemployment and the relatively low employment rate, the education and training systems, as well as aspects of labour legislation that discourage hiring, need to be reappraised.

— *Third*, looking forward, it is important (i) for the government (in the conduct of its wage policy for civil servants) to succeed in containing the growth of wage outlays, since this would have a signalling effect for the rest of the economy, and (ii) for the social partners to contribute to higher productivity and wage moderation, with a view to reducing unit labour cost growth and inflation and enhancing external competitiveness.

If these conditions are met, Greece's medium-term growth prospects would be assured and convergence toward EU income levels would continue at a satisfactory pace.

II. The international economic environment and economic developments and prospects in the euro area

1. The international economic environment[1]

1.1 Overview

The world economy continued to recover in the first half of 2004 in spite of the significant geopolitical and economic uncertainty mirrored in the sharp escalation of oil prices. For the first time in several years, world economic activity was characterised by the simultaneous acceleration of GDP growth in all of the large economies, and in particular by the strong recovery of Japan. US economic growth remained strong in the first half of the year, in spite of a moderation in the second quarter. GDP growth in the large Asian economies (except Japan) also remains robust, with China's economy on the verge of overheating. Economic growth in the countries of Latin America is currently on the upswing, while Russia's growth performance remains strong. Recovery in the euro area, which had gradually begun in the second half of 2003, continued into the first half of this year, though at a more subdued pace than in other advanced economies.

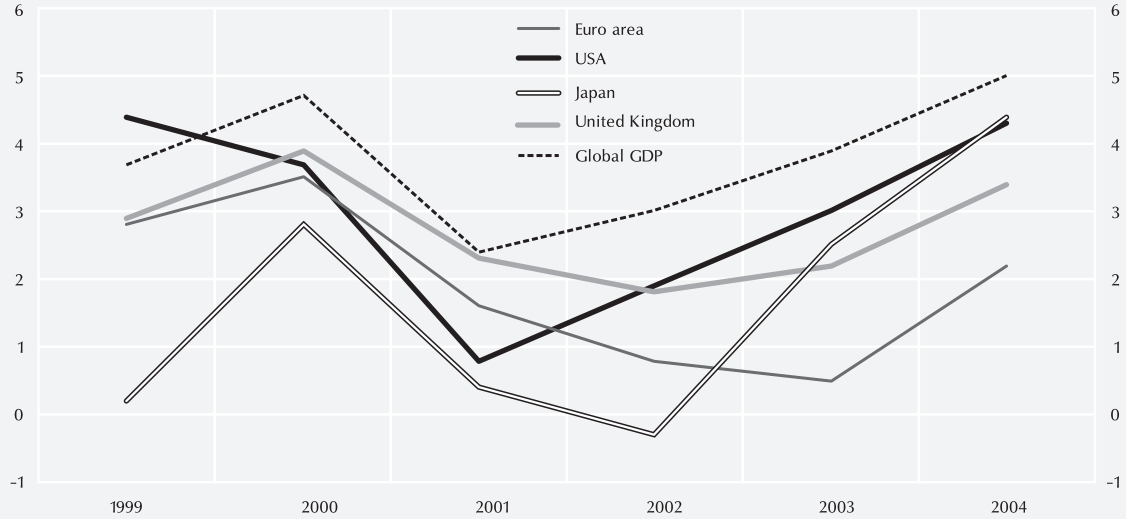
Global economic growth is expected to climb to 5.0% in 2004 (from 3.9% in 2003), thus reaching its highest rate since 1976 (5.1%). According to estimates, this acceleration relative to 2003 will almost exclusively be driven by GDP growth in the advanced economies (3.6% in 2004, compared with 2.1% in 2003), whereas the robust growth rate recorded last year in the emerging and developing economies will strengthen only slightly (to 6.6%, from 6.1% in 2003). This strong growth of global economic activity is also reflected in the

1 The analysis that follows is based on developments until September 2004 as evaluated by services of the Bank of Greece and on forecasts of international organisations, in particular the recent forecasts of the International Monetary Fund (*World Economic Outlook*, September 2004).

Chart II.1

Real GDP (1999-2004)

(Annual percentage changes)



Source: IMF, *World Economic Outlook,* September 2004.

volume of world trade in goods and services, which is expected to increase to 8.8% in 2004 (from 5.1% in 2003). Among the major advanced economies, GDP growth is projected to be highest in the US and Japan (4.3-4.4%), while in the United Kingdom it is expected to come to 3.4%. In spite of a significant acceleration in 2004, GDP growth will nonetheless remain lower in the euro area (2.2% according to the IMF, 2.0% according to the OECD and 1.6-2.2% according to the ECB staff's latest macroeconomic projections).

Underlying the strong recovery of the global economy are the following factors:

– The expansionary monetary and fiscal policies conducted in the past few years by several advanced economies, primarily the United States but also Japan in its attempt to put an end to protracted recession and deflation.

– The recovery of fixed capital formation in the advanced economies: investments had declined in 2001 and 2002, but increased slightly in 2003, after registering strong growth rates in previous years (see Table II.1).

– The switch to a market economy (to a greater or lesser extent, depending on the case) and the greater economic openness in increasingly more countries worldwide.[2] This development is largely reflected in the rapid growth of China, Russia and the countries of Central and Eastern Europe (most of which have now joined the EU).

Investment growth, which has so far been more apparent in the United States and certain other economies and less so in the euro area, stands out as a particularly positive development, capable of increasing the sustainability of the global recovery. Furthermore, the increase in the number of countries which have now switched, even if only partially, to a market economy is a structural characteristic of the global economy that will have positive effects in both the medium and the long term.

2 See also Bank for International Settlements, *Annual Report* for 2003, June 2004.

Table II.1
Gross fixed capital formation
(Annual percentage changes)

	1996-2000	2001	2002	2003	2004*	2005*
Advanced economies	**5.4**	**–0.9**	**–2.0**	**2.5**	**5.7**	**3.5**
USA	7.9	–1.7	–3.1	4.5	8.7	3.3
Japan	1.1	–1.3	–6.1	3.2	4.7	3.7
Euro area	4.0	–0.3	–2.7	–0.6	2.1	3.4

* Forecasts.
Source: IMF, *World Economic Outlook*, September 2004.

Economic policy in most advanced economies has continued to boost economic recovery so far this year. Meanwhile, monetary authorities are trying to determine what sort of consequences the conduct —often for several years— of a relaxed macroeconomic policy and the high level of liquidity are likely to have on the world economy. Indeed, the strengthening in 2004 of global economic recovery has dismissed earlier fears about the possible generalisation of the deflation phenomenon that has hit certain economies. This significant turnaround is attributable both to the rise in the international prices of commodities,[3] especially fuel, and to the high level of liquidity in the international financial system caused by the historically low nominal and real interest rates. Lowering interest rates to such levels was a monetary policy option that several large economies (e.g. the United States and Japan) resorted to from 2001 onwards as a means of forestalling or halting recession.

Some central banks raised their interest rates in 2004 (see Chart II.2), after taking into consideration *inter alia* the lag with which monetary policy affects the economy. Thus, the US Federal Reserve System, after three years of successive interest rate cuts which had brought the intended federal funds rate down to the historically low level of 1.0%, increased this rate to 1.25% on 30 June before raising it again to 1.5% and 1.75% respectively on 10 August and 21 September. Among the other central banks that have raised their key rates in recent months are the Bank of England (in June and August[4]) and the Swiss National Bank (in June).

Turning to budgetary policy, the aggregate fiscal deficit of the advanced economies is not projected to decline significantly in 2004, in spite of the favourable economic conjuncture. According to the IMF, the general government deficit of the seven most advanced economies (collectively known as the G7) is forecast to decrease only slightly in 2004 to 4.5% of GDP (against 4.6% in 2003 and 4.0% in 2002). This persistently high general government deficit-to-GDP ratio is mainly attributed to the relaxed fiscal policy that continued to be conducted in 2004 in some of these economies, especially the United States, where the cyclically adjusted deficit is estimated to have increased to 4.4% in 2004 from 3.8% in 2003, 3.3% in 2002 and a mere 0.6% in 2001.

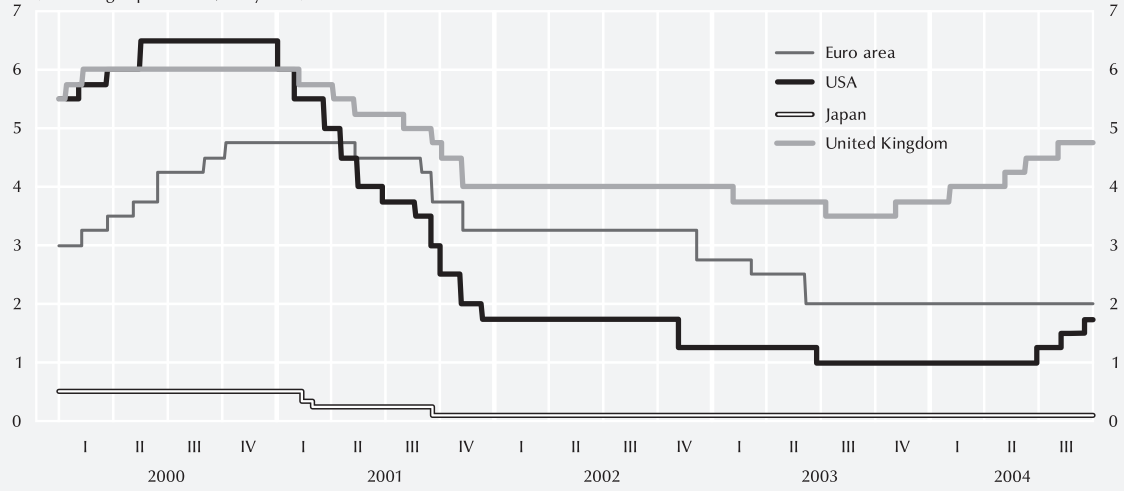
An important question that remains to be answered with regard to the global economic outlook is whether or not the recovery can be sustained. Underlying the uncertainty on this issue are the fol-

3 Mainly globally tradable primary products.
4 So far, the Bank of England has raised its key rate four times this year, by a total of 100 basis points. On 5 August, the Bank's interest rate was set at 4.75%.

Chart II.2

Central bank key rates (1 January 2000 - 30 September 2004)

(Percentages per annum, daily data)

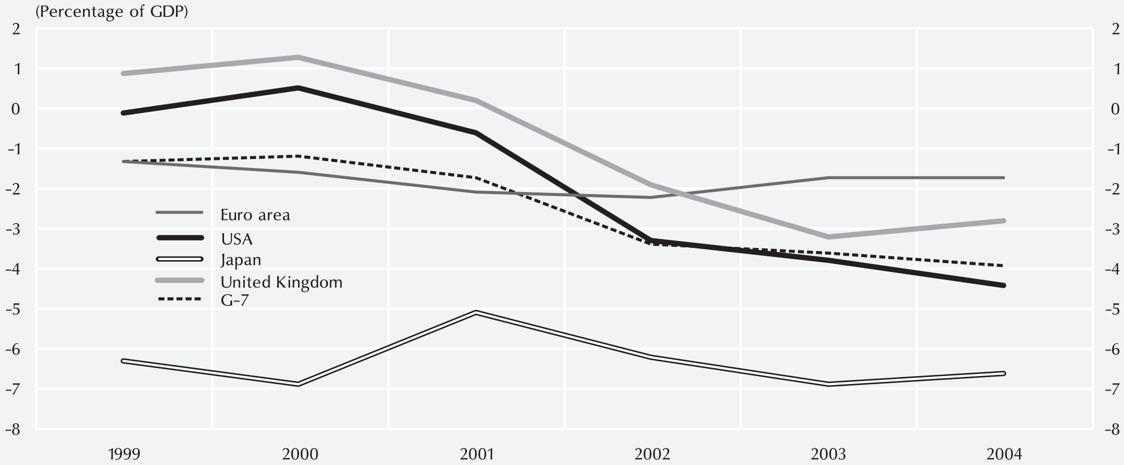


Sources: For the euro area: ECB, minimum bid rate in the main refinancing operations. For the USA: Federal Reserve, intended federal funds rate. For Japan: Central Bank of Japan, official discount rate. For the United Kingdom: Bank of England, repo rate.

Chart II.3

Cyclically adjusted fiscal balance (1999-2004)

(Percentage of GDP)



Note: Cyclically adjusted fiscal balance at general government level. G-7: The 7 most advanced economies. For the euro area and the United Kingdom: excluding one-off proceeds from the sale of mobile phone licenses. The euro area is here understood as not including Luxembourg.

Source: IMF, *World Economic Outlook*, September 2004.

lowing main factors: (a) the repercussions on economic activity and inflation likely to be caused by the continued escalation of international oil prices (in US dollars) to record-high levels from the third quarter of 2003 onwards (based on average quarterly levels);[5] (b) the concurrently large fiscal and current account deficits of the United States and, more importantly, the manner in which these deficits will be adjusted to sustainable levels; and (c) the response of international financial markets to international political and economic developments.

5 For details, see Section 1.3 later in this chapter.

1.2 Developments in major economic areas

In the *United States*, economic growth in 2004 accelerated for the third year running, with GDP growth remaining steadily above potential output growth since the second quarter of 2003. Quarter-on-quarter growth was 1.1% in the first quarter of 2004 (or 4.5% in annualised terms), compared with 1.0% (or 4.2% in annualised terms) in the fourth quarter of 2003. This first-quarter rise in GDP was driven by private consumption and gross private investment, mainly in equipment and software, as well as by federal public expenditure for defence (increase by 2.6% over the previous quarter or by an annualised 10.6%). On the other hand, as exports increased at a slower pace than imports, net exports had a negative (annualised) 0.8 percentage point impact on GDP growth. Quarter-on-quarter GDP growth slackened to 0.8% in the second quarter (or to an annualised 3.3%), mainly as a result of the slowdown in private consumption growth (which fell from 1.0% to 0.4% or from an annualised 4.1% to 1.6%). The acceleration in import growth (with export growth remaining stable) caused the negative contribution of net exports to GDP growth (in annualised terms) to widen to 1.1 percentage points.

Recent economic data and consumer confidence indicators are rather encouraging about the short-term prospects for the US economy. Meanwhile, the significant depreciation of the US dollar, for the most part in 2003, is expected to give exports a lagged boost in upcoming quarters. According to the IMF, GDP growth is projected to reach 4.3% in 2004[6] (from 3.0% in 2003). Employment gradually recovered, mainly from March through May 2004, and the unemployment rate fell to 5.4% in August. Even though a total 1.7 million jobs have been created since August 2003 (when employment resumed its upward trend), the total number of employed are still some 1 million less than in 2000. CPI inflation increased from 2.3% in April to 3.3% in June, i.e. to its highest level since 2001, and then receded once again to 2.7% in August. Core inflation decreased slightly to 1.8% in July from 1.9% in June.

The current account deficit widened to 5.1% of GDP in the first quarter of 2004 and to 5.7% in the second quarter, from 4.5% in the fourth quarter of 2003. According to the IMF, this deficit is projected to increase to 5.4% of GDP in 2004 from 4.8% in 2003. The fiscal deficit of general government is expected to increase in 2004 (4.9% of GDP, from 4.6% in 2003), while the cyclically adjusted deficit should widen to 4.4% of GDP from 3.8% in 2003. The gross public debt is projected to increase to 61.5% of GDP from 60.5% in 2003.

The economy of *Japan* recovered in 2003 from its protracted stagnation. Price deflation, nonetheless, remains a problem for the sixth consecutive year, though less so than in the past. From the second quarter of 2003 through the first quarter of 2004, quarter-on-quarter GDP growth was high (1.3% on average or 5.1% in annualised terms). In the first quarter of 2004, the GDP growth rate was 1.6% over the previous quarter (6.4% in annualised terms), i.e. slightly lower than the rate of 1.9% recorded for the fourth quarter of 2003 (7.6% in annualised terms). GDP growth was driven primarily by strong private consumption, mainly as a result of positive developments in employment, and to a lesser extent by private non-residential investment. In the second quarter of 2004, GDP growth slackened to 0.3% (or 1.3% in annualised terms), mainly because of sluggishness in domestic demand (against a rise of 1.3% in the first quarter).

6 The OECD recently issued a similar forecast ("What is the Economic Outlook for OECD countries? – An interim assessment", 21 September 2004).

The overall outlook for the Japanese economy is positive, in spite of recent less encouraging indications. The IMF and the OECD project GDP growth to reach 4.4% in 2004, against 2.5% in 2003, and the unemployment rate to fall to 4.7% from 5.3% last year. The consumer price index will continue to slowly decrease (–0.2% in 2004 as in 2003, compared with –0.9% in 2002). The country's budgetary position, though expected to improve somewhat in 2004 mainly because of favourable cyclical conditions, will nonetheless remain a reason for concern. The fiscal deficit-to-GDP ratio is projected to fall to 6.9% from 8.2% in 2003, while the gross public debt will widen further to 169.6% of GDP from 166.2% one year earlier.

In the *United Kingdom*, quarter-on-quarter GDP growth came to 0.7% and 0.9% respectively in the first and second quarters of 2004, compared with 1.0% in the fourth quarter of 2003. This continued GDP growth was driven by a strengthening in (a) household consumption (at a quarterly rate of 1.1% and an annual rate of 3.2% in the second quarter of 2004), underpinned by favourable labour market developments and the continuous rise in real estate prices, and (b) total investment (at a quarterly rate of 1.4% and an annual rate of 6.3% in the second quarter of 2004). Annual HICP inflation remains low (1.4% in July), in spite of an acceleration in May (1.5%) and June (1.6%) from April levels (1.2%), owing primarily to the oil price escalation. Developments in demand (which continues to exceed production capacity), intensifying cost-side pressure on prices and the conditions prevailing on the real estate market are the main factors which led the Bank of England to raise its key rate four times so far this year. According to the IMF and the OECD, GDP growth is projected to accelerate to 3.4% in 2004 from 2.2% in 2003. The unemployment rate will decrease further to 4.8% (from 5.0% in 2003). The general government deficit-to-GDP ratio is forecast to decline to 3.0% from 3.4% in 2003.

Russia's economy continues to be on the upswing, characterised by a solid growth performance and rising real income and employment. GDP growth accelerated to 7.3% in 2003 (from 4.7% in 2002) and is projected to remain at this level in 2004. The main factors underlying these positive developments are: the escalation in world oil prices and the increase in Russia's own oil production,[7] as well as progress towards economic stability.

China's economy continues to grow at a fast pace. The measures taken by the authorities to avoid overheating are estimated to have had some effect from the second quarter of 2004 onwards. Compared with the first quarter, fixed capital formation slowed only slightly in the immediately following months. In July, the annual rate of increase in the volume of fixed capital formation was 31% (first quarter: 48%). Moreover, the annual rates of increase in August were 15.9% for industrial production, 37.7% for exports and 37.4% for imports. According to the IMF, GDP growth is projected to reach 9.0% this year, compared with 9.1% in 2003, while the current account surplus will decline to 2.4% of GDP from 3.2% in 2003. CPI inflation is likely to increase to 4.0% in 2004 (the annual CPI rate was 5.3% in July), from 1.2% one year earlier.

India has also been recording a solid economic performance (with an annual GDP growth rate of roughly 6% in recent years) after launching significant economic reforms. GDP growth reached 7.2% in 2003 and is expected to decline to 6.4% in 2004. With the second largest population in the

7 Russia has increased its oil production in recent years and in 2003 ranked second worldwide in crude oil production, after Saudi Arabia.

world (17.2% of the global population), India produces 5.7% of world GDP, measured at purchasing power parities.

1.3 International trade and commodity prices

The volume of world trade in goods and services is projected to increase by 8.8% in 2004, compared with an increase of 5.1% in 2003. This stronger growth of world trade can mainly be attributed to the international trade performance of the advanced economies. The emerging and developing economies are estimated to have maintained a buoyant and steady rate of external trade growth of 12%.

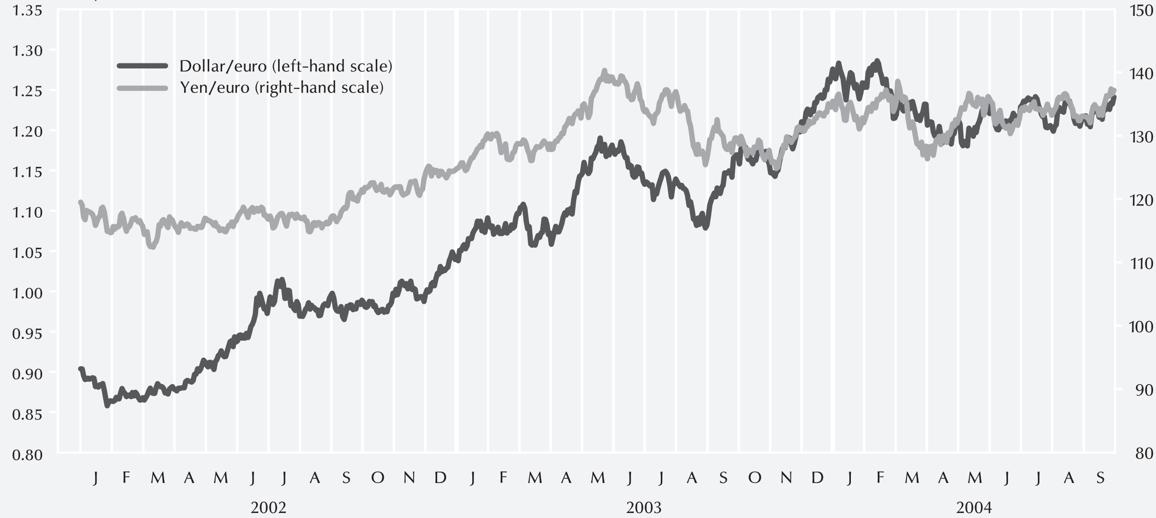
Oil prices continued to push upwards in 2004 for the second year in a row, culminating at unprecedented levels in August.[8] However, there is relatively little concern that this year's oil price escalation could lead to a world recession (unlike what happened with the two oil crises in the 1970s), due to changes in the following basic parameters: (a) the large economies dependency on oil and the OPEC has decreased; (b) the rather slow rise in oil prices from $13.1 per barrel in 1998 to the projected (by the IMF) average levels of $37.3 this year gave the economies time to absorb its impact on GDP and inflation; and (c) recent oil prices, when deflated, come to about one half the prices recorded during the second oil crisis of 1979-80.[9]

According to the IMF, the mean of average quarterly spot prices for three types of crude oil mounted gradually from $26.5 per barrel in the second quarter of 2003 to $32.1 in the first quarter of 2004 and to $35.6 in the second quarter of 2004. This increase became sharper in the third quarter of 2004, when world oil prices soared above $45 in August and September. Based on IMF projections for 2004, the average annual spot price of crude oil should average $37.3 per barrel, compared with $28.9 in 2003. The improvement in GDP growth concurrently in the United States, Japan and the EU, and the robust growth performance of China are estimated to have caused demand to post its highest increase in the last 24 years.[10] Meanwhile, developments in global supply were also conducive to a crude oil price increase. The main factors that caused world oil prices to soar to record-high levels in the second half of August were: OPEC's decision on two occasions (1 November 2003 and 1 April 2004) to cut back on production, the fact that several oil producers are already producing at near capacity, supply-side problems in Venezuela, Russia and Nigeria, geopolitical tension and uncertainty in the Middle East, fear of a terrorist attack on the oil infrastructure in Iraq, and increased speculation in the oil futures market.[11] The situation improved somewhat afterwards, but in the second half of September oil prices once again began to escalate.

The prices of non-fuel commodities (in US dollars) are projected to increase by 16.8% in 2004, compared with a rise of 7.1% in 2003. After rising in the first half of 2004 to their highest level in recent years and easing off somewhat after that, non-fuel commodity prices stood 21.2% higher in August 2004 than one year earlier. Metals are, as in 2003, estimated to be the commodity with the

8 In August, the average price of Brent crude oil rose above $43 per barrel, while the average price of US crude oil neared $45 per barrel. The second highest average monthly price of crude oil ever recorded on the world market was in November 1979 ($39.7 per barrel).
9 Current oil prices of around $40 per barrel are estimated to be equivalent in real terms to about half the corresponding prices of 1980.
10 US oil reserves reached a 28-year low in January 2004, but then gradually increased in the four following months.
11 The decision of the OPEC members to increase their official total daily production by 2 million and 0.5 million barrels respectively on 1 July and 1 August 2004 to a certain extent contained this exorbitant price increase.

Chart II.4
Exchange rate of the euro against the US dollar and the Japanese yen
(Daily data)



Sources: ECB and Bank of Greece.

strongest increase in world demand,[12] owing to the significant share of metal production absorbed by China's robust industrial activity.

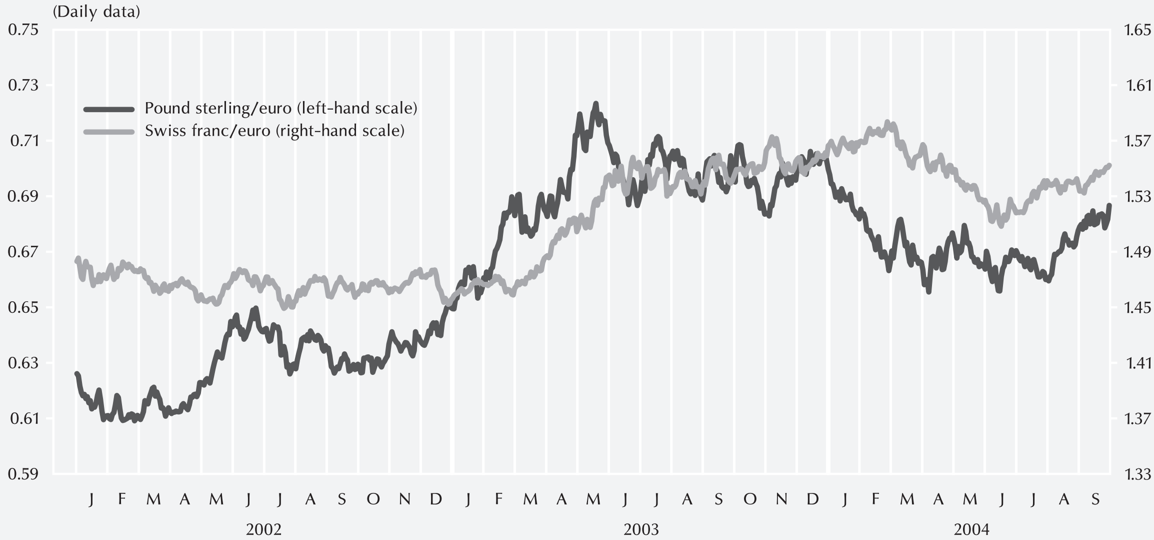
1.4 International financial markets

The euro climbed to its highest level ever in January-February 2004, but then depreciated slightly. More specifically, the euro's nominal effective exchange rate (weighted for external trade of the euro area with 42 trading partners), after increasing by 12.4% in 2003 (in average annual terms), remained 3.1% higher in August 2004 than the average level of 2003. The index of the euro's real effective exchange rate (deflated by the CPI) has also followed a similar course to that of the nominal effective exchange rate index. After rising by 11.9% in 2003 (suggesting a loss in international price competitiveness for the euro area), it stood 2.4% higher in August 2004 than the 2003 average.

The bilateral euro/US dollar exchange rate underwent stronger fluctuations. After gaining 19.6% against the US currency in 2003 (in average annual terms), the euro strengthened further in early 2004, peaking at $1.2646 in February. It depreciated in the following months to a parity of $1.2176 in August, which was 7.6% higher than the average level for 2003. After strengthening by 10.9% against the yen in 2003, the euro gained further ground, peaking in February. Although it has depreciated since then, its exchange rate against the yen still remains above the 2003 average. In fact, the euro/yen exchange rate in August 2004 was 2.7% higher than in 2003. Against the pound sterling, the euro has been on a downward course since June 2003. This trend intensified in the first half of 2004. By August 2004, the euro/pound sterling exchange rate had decreased by 4.3% relative to 2003, a year during which the euro had gained considerable ground against the

12 The international commodity price index that is compiled by the IMF reflects the US dollar price developments of 48 different exportable commodities broken down into 5 categories: food (weight of 21.7% in the general index), beverages (weight: 3.1%), agricultural raw materials (weight: 11.3%), metals (16.1%), fuels (weight: 47.8%).

Chart II.5
Exchange rate of the euro against the pound sterling and the Swiss franc
(Daily data)



Sources: ECB and Bank of Greece.

pound sterling (+11.2% relative to 2002). Against the Chinese yuan (which is effectively pegged to the US dollar), the euro had appreciated by 7.6% in August relative to the 2003 average.

In international bond markets, 10-year government bond yields resumed their upward course in the second quarter of 2004, after declining from December 2003 to March 2004. US and euro area long-term bond yields reached their highest level of the year in June 2004. The market perception that inflation and growth have both been picking up, combined with the expectation that central banks, first among them the Federal Reserve and the Bank of England, will raise their key rates, has contributed to this development. Yields then dropped again in the following months, as soon as inflation and growth expectations were revised downwards. The yields of the 10-year US government bond increased to 4.27% in August 2004 compared with an average 4.0% in 2003. The comparable euro area bonds yielded 4.17% in August, against 4.16% in 2003. The yields of the corresponding Japanese bonds, though comparatively smaller, also increased in the course of the year to 1.63% in August, from 0.99% in 2003 (see Section 3.3 later in this chapter).

The world stock markets continued their upward course in the first months of 2004. The uncertainty that had marked transactions in the first half of the year, as measured by "implied volatility",[13] basically remained below the last five year average. However, in spite of the favourable impact from the increase in profitability, stock market developments were negatively affected from March 2004 onwards by the adverse oil market developments. The US Standard & Poor's 500 index rose to its highest level of the year in February, while the broad Dow Jones EURO STOXX and the Nikkei 225 indices both peaked in April. In August 2004 the US and the Japanese indices reached levels that were respectively 0.7%

13 A measure of expected volatility (standard deviation in terms of annualised percentage changes) in the prices of stocks (or of futures contracts), which can be extracted from the prices of options on stock market indices.

and 6.5% higher than in December 2003 (based on monthly averages), whereas the broad European index was, in turn, 0.2% lower (see Section 3.4 later in this Chapter).

2. Macroeconomic developments and prospects in the euro area[14]

2.1 Inflation

Inflation in the euro area, as measured by the HICP, after falling to a four-year low of 1.6% in February 2004, began to rise, mainly reflecting the strong increase in oil prices, and remained, with small fluctuations, above 2%. It moderated slightly to 2.2% in September (flash estimate) from 2.3% in July and August, 2.4% in June and 2.5% in May. During the same period, core inflation remained at 2.1-2.2%.

The recovery of global economic activity is expected to maintain the prices of oil and non-oil commodities at high levels, resulting in continued pressures on prices in the months to come. Furthermore, increases in indirect taxes and administered prices in a number of euro area countries during the current year should add to upward pressure on prices. On the other hand, the relatively high rates of unemployment seen in several euro area countries and the existing excess capacity should dampen price developments. In view of all these factors, inflation is expected to remain above 2% throughout 2004 and to decline below that level in the course of 2005. According to the latest ECB staff projections, the average rate of inflation in the euro area should range between 2.1% and 2.3% in 2004 and between 1.3% and 2.3% in 2005.

It should be noted that the prospect of inflation falling below 2% in the course of 2005 is based, to a large extent, on the assumption that the increase in oil prices will not pass through to wages. In the past, oil price shocks have triggered price-wage spirals that strengthened inflation dynamics in the European and other economies.

2.2 Economic activity

The latest available data support the assessment that economic recovery in the euro area under way since the third quarter of 2003 is continuing and should keep its pace in 2005.

Quarter-on-quarter GDP growth was 0.6% in the first quarter of 2004 and 0.5% in the second quarter, compared with 0.4% both in the third and in the fourth quarter of 2003.[15] While in the first half of 2004 stronger GDP performance was mainly driven by higher private consumption, in the second quarter an increase in public consumption also played a role. By contrast, investment was virtually stagnant relative to the last quarter of 2003 and rose only moderately year-on-year, partly reflecting the impact of special factors such as reduced construction investment in Germany.

According to the latest (index-based) European Commission forecast, quarterly GDP growth rates in the euro area for the third and the fourth quarters of 2004 should range between 0.3% and 0.7%. IMF forecasts point to euro area growth of

14 The analysis contained in this section is based on developments until August 2004 and on forecasts by international organisations, such as the European Commission's Spring Forecasts, ECB staff macroeconomic projections (September 2004) and the recent IMF forecasts (*World Economic Outlook*, September 2004).
15 It should be noted that in Germany, the largest economy in the euro area, the GDP growth rate was 0.5% in the second quarter of 2004, compared with 0.4% in the first quarter of 2004 and 0.3% in the fourth quarter of 2003. Moreover, quarter-on-quarter growth remained strong in France, the second largest economy in the euro area, at 0.7% in the second quarter, compared with 0.8% in the first quarter. By contrast, the GDP growth rate in the Netherlands, quite unexpectedly, turned negative (–0.2%) in the second quarter, after a performance of 0.6% in the first quarter of 2004.

2.2% in 2004 and in 2005. The figure for 2004 is higher than the earlier IMF forecast (1.7% in April 2004). A growth rate of 2% in the euro area is now forecast for 2004 by the OECD, following the upward revision in September of its June forecast for 1.6%.[16] Moreover, according to the latest ECB staff projections, GDP growth should range between 1.6% and 2.2% this year and between 1.8% and 2.8% in 2005.

The prospects for economic activity in the remainder of 2004 and in 2005 are still positive. Sustained strong growth in the major trading partners of the euro area is expected to bolster euro area exports. Within the euro area, investment should benefit from the improved external environment and favourable financing conditions. As the corporate sector is pressing ahead with restructuring and enhancing its efficiency, the associated rise in profits is expected to foster business investment. It should be noted that the business climate indicator showed some improvement during the first seven months of 2004. Furthermore, the recovery of private consumption should continue, supported by the increase in real disposable income and higher employment.

Macroeconomic policies continue to have a beneficial effect on economic activity in the euro area. The short-term interest rates of the ECB, both in nominal and in real terms, stand at historically low levels, while the fiscal policy stance can be characterised as overall neutral, given that the cyclically adjusted deficit for the euro area as a whole is forecast (by the IMF) to remain unchanged in 2004 relative to last year.

Looking at developments in individual countries, the recovery of economic activity is expected to reduce disparities in growth performances across euro area countries, as the negative rates of GDP change recorded last year in countries such as Germany, the Netherlands and Portugal are projected to turn positive during the current year. According to the IMF, Ireland and Greece will be the best performers in 2004, with growth rates of 4.7% and 3.9% respectively, significantly exceeding the euro area average (2.2%).

Nevertheless, economic prospects continue to be surrounded by a number of uncertainties. First of all, recovery in the euro area is not yet adequately self-sufficient, as it relies heavily on external demand. The pickup of private consumption remains fragile, as reflected in consumer confidence indicators, and this is partly attributed to the very slow pace of employment growth. Also, the hike in oil prices remains a source of concern.

Developments in the European Union during the current year are dominated by the recent enlargement. The accession of ten new Member States — the economies of which have been growing at rates considerably higher than the euro area average – is expected to provide fresh impetus to the economy of the EU, although the share of the new Member States in the EU's GDP is relatively small.[17] It should be noted that three new entrants (Estonia, Latvia and Slovenia) have already joined, with effect from 28 June 2004, the Exchange Rate Mechanism II, as part of their preparation for subsequent entry into the euro area.

2.3 Labour market

In spite of protracted economic weakness in 2001-2003, the increase in the unemployment rate in the euro area was limited in comparison with past downturns or with labour market devel-

16 See footnote 6.
17 The GDP of the ten new entrants, taken together, is equal to about 5% of the EU-15 GDP, and their population (74 million) is about 20% of the EU-15 population.

opments in other advanced economies (e.g. the United States). A broadly similar picture is provided by developments in employment, with no net job destruction recorded in that period.[18]

The rate of unemployment in the euro area stood at 9% in July, unchanged from the previous quarter. The quarter-on-quarter increase in employment was nil in the first quarter of 2004, as continuing job creation in the services sector was offset by declines in agricultural and manufacturing employment.

With the gradual pickup of GDP growth, employment is expected to rise, of course taking account of the usual lags with which labour market developments respond to economic activity. Survey results available up to July suggest a small improvement in business expectations regarding employment in the second half of 2004. The IMF forecasts a modest increase of about 0.5% in employment for the current year and an acceleration to about 0.9% on average for 2005. The rate of unemployment is projected to increase slightly to 9.0% in 2004, from 8.9% in 2003, and to fall to 8.7% in 2005.

During the current year, the cyclical rise in productivity, in conjunction with unchanged —as expected— nominal wage growth, should lead to a containment of unit labour costs and an improvement in the price competitiveness of the euro area as a whole.

2.4 Fiscal developments

In 2003, fiscal deficits continued to rise in most euro area countries, as well as in the euro area as a whole, mainly reflecting the prolonged economic weakness. According to the latest European Commission forecasts (April 2004), the deficit for the euro area was expected to remain, at average annual levels, virtually unchanged in 2004 and 2005, unless corrective action were to be taken. Specifically, both the nominal and the cyclically adjusted fiscal deficit were expected to stabilise at 2.7% and 2.2% of GDP respectively, showing no change from 2003, while the nominal deficit would decline only marginally to 2.6% of GDP in 2005. The general government debt-to-GDP ratio in the euro area rose to 70.7% in 2003 from 69.4% in 2002, while it had been expected (by the European Commission in April 2004) to remain broadly unchanged in 2004 and fall to 69.4% in 2005. According to more recent estimates from the IMF (September 2004), in 2004 the euro area fiscal deficit should reach 2.9% of GDP and public debt should come to 70.9% of GDP, before declining slightly to 70.6% of GDP in 2005.

In 2003, four euro area countries, i.e. France, Germany, Greece and the Netherlands, had deficit ratios that exceeded the reference value of 3% of GDP. According to European Commission forecasts, this situation is expected to continue in 2004. The "excessive deficit procedure" (EDP) has been initiated for these Member States, and the ECOFIN Council has issued recommendations (most recently, on 5 July 2004, in the case of Greece), calling upon the Member States concerned to correct their excessive deficits. It should be noted that the EDP was initiated by the European Commission also in respect of six new entrants,[19] as these too ran deficits of over 3% of GDP in 2003 and are expected to continue to do so in 2004. The ECOFIN Council decided, also in its meeting of 5 July 2004, that an excessive deficit existed in these countries and recommended that corrective mea-

18 Between 2000 and 2003, total employment in the euro area rose by 2.8 million persons. Even in 2003, when the impact of protracted economic weakness on the labour market was more markedly felt, employment in the euro area did rise, albeit slightly, by 200,000 persons or 0.2%.
19 The Czech Republic, Cyprus, Hungary, Malta, Poland and Slovakia.

Table II.2
Changes in key ECB interest rates
(Percentages per annum)

Date of interest rate change[1]	Deposit facility	Main refinancing operations	Marginal lending facility
6 December 2002	1.75	2.75	3.75
7 March 2003	1.50	2.50	3.50
6 June 2003	1.00	2.00	3.00

1 For the deposit and marginal lending facilities, effective dates of interest rate changes (one day following the relevant ECB decision); for the main refinancing operations, interest rate changes are effective from the first operation following the date indicated.
Source: ECB.

sures be taken. Moreover, Portugal succeeded in reducing its fiscal deficit below 3% of GDP in 2003 (to 2.8%), in line with the Council's recommendation. However, according to European Commission and IMF forecasts, there is a risk that the deficit might exceed the reference value of 3% once again in 2004. Close to the reference value is also the fiscal deficit of Italy, and the Italian government announced[20] measures for its containment.

For the next few years, as suggested by the updated stability programmes of Member States, the cyclically adjusted fiscal balance of the euro area as a whole will improve, by almost 0.5% of GDP annually. Thus, the fiscal balance (a deficit equal to 0.7% of GDP) would approach the objective of a fiscal position "close to balance" by 2007. However, in the light of past experience, the attainment of this goal over the projected horizon is less than certain, as in some cases the envisaged fiscal adjustment seems insufficient and relying on overoptimistic assumptions about economic growth.[21] Still, fiscal consolidation is essential, if automatic stabilisers are to operate freely, without the risk of excessive fiscal deficits. On the other hand, it is encouraging that, although in the recent past the application of the EU fiscal framework has given rise to tension, no Member State has questioned the objectives set in the Treaty and the Stability and Growth Pact, i.e. the achievement and maintenance of sound fiscal positions, as a necessary element for the smooth functioning of EMU (see also Appendix to Chapter IV).

3. Monetary developments and policy

3.1 The monetary policy of the ECB

ECB key interest rates have remained unchanged for more than a year, since the latest cut by 50 basis points on 6 June 2003. Thus, during the first nine months of 2004, the minimum bid rate for the main refinancing operations remained at 2%, the marginal lending facility rate at 3% and the deposit facility rate at 1% (see Chart II.6 and Table II.2). The Governing Council of the ECB takes the view that low rates lend support to economic recovery in the euro area, without implying risks to price stability over the medium term.

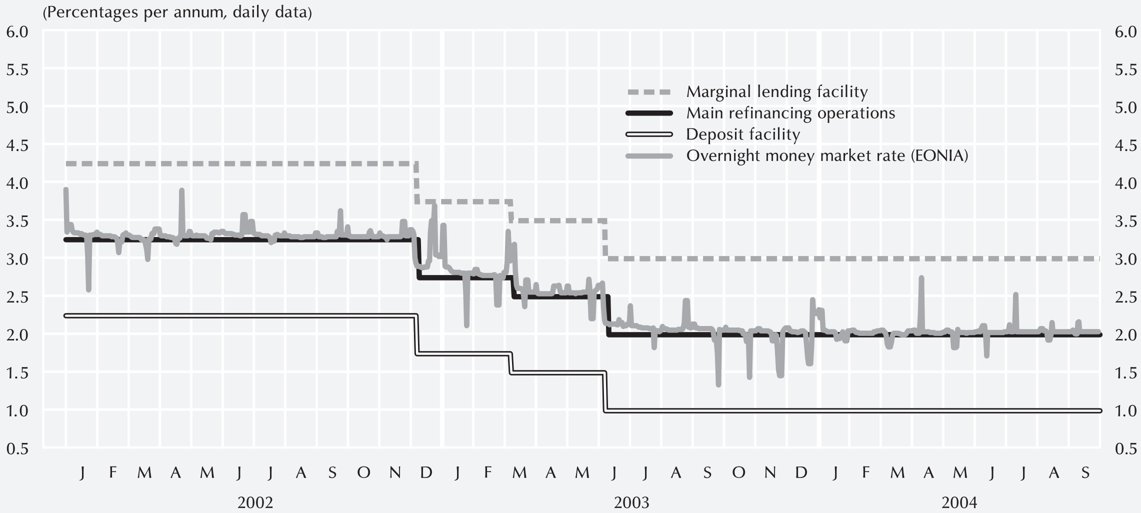
Indeed, as far as macroeconomic developments in the euro area are concerned, the gradual economic recovery continued in the first half of 2004 and GDP growth is expected to accelerate further in the remainder of 2004 and in 2005 (see Section 2

20 At the ECOFIN meeting of 5 July 2004.
21 See also European Commission, *Public Finances in EMU — 2004*.

Chart II.6

ECB interest rates and the overnight money market rate (EONIA)
(1 January 2002 - 30 September 2004)

(Percentages per annum, daily data)



Source: ECB.

of this chapter). Moreover, during the first quarter of 2004, euro area inflation stood at levels consistent with price stability, i.e. slightly below 2%. From April onwards, however, increases in oil prices and tobacco tax led to a considerable rise in inflation (May: 2.5%). Despite some moderation of inflation in the next months (September: 2.2%), high oil prices are expected to keep exerting inflationary pressures and maintain inflation above 2% until the end of the year. According to ECB staff macroeconomic projections,[22] inflation is expected to fall below 2% in the course of 2005, as a result of generally limited increases in import prices combined with wage moderation, although there is uncertainty as to future developments in oil prices, indirect taxes and administered prices in euro area countries (for the above projections see Section 2 of this chapter).

The assessment of the Governing Council that the monetary policy of the ECB is still appropriate for maintaining price stability in the medium term is confirmed by the analysis of monetary and credit developments. Indeed, the annual growth rate of the broad monetary aggregate M3[23] continued decelerating during the period under review, reflecting agents' portfolio shifts to longer-term assets not included in M3. Nonetheless, liquidity in the euro area remains higher than needed for the financing of non-inflationary growth and could have an upward impact on inflation, should the excess liquidity be channeled to liquid assets, particularly at a time when both consumer confidence and economic activity are strengthening.

3.2 The evolution of M3, its components and counterparts, and the issuance of debt securities

The annual growth rate of M3 fell to 5.3% in the second quarter of 2004, from 7.6% in the last quarter of 2003 (see Chart II.7 and Table II.3). As already mentioned, this development largely

22 See ECB, *Monthly Bulletin*, September 2004 (Box 4), and the press conference of the President of the ECB dated 2 September 2004, www.ecb.int.

23 For the definitions of monetary aggregates, see the Glossary.

Table II.3
Main components of M3 in the euro area

(Annual percentage changes,[1] derived from data adjusted for seasonal and calendar effects, quarterly averages[2])

	2003	2004		
	Q4	Q1	Q2	August
M1	**11.0**	**11.1**	**10.2**	**9.3**
Currency in circulation, M0	26.5	24.0	21.6	20.3
Overnight deposits	8.8	9.1	8.5	7.5
Other short-term deposits (=M2–M1)	**4.9**	**3.3**	**1.7**	**2.0**
Deposits with an agreed maturity of up to two years	–2.9	–4.4	–7.0	–5.7
Deposits redeemable at notice of up to three months	11.1	9.2	8.1	7.5
M2	**7.9**	**7.2**	**6.0**	**5.7**
Marketable instruments (=M3–M2)	**5.8**	**2.4**	**1.7**	**4.5**
Repurchase agreements	–1.6	–4.1	–2.4	3.9
Money market fund shares/units	12.8	8.6	5.9	4.9
Money market paper and debt securities issued with a maturity of up to two years	–11.3	–14.4	–11.9	2.9
M3	**7.6**	**6.5**	**5.3**	**5.5**

1 Annual rates of change in the corresponding index, which is compiled on the basis of outstanding stocks for December 1998 and cumulative monthly frows, 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*).
Source: ECB.

reflected portfolio shifts to longer-term assets, against a background of improved financial market conditions. However, M3 growth has been accelerating slightly since July (August: 5.5%), which is attributed to the slow pace of portfolio restructuring, as investors remain cautious to engage in higher risk investments, following adverse stock market developments in past years. Another factor that exerted an expansionary influence on M3 growth was the low level of interest rates, which reduced the opportunity cost of holding money,[24] fuelling demand for liquid assets, especially those included in M1. Thus, the annual growth rate of M1 remained high during the first eight months of 2004, even though it weakened to 9.3% in August and 10.2% in the second quarter of 2004, from 11% in the last quarter of 2003 (see Table II.3).

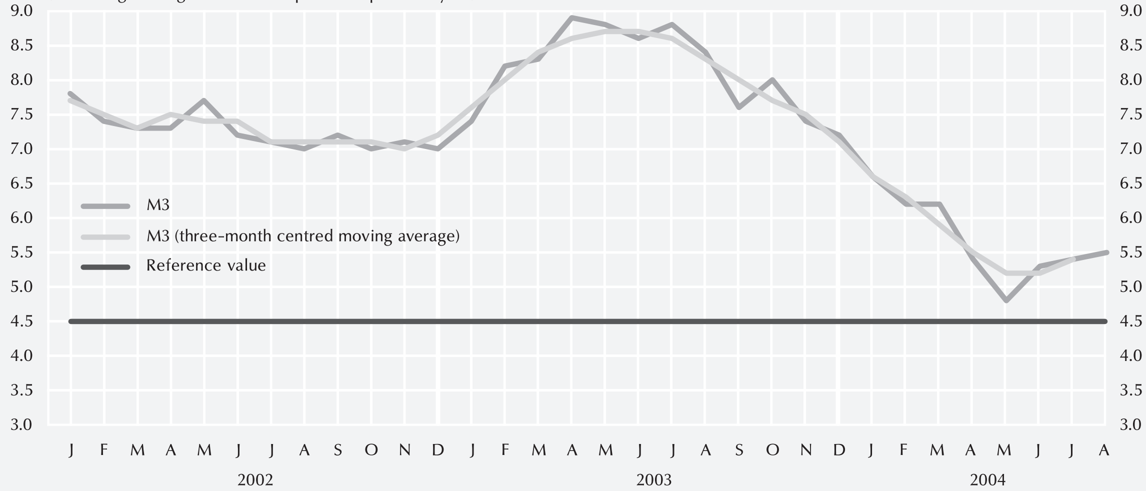
Turning to the counterparts of M3, the improved conditions in the loan market and, more generally, in the economic environment of the euro area led to a slightly faster increase in loans to the private sector, which account for the bulk of total credit expansion. In particular, the growth rate of these loans rose to 6% in August and 5.6% in the second quarter of 2004, from 5.3% in the fourth quarter of 2003 (see Table II.4). According to the results of the latest (July 2004) Eurosystem survey on bank lending, during the second quarter of 2004 the percentage of banks that reported a tightening of credit standards for loans to enterprises and households fell significantly and was smaller than the percentage of banks that reported an easing of credit standards. This supports the picture of improved financing conditions. The annual growth rate of bank loans to households accelerated considerably and reached 7.5% in August 2004, compared with 6.4% at the end of 2003. This pickup is mainly attributable to

24 The opportunity cost of holding money is measured as the difference between the 3-month EURIBOR and the weighted average of the rates of return on M3 components (own rate of return of M3).

Chart II.7

M3 in the euro area (January 2002 - August 2004)

(Percentage changes[1] over same period of previous year)



1 Adjusted for seasonal and calendar effects.

Source: ECB.

T a b l e II.4

Main counterparts of M3 in the euro area

(Annual percentage changes,[1] derived from data adjusted for seasonal and calendar effects, quarterly averages[2])

	2003	2004		
	Q4	Q1	Q2	August
Longer-term financial liabilities of MFIs	**6.1**	**6.4**	**7.5**	**7.7**
Deposits with an agreed maturity of over two years	5.2	5.5	6.4	7.0
Deposits redeemable at notice of over three months	–14.0	–11.5	–8.5	–3.3
Debt securities issued with a maturity of over two years	9.2	10.0	10.8	10.8
Capital and reserves	4.2	3.2	4.7	4.2
Credit to euro area residents	**5.9**	**5.8**	**6.0**	**6.1**
Credit to general government	**6.6**	**6.1**	**6.5**	**6.6**
– Debt securities other than shares	9.9	9.1	9.1	9.1
– Loans	1.5	1.2	2.2	2.6
Credit to other euro area residents	**5.7**	**5.7**	**5.9**	**6.0**
– Debt securities other than shares	15.9	12.4	8.9	9.8
– Shares and other equity	3.6	4.9	7.1	3.2
– Loans	5.3	5.4	5.6	6.0

1 Annual rates of change in the corresponding index, which is compiled on the basis of outstanding stocks for December 1998 and cumulative monthly frows, 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*).

Source: ECB.

increased demand for housing loans, due to low interest rates and high house prices. By contrast, the annual growth rate of bank loans to non-financial enterprises fell in the first quarter of 2004 (3.2% in March, down from 3.5% at the end of 2003), reflecting the efforts of enterprises to improve their gearing ratio (i.e. the ratio of own to borrowed funds) as well as the effects of subdued economic activity in the beginning of 2003. This rate, however, strengthened gradually in the next months (August: 4%), as a result of improvements in financing conditions and in the euro area economic environment.

The annual rate of credit expansion to general government, having declined to 6.1% in the first quarter of 2004 from 6.6% in the last quarter of 2003, rose again in the second quarter of 2004 to 6.5%, and further to 6.6% in August, due to higher public sector borrowing requirements in some countries of the euro area.

The annual growth rate of longer-term liabilities of euro area MFIs accelerated significantly, reaching 7.7% in August and 7.5% in the second quarter of 2004, from 6.1% in the last quarter of 2003. This acceleration reflects a corresponding slowdown of the annual growth rate of M3 and, as already mentioned, is due to the gradual shift of investors to longer-term assets, spurred by improved financial market conditions and an increase in the yields of such assets in the second quarter.

Finally, the annual growth rate of the outstanding amount of debt securities issued by non-financial corporations dropped dramatically in the first half of 2004, reaching 3.0% in the second quarter, from 9.7% in the last quarter of 2003. This development can be attributed to increased recourse to internal financing and to the fact that many enterprises took advantage of the particularly low cost of fund-raising through the issuance of debt securities in 2003 to prefinance part of their needs for the current year. By contrast, the annual growth rate of the outstanding amount of debt securities issued by the general governments of euro area countries continued to increase, fostered by fiscal developments in certain euro area countries, and reached 5.6% in the second quarter of 2004, against 5.4% in the fourth quarter of 2003.

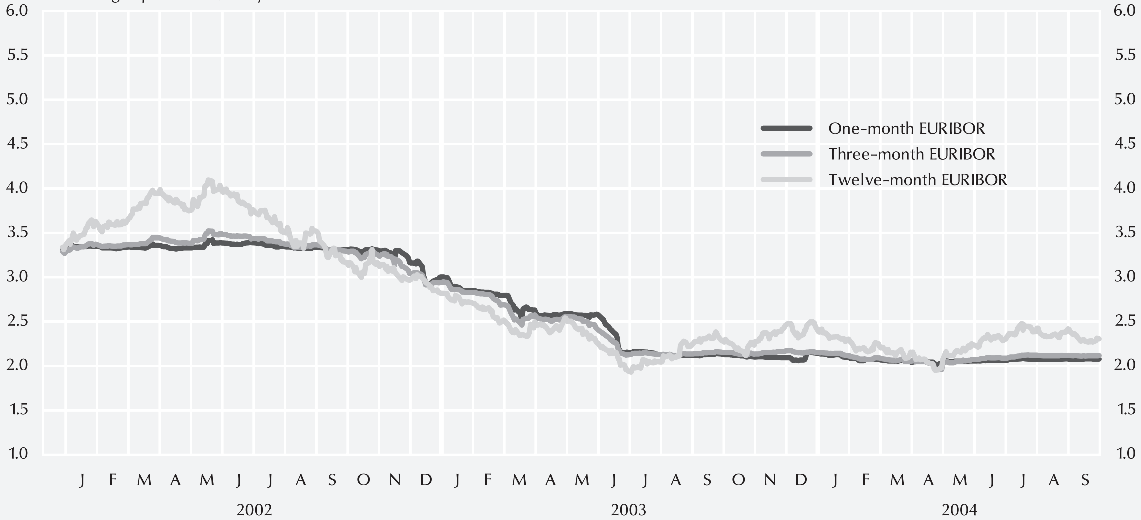
3.3 Money market interest rates, bank rates and yields on long-term government paper

Interest rates in the single euro area money market fell significantly until June 2003 and have remained at quite low levels ever since, in line with the evolution of ECB key interest rates (see Chart II.8). In particular, the overnight interest rate in the interbank market (EONIA) (see Chart II.6) and short-term market rates (one-month and three-month[25] EURIBOR) stabilised close to the ECB minimum bid rate for main refinancing operations. Longer-term interest rates (six-month[26] and twelve-month[27] EURIBOR) continued to drop in the first quarter of 2004, rose in the second quarter, but fell again from June onwards. By September 2004, these rates had fallen back to their December 2003 levels, in line with revised market expectations about future developments in short-term interest rates. As a result, the slope of the money market yield curve, as measured by the spread between the twelve-month and the one-month EURIBOR rates, flattened during the last months. In September this spread fell back to its December 2003 levels, partly reversing the increase recorded after the first quarter of 2004 (see Chart II.9).

During the first seven months of 2004, the average monthly interest rates applied by MFIs on short-term deposits and loans stabilised at historically low levels. For example, the average monthly rate on household deposits with an agreed maturity of up to one year stood at 1.91% in July, compared with 1.89% in December 2003.

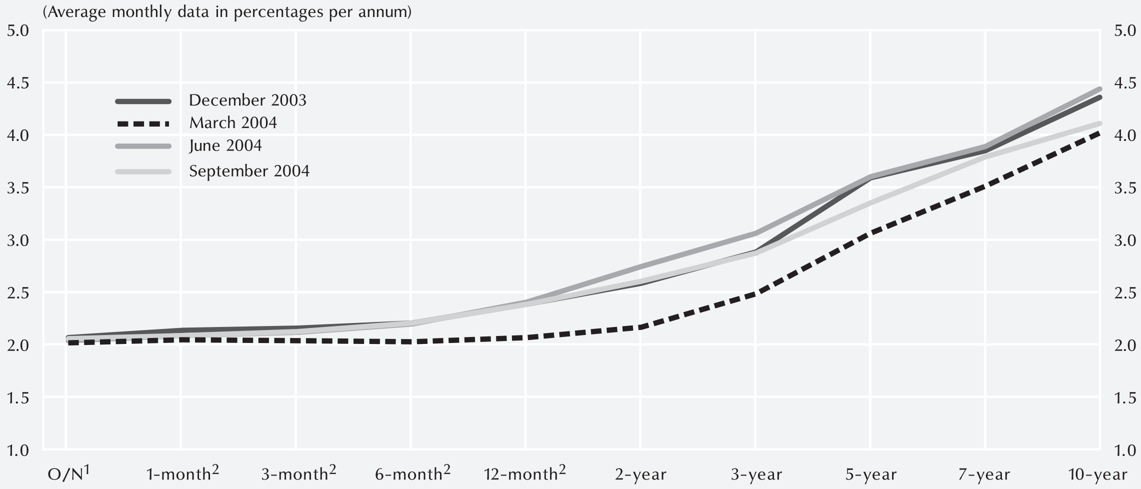
25 The average monthly rate fell to 2.12% in September 2004, from 2.15% in December 2003.
26 Average monthly rate: September 2004, December 2003: 2.20%.
27 Average monthly rate: September 2004, December 2003: 2.38%.

Chart II.8
Short-term interest rates in the euro area (1 January 2002 - 30 September 2004)
(Percentages per annum, daily data)



Source: ECB.

Chart II.9
Money market and bond market yield curves in the euro area
(Average monthly data in percentages per annum)



1 Overnight money market rate (EONIA).
2 Interbank offer rates (EURIBOR) for the respective maturities.

Source: ECB.

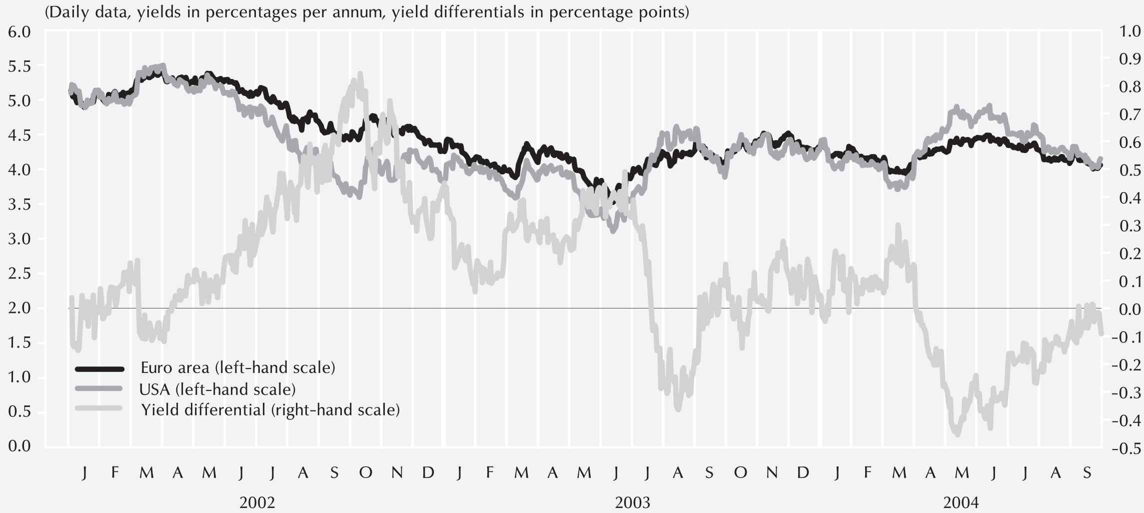
In contrast with short-term interest rates, rates on longer-term deposits and loans fluctuated widely over the same period, mirroring, with the typical lags, the path of long-term bond yields. Overall, in the period December 2003-July 2004, the average monthly interest rates on long-term loans to non-financial corporations fell by 5-15 basis points, while interest rates on housing loans declined by approximately 25 basis points.

Government bond yields in the euro area followed a downward course in the first quarter of 2004, which was reversed in the second quarter (see Chart II.10). This development seems to

Chart II.10

Ten-year bond yields in the euro area and the United States
(1 January 2002 - 30 September 2004)

(Daily data, yields in percentages per annum, yield differentials in percentage points)



Source: ECB.

relate to an upward revision of market expectations about economic growth. Nonetheless, government bond yields started falling anew in July, as market expectations regarding global economic growth were affected by high oil prices. In this context, the average monthly yield of the ten-year bond in the euro area and the United States was 4.11% and 4.13% respectively in September, compared with 4.02% and 3.81% in March 2004, and 4.36% and 4.26% in December 2003. The increase in government bond yields in the second quarter was less pronounced in the euro area than in the United States; consequently, the ten-year government bond yield spread between the euro area and the United States turned negative from March onwards.

The drop in government bond yields since July is also reflected in the implied forward euro area overnight interest rate curve, which in early September shifted downwards compared with the end of 2003, despite a rise in those rates in the second quarter of 2004. This curve is derived from interest rate swaps with maturities of up to ten years and incorporates market expectations about the future path of short-term interest rates, which are connected with growth and inflation expectations. However, the volatility[28] of government bond prices in the euro area remained low during the period under review and in early September stood at a level considerably lower than the average for the past five years.

3.4 Stock market developments

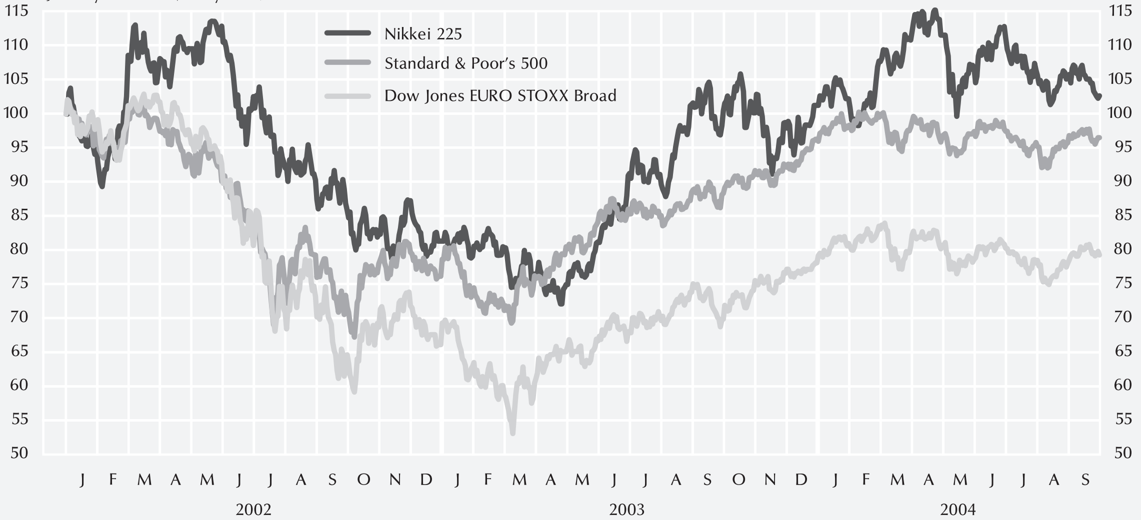
Until early March 2004, share prices in euro area stock markets continued the rising course they had taken up in March 2003, reflecting an upward revision of market expectations about economic activity and corporate earnings in the euro area. Thereafter, however, this upward trend came to a halt and at end-September stock prices were slightly higher than at end-2003 (see Chart II.11). This development was the result of

28 Volatility in the bond market is calculated on the basis of implied volatility of the prices of futures contracts on the German ten-year bond.

Chart II.11

Stock price indices (1 January 2002 - 30 September 2004)

(January 2002=100, daily data)



Source: Bloomberg.

counterbalancing factors, i.e. on the one hand, increased uncertainty relative to the early part of the year, as reflected in higher stock market volatility, and investors' concerns regarding the outlook for corporate earnings and oil prices, and on the other hand, the low level of long-term interest rates. In particular, at end-September 2004, the broad Dow Jones EURO STOXX index[29] increased by 1.5% compared with the levels of end-December 2003.

29 This index is compiled on the basis of the stock prices of 325 euro area companies.

III. Macroeconomic developments in Greece

1. Inflation developments, determinants and prospects

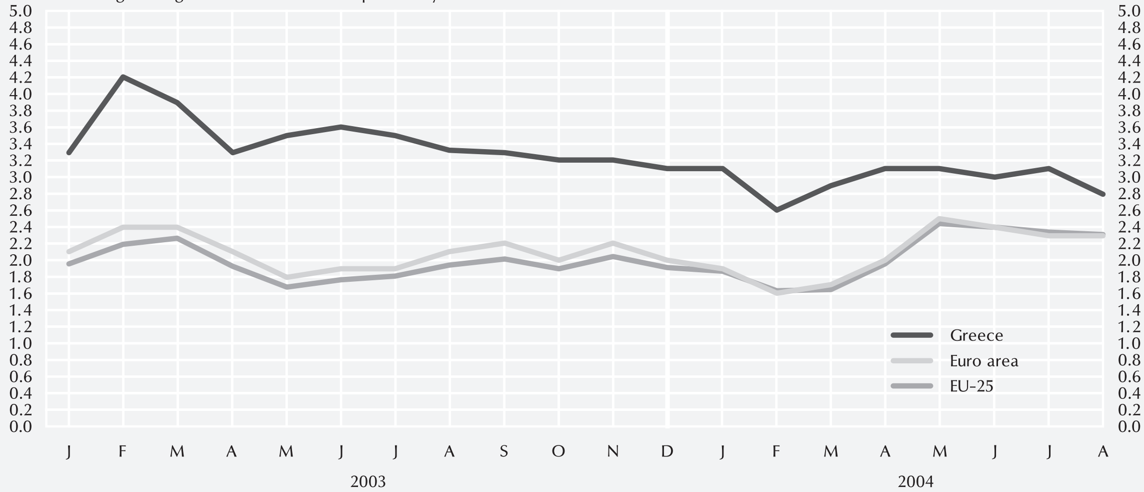
The average annual rate of inflation in Greece, on the basis of the Harmonised Index of Consumer Prices (HICP – see Chart III.1), fell to 3.0% in the first eight months of 2004 (from 3.6% in the corresponding period of 2003), exclusively on account of exogenous effects (mainly the fall in the prices of fresh fruit and vegetables). In contrast, core inflation, as measured by the annual rate of change in the HICP excluding energy and unprocessed food (see Chart III.2), not only remained high (3.5% on average in the first eight months of the year), but also accelerated compared with the corresponding period of 2003 (3.1%). Indeed, core inflation has been following an almost steady upward trend since the second half of 2003: from 2.8% in the second quarter of 2003 it is estimated to have risen to 3.7% in the third quarter of 2004. Thus, the differential of the Greek HICP inflation over the average annual inflation in the euro area (2.1%) narrowed to 0.9 percentage point on average in the first eight months of 2004, from 1.5 percentage points in the corresponding period of 2003. However, the differential of the Greek core inflation over the respective euro area figure in the same period (2.1%) widened to 1.4 percentage points, from 1.1 percentage points in the first eight months of 2003; in August 2004 this differential stood at 1.3 percentage points (3.5%, August 2003: 2.2%).

Moreover, on the basis of the Consumer Price Index (CPI), the average annual rate of inflation declined to 2.8% in the first eight months of 2004, from 3.7% in the corresponding period of 2003. In the same period however, core inflation, as measured in this case by the annual rate of change in the CPI excluding fuel and fresh fruit and vegetables, remained high (3.4% on average) and steadily

Chart III.1

Harmonised index of consumer prices in Greece, the euro area and the European Union
(January 2003 - August 2004)

(Percentage changes over same month of previous year)

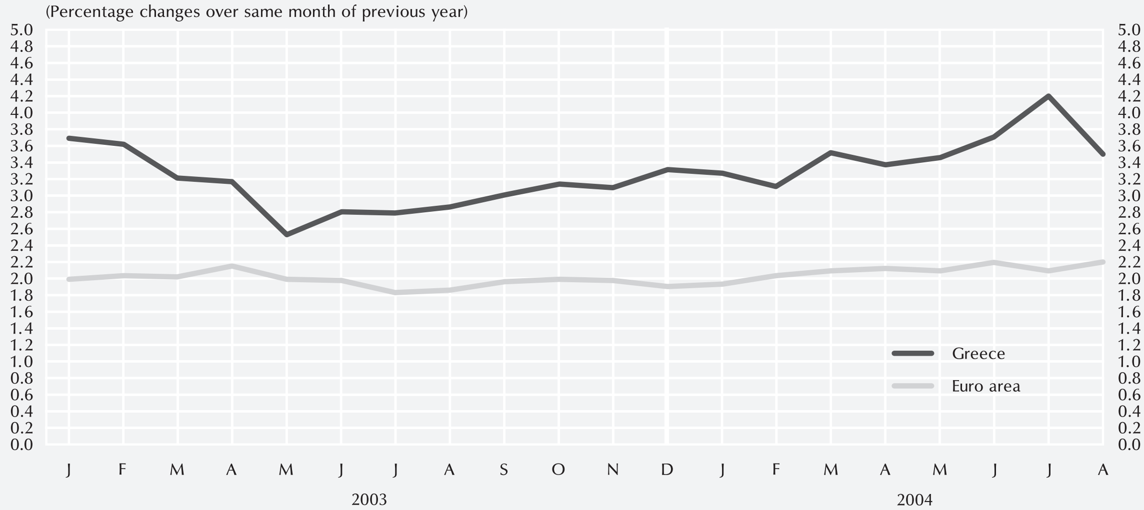


Sources: NSSG and Eurostat.

Chart III.2

Core inflation in Greece and the euro area on the basis of the HICP excluding energy and unprocessed food
(January 2003 - August 2004)

(Percentage changes over same month of previous year)



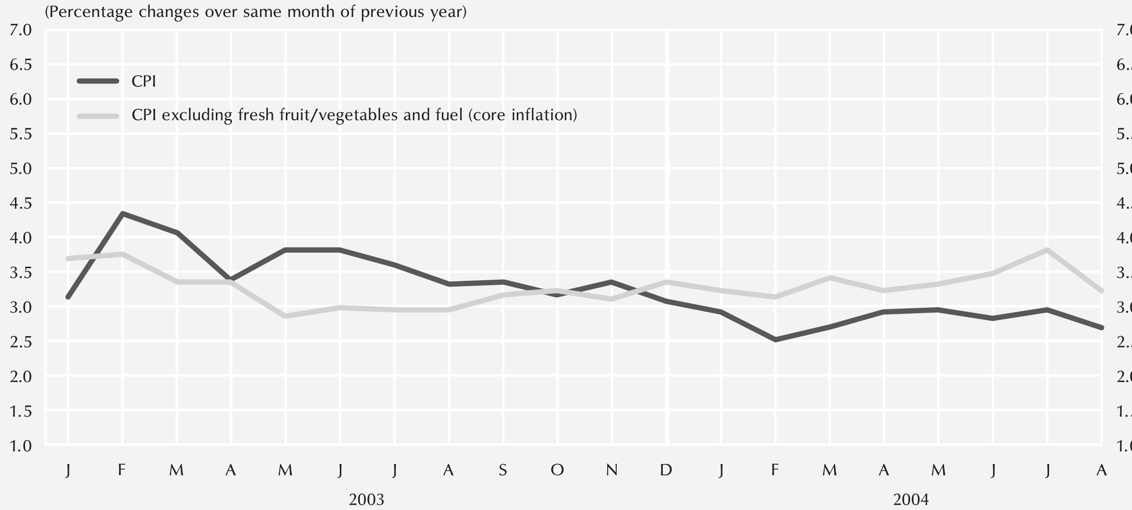
Sources: NSSG and Eurostat.

rose further from 3.0% in the third quarter of 2003 to an estimated 3.5% in the third quarter of 2004 (see Chart III.3).

As already mentioned, the slowdown observed in the average annual growth rates of the CPI and the HICP in the first eight months of 2004 (compared with the corresponding period of the previous year) is exclusively attributable to exogenous factors. Specifically, in the first quarter of the year fuel retail prices were 5.7% lower than in the corresponding period of 2003 (when

Chart III.3

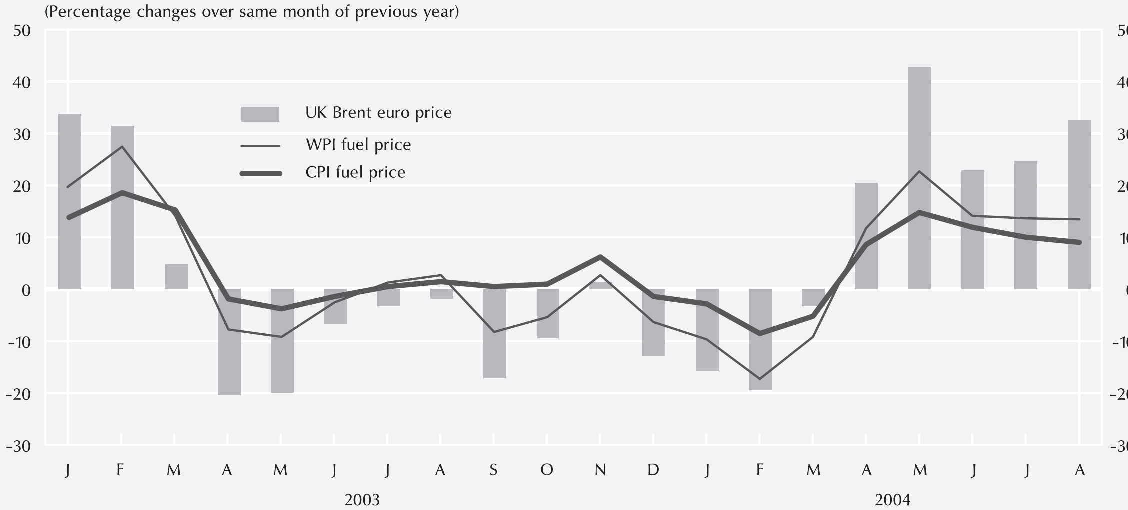
Consumer price index and core inflation in Greece
(January 2003 - August 2004)
(Percentage changes over same month of previous year)



Source: Calculations based on NSSG data.

Ghart III.4

Evolution of CPI/WPI fuel prices and of the euro price of Brent crude oil
(January 2003 - August 2004)
(Percentage changes over same month of previous year)

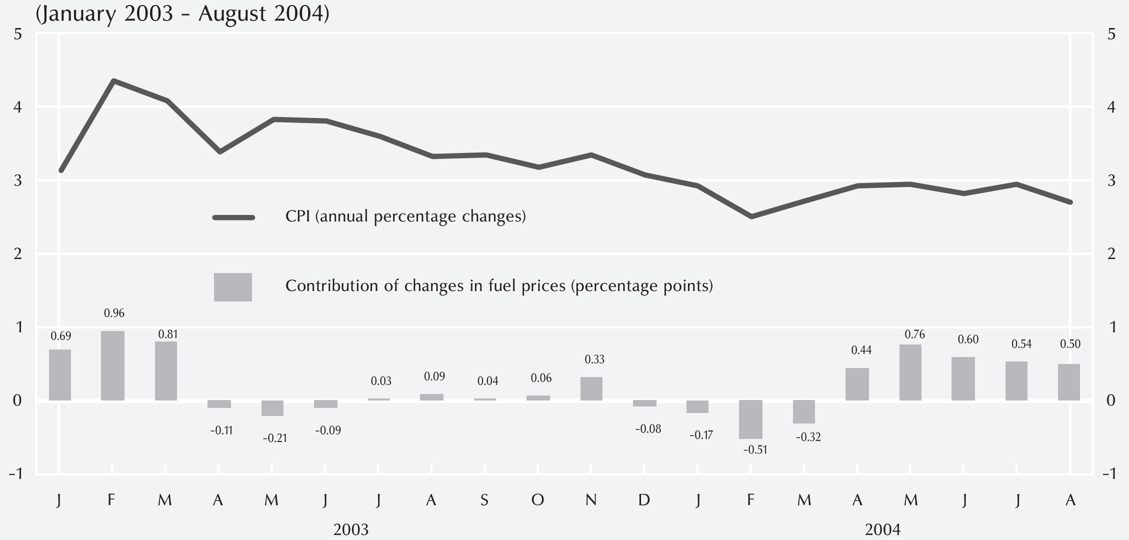


Source: Calculations based on NSSG data and, for crude oil prices (UK Brent), on US Department of Energy data.

world crude oil prices soared due to uncertainty on account of the then anticipated war in Iraq – see Charts III.4 and III.5). In addition, unprocessed food prices fell considerably from the second quarter of 2004 onwards. Fresh fruit and vegetable prices were decreasing at an annual rate of 28.2% in July and of 20.3% in August[1] (see Chart III.6).

1 The average annual rate of change in fresh fruit and vegetable prices (on a CPI basis) was negative (–11.3%) in the first eight months of 2004, while it was positive (+12.6%) in the corresponding period of 2003.

Chart III.5
Inflationary contribution of changes in fuel prices
(January 2003 - August 2004)



Source: Calculations based on NSSG data.

As regards fuel prices, it should be noted that the prices of Brent oil in US dollars rose at a high average annual rate (22.5%) in the first eight months of 2004 (to an average of $34.8 per barrel, from $28.4 in the corresponding period of 2003). Still, given that the exchange rate of the euro vis-à-vis the US dollar, despite having declined from its level in early 2004, remains above its levels in 2003 (showing an average annual appreciation of 10.4% in the first eight months of 2004), Brent oil prices in euro rose at an average annual rate of only 10.9% in the same period.[2] In the domestic market,[3] fuel prices included in the CPI increased at an average annual rate of 4.3% in the first eight months of 2004, compared with 5.0% in the corresponding period of 2003. More recently however —in the April-August 2004 period— they rose at an average annual rate of 10.8%, while in the corresponding period of 2003 they had declined by 1.0%.[4]

The rise in core inflation reflects the faster growth of prices of goods (excluding fuel and fresh fruit and vegetables).[5] This growth was only partly offset by the slight slowdown of the average annual rate of increase in services prices,[6] which however remains close to 4% and appreciably higher

2 Indicatively, the price of Brent crude oil was €25.0 in the first quarter of this year (compared with €28.4 in the same quarter of 2003), but rose to €29.3 in the second quarter (compared with €22.7 in the second quarter of 2003) and to €34.1 in August (28.7% higher than in August 2003). See ECB, *Monthly Bulletin*, September 2004, section "Euro area statistics", Table 5.1.

3 The divergence between changes in world crude oil prices and changes in domestic retail or wholesale prices of oil products reflects developments in the other components of fuel prices in the domestic market (process-distribution-trading costs and taxes). In particular, domestic consumer prices of fuel are less vulnerable to changes in world crude oil prices, as 54-55% of the retail gasoline and motor oil prices represents indirect taxes, most of which are fixed (defined per volume unit) and thus not do not change along when the price of the product does (except for VAT). In addition, 16-19% of the retail price reflects the processing, distribution and trading costs and the profit margin, while raw material costs account for the remaining 26-30% of the retail price. See also a relevant study by "Hellenic Petroleum S.A." (*The Oil Products Market*, 10 May 2004), available on the website of the Ministry of Development (www.ypan.gr). (It should be recalled that the share of indirect taxes in the retail price of heating oil is appreciably smaller during the winter period.)

4 In addition, at wholesale level, fuel prices rose at an average annual rate of 4.0% in the first eight months of 2004 (compared with 5.4% in the corresponding period of 2003). However, most recently —in the April-August 2004 period— the average annual growth rate was much higher (15.3%, compared with a deceleration of 2.9% in the corresponding period of 2003).

5 Their prices' annual rate of increase (on a CPI basis) was 2.9% in the first eight months of 2004, compared with 2.5% in the corresponding period of 2003.

6 Down to 4.0% in the first eight months of 2004, from 4.2% in the corresponding period of 2003 on a CPI basis (or to 3.9% from 4.2% on an HICP basis)

Chart III.6

Core inflation, prices of fresh fruit/vegetables and fuel
(January 2003 - August 2004)
(Annual percentage changes)

Source: Calculations based on NSSG data.

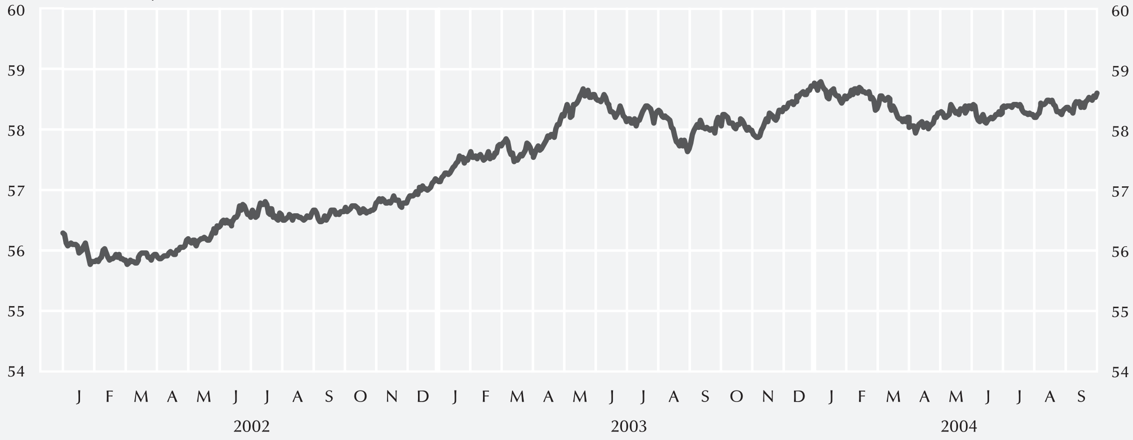
than average inflation. It is worth noting that the strengthening of inflationary pressures in the goods sector stems mainly from processed food, the prices of which increased at a high average annual rate in the first eight months of 2004 (5.4% compared with 3.3% in the corresponding period of 2003, on a HICP basis).[7] Indicatively, in July, when core inflation peaked at 4.2% on a HICP basis,[8] the annual rate of increase in processed food prices was also very high (6.1%).

This pattern of core inflation should be seen in conjunction with the even more intense inflationary pressures manifested at the level of wholesale prices. Indeed, wholesale prices of domestic industrial products for home consumption (excluding fuel) rose at an average annual rate of 4.3% in the first eight months of the year (com-

7 The prices of the other industrial consumer goods (excluding energy and food) rose by a mere 2.1%, but nevertheless more than in the corresponding period last year (1.7%).

8 To a certain extent, the rise of core inflation to 4.2% in July from 3.7% in June reflects the fact that the summer sales period started in July 2004 later than it had started in July 2003.

Chart III.7
Effective exchange rate index, weighted on the basis of Greece's external trade
(January 2002 - September 2004)
(1990=100, daily data)



Note: As of January 2001, changes in this index are relatively limited, since Greece's trade with the other euro area countries (which accounts for a substantial part of the whole) is carried out in euro.

Source: Bank of Greece.

pared with only 2.7% in the corresponding period last year).[9]

These unfavourable developments mainly reflect the faster than in 2003 growth of unit labour costs combined with persisting pressures on the demand side (discussed in more detail below), as well as spillover effects of the increase in world oil prices observed again since the second quarter of the current year.

To some extent, these inflationary pressures are moderated by the continuing appreciation of the euro, which restrains the rise in the prices of imported goods. Specifically, the effective exchange rate of the euro weighted on the basis of Greece's external trade (see Chart III.7) increased at an average annual rate of 0.7% in the first eight months of 2004 (compared with 3.1% in the corresponding period of 2003). Owing partly to the appreciation of the euro, wholesale prices of imported goods (excluding fuel) increased modestly both this year and the previous one (average annual growth rate: 0.3% in the first eight months of 2004 and 0.9% in the corresponding period of 2003 – see Chart III.8).

The upward trend of core inflation, the considerably faster rise in wholesale prices of domestic industrial products for home consumption (in contrast to a minimal rise in wholesale prices of imported goods) and, finally, the even faster increase of prices at which exporters offer their products (whether expressed in euro or in foreign currency terms)[10] suggest that domestic inflationary pressures, combined with lower inflation in Greece's trading part-

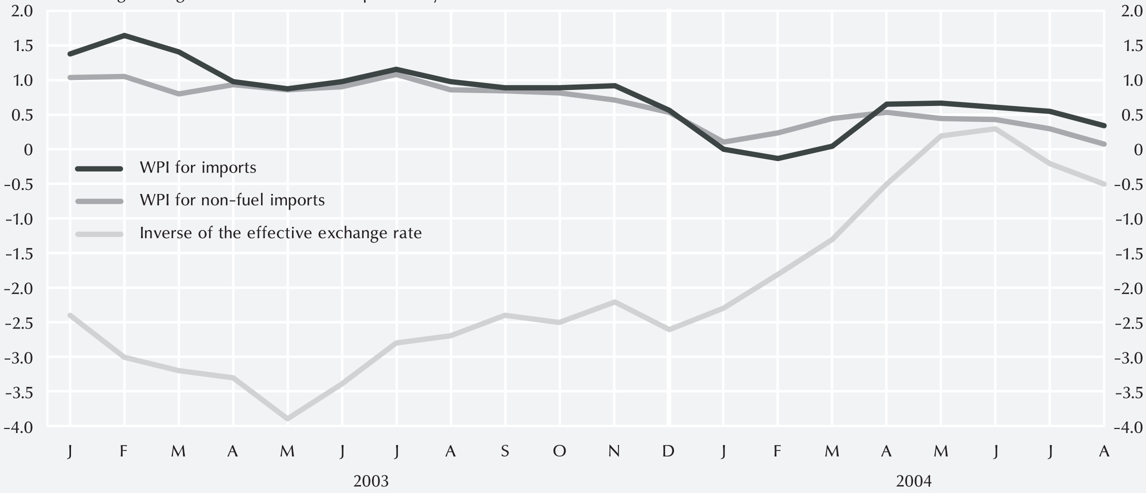
9 A similar acceleration during the seven months from January to July (from 2.3% to 3.8%) was seen in the producer price index (excluding energy), which is comparable in coverage.

10 Wholesale prices of export-oriented products (excluding fuel) rose at an average annual rate of 3.7% in the first seven months of 2004, compared with a deceleration of 0.9% in the corresponding period last year. (For the compilation of data on "wholesale prices of export-oriented products", see the relevant methodological note "Price indices: producer prices/wholesale prices metadata/summary methodology page" on the website of the NSSG – www.statistics.gr). Expressed in foreign currency (using the effective exchange rate of the euro weighted on the basis of Greece's external trade), such prices are estimated to have risen at an average annual rate of 4.5% in the period under review (compared with 2.1% in the corresponding period last year – see also Table III.1). It should be recalled that in the first 8-9 months of 2003 exporters were lowering or keeping unchanged their prices in euro (thus limiting the price increase in foreign currency that would have come as a result of the appreciation of the euro), while already since the last quarter of 2003 this pricing policy has been abandoned. It is estimated that this mainly reffects increased pressures from the side of labour costs.

Chart III.8

Wholesale import price index and the inverse of the effective exchange rate of the euro, weighted on the basis of Greece's external trade (January 2003 - August 2004)

(Percentage changes over same month of previous year)



Sources: NSSG and Bank of Greece.

Table III.1

Export price index and effective exchange rate of the currrency (2003-2004)

(Percentage changes over same month of previous year)

	Effective exchange rate of domestic currency	Wholesale prices of exported products			
		Total		Excluding oil	
		In domestic currency	In foreign currency	In domestic currency	In foreign currency
2003 Jan.	2.4	1.4	3.7	–1.0	1.3
Feb.	3.0	1.9	4.9	–1.4	1.6
March	3.2	0.0	3.2	–1.5	1.6
Apr.	3.3	–2.2	1.0	–1.3	1.9
May	3.9	–3.3	0.5	–2.4	1.4
June	3.4	–0.3	3.1	–0.2	3.2
July	2.8	0.7	3.5	0.3	3.1
Aug.	2.7	0.7	3.3	0.1	2.7
Sept.	2.4	–0.7	1.7	0.5	3.0
Oct.	2.5	0.2	2.8	1.2	3.7
Nov.	2.2	1.8	4.1	1.8	4.1
Dec.	2.6	1.1	3.7	2.2	4.9
2004 Jan.	2.3	1.9	4.2	3.7	6.1
Feb.	1.8	0.5	2.3	3.4	5.2
March	1.3	2.3	3.6	3.9	5.2
Apr.	0.5	4.6	5.2	3.6	4.1
May	–0.2	7.5	7.3	5.5	5.3
June	–0.3	4.8	4.5	3.7	3.3
July	0.2	4.1	4.3	3.0	3.2
Aug.	0.5	4.0	4.5	2.9	3.4

Source: Calculations based on NSSG and Bank of Greece data.

Table III.2

Harmonised index of consumer prices: Greece and the EU (2002-2004)

(Annual percentage changes)

Country	2002 (year average)	2003 (year average)	Aug. 2003	Aug. 2004
Austria	1.7	1.3	1.0	2.2
Belgium	1.6	1.5	1.6	2.0
Cyprus	2.8	4.0	2.4	2.8
Czech Republic	1.4	–0.1	–0.2	3.2
Denmark	2.4	2.0	1.5	0.9
Estonia	3.6	1.4	1.4	3.9
Finland	2.0	1.3	1.2	0.3
France	1.9	2.2	2.0	2.5
Germany	1.3	1.0	1.1	2.1
Greece	*3.9*	*3.4*	*3.3*	*2.8*
Hungary	5.2	4.7	4.7	7.2
Ireland	4.7	4.0	3.9	2.5
Italy	2.6	2.8	2.7	2.4
Latvia	2.0	2.9	3.4	7.8
Lithouania	0.4	–1.1	–0.9	2.2
Luxembourg	2.1	2.5	2.3	3.6
Malta	2.6	1.9	1.8	2.5
Netherlands	3.9	2.2	2.2	1.2
Poland	1.9	0.7	0.6	4.9
Portugal	3.7	3.3	2.9	2.4
Slovakia	3.5	8.5	9.0	7.0
Slovenia	7.5	5.7	5.7	3.7
Spain	3.6	3.1	3.1	3.3
Sweden	2.0	2.3	2.2	1.2
United Kingdom	1.3	1.4	1.4	1.3
EU–15	2.1	2.0	2.0	2.1
EU–25	2.1	1.9	1.9	2.3
Euro area	2.3	2.1	2.1	2.3

Source: Eurostat.

ners and the appreciation of the euro, negatively affect the price competitiveness of Greek products,[11] both in the domestic and in foreign markets.[12]

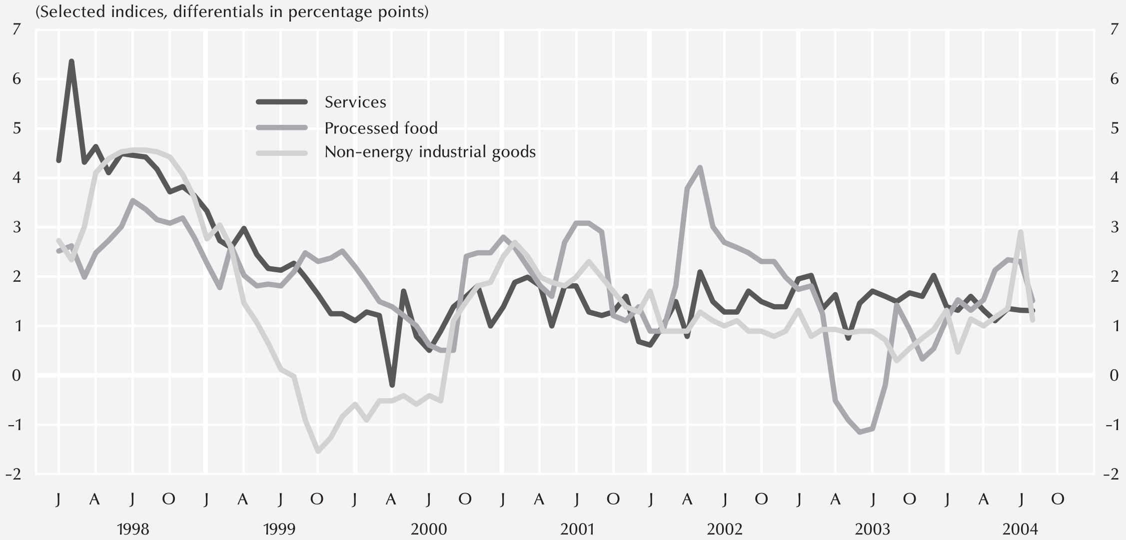
As it has been repeatedly pointed out,[13] the inflation differential between Greece and the euro area (see Table III.2) is largely attributable to the faster growth of domestic demand and the relatively high positive "output gap" that have been observed in Greece in recent years (see also below). The expansionary fiscal policy pursued in Greece in recent years (see also Chapter IV) also contributed to this positive differential. Another major factor was the faster increase in unit labour costs. Moreover, among more permanent factors, the upward deviation of Greek inflation from that of the euro area

11 The decline in the price competitiveness of Greek products becomes evident, among other things, from the rise in the indices of the real effective exchange rate (EER) of the euro weighted on the basis of Greece's external trade. Specifically, it is estimated that: (a) the euro's real EER index calculated on the basis of relative unit labour costs in manufacturing rose at an annual rate of 6.0% in the first half of 2004 (due primarily to the increase in relative labour costs and secondly to the appreciation of the euro) and (b) the real EER index calculated on the basis of relative consumer prices rose at an annual rate of approximately 2.0% in the same period (due almost as much to the increase in relative prices as to the appreciation of the euro).

12 According to the sample survey *Greek manufacturing: estimates for 2003 and expectations for 2004* conducted (in March and April 2004) by ICAP and the Federation of Greek Industry (SEB), 27.3% of the manufacturing firms that replied deemed the effects of the appreciation of the euro in 2003 positive, while 29.2% considered them negative. As regards negative effects, 17.0% of respondents find that the appreciation contributed to a decrease in export competitiveness (this percentage is much higher among large firms with assets of at least €30 million). In addition, 9.1% of respondents find that the appreciation had a negative effect because it made imports from non-EU countries more competitive in the domestic market.

13 For the determinants of inflation differentials between Greece and the euro area, see (a) Bank of *Greece, Monetary Policy – Interim Report 2003*, October 2003, pp. 47-51, (b) Bank of Greece *Monetary Policy 2003-2004*, March 2004, pp. 39-45, and (c) Bank of Greece *Annual Report 2003*, April 2004, pp. 137-41.

Chart III.9
Annual inflation differentials between Greece and the euro area (1998-2004)
(Selected indices, differentials in percentage points)



Source: Calculations based on Eurostat and ECB data.

is partly attributable to the catching-up of price and income levels, which is linked to the process of real convergence ("Balassa-Samuelson effect"). At the same time, structural factors, such as price rigidities and inadequate competitive conditions in key domestic markets, have also contributed, to some extent, to the observed inflation differential and its persistence.

The inflation differential is particularly important as regards tradable goods (and —additionally in the case of Greece— tradable services, e.g. tourism). An analysis of price developments in the three items that constitute the core inflation basket on a harmonised basis (non-energy industrial goods, processed food and services), reveals the following:

— The positive differential between Greece and the euro area as to the average annual rate of increase in the prices of non-energy industrial goods (a major category of internationally tradable goods) rose from 0.9 percentage point in the first eight months of 2003 to 1.3 percentage points in the corresponding period of the current year.

Table III.3
Contribution to the inflation differential between Greece and the euro area (2001-2004)
(Percentage points)

	Differential of average annual rates of HICP change	Contribution to the inflation differential stemming from the difference in the average annual rates of change in:		
		core inflation	unprocessed food prices	energy prices
2001	1.4	1.6	0.1	–0.3
2002	1.6	1.2	0.4	0.0
2003	1.3	0.9	0.4	0.0
2004 (Jan-Oct.)	0.9	1.2	–0.4	0.1

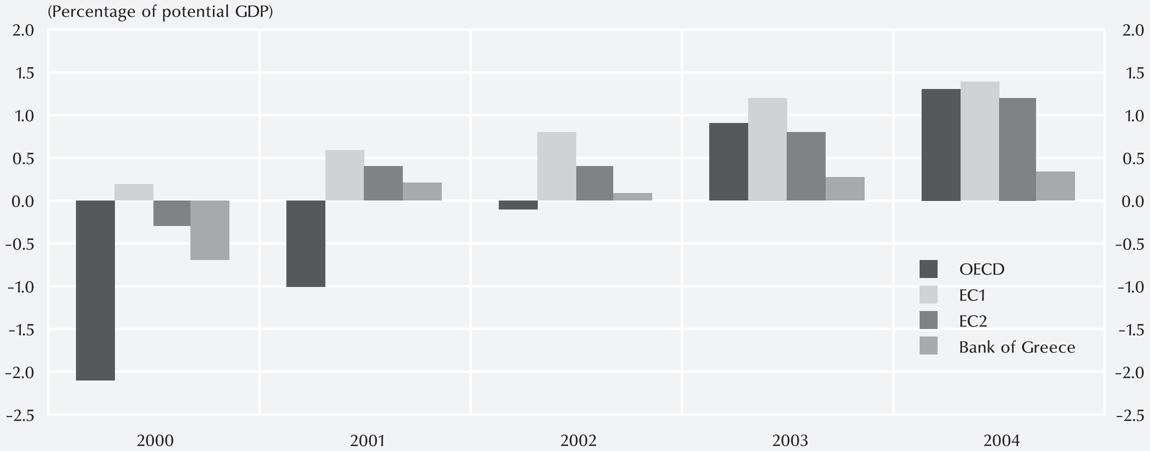
Source: Calculations based on Eurostat and ECB data.

— In processed food (another major category of internationally tradable goods), the positive inflation differential between Greece and the euro area

Chart III.10

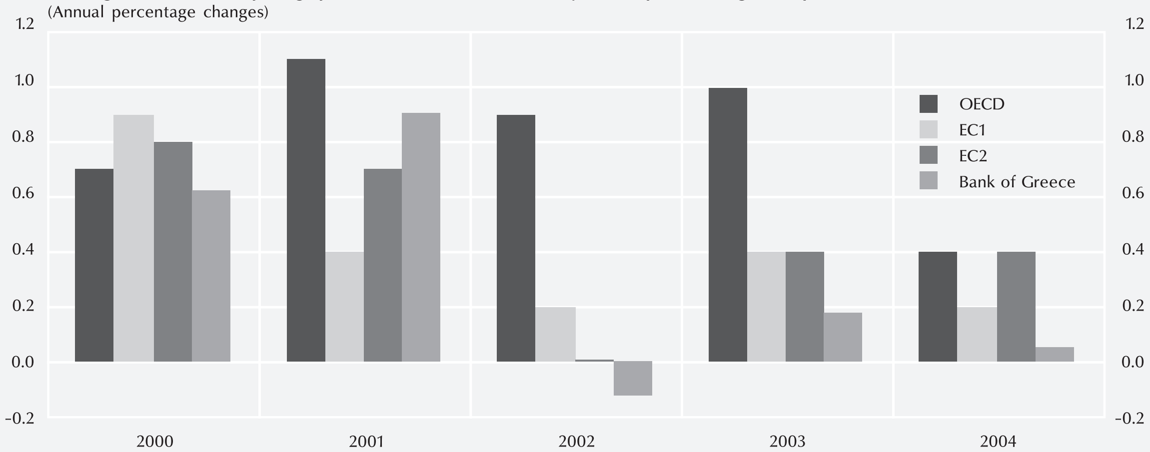
The output gap of the Greek economy

(Percentage of potential GDP)



Ghanges in the output gap of the Greek economy as a percentage of potential GDP

(Annual percentage changes)



EC1: European Commission estimate of the output gap on the basis of trend GDP.
EC2: European Commission estimate of the output gap on the basis of a production function.

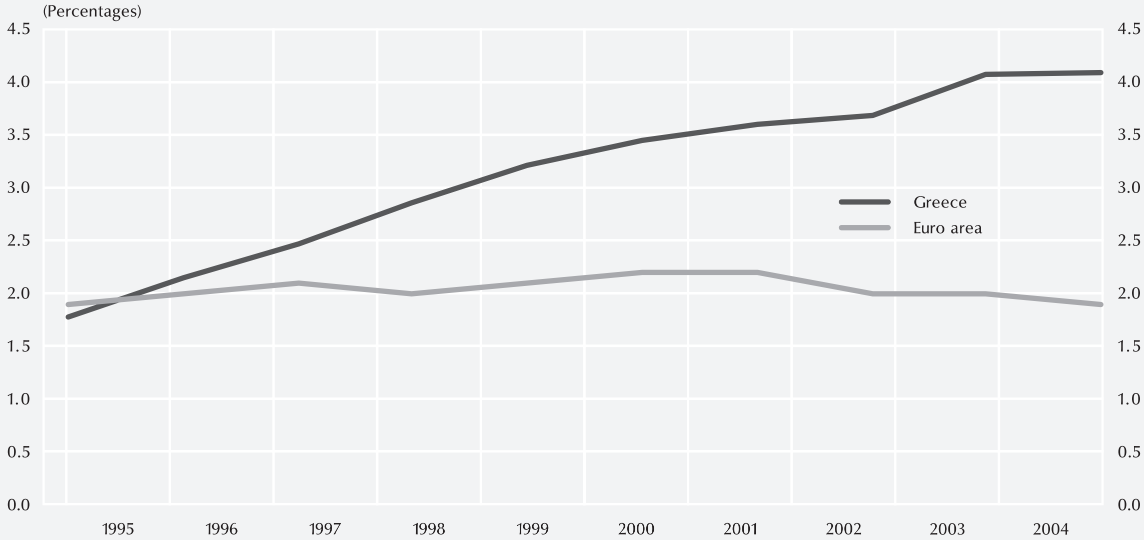
Sources: OECD, *Economic Outlook,* June 2004.
European Commission, *Spring 2004 Economic Forecasts*.
Bank of Greece: Estimates of the Economic Research Department.

widened much more, from just 0.1 percentage point in the first eight months of 2003 to 1.7 percentage points in the corresponding period of 2004.

— By contrast, in services (which are not internationally tradable, with the most notable exception of those connected with tourism) the positive differential decreased slightly, from 1.5 percentage points in the first eight months of 2003 to 1.3 percentage points in the corresponding period of the current year (see Chart III.9 and Table III.3).

It is also worth noting that the differential between the cumulative increase in the prices of goods and services (excluding energy and unprocessed food) in Greece during the 2001-2004 four-year period and the corresponding increase in the euro area is almost 6.0 percentage points and implies an appreciable loss of price competitiveness, which obviously —subsequent to the introduction of the single currency— cannot be dealt with through an exchange rate adjustment but requires other policy measures (see also Chapter VI).

Chart III.11
Potential GDP growth rate
(Percentages)



Sources: Bank of Greece and OECD.

As it has been repeatedly pointed out in previous Reports,[14] the persistently high levels of core inflation are attributable on the one hand to macroeconomic factors (connected both to demand and to costs of production), and on the other hand to unsatisfactory competitive conditions in certain markets (which do not operate efficiently). Depending on the case, excess demand, price inelasticity of demand (for some articles) and/or exploitation of dominant market position by some enterprises lead to greater price increases than justified by developments in cost factors. Thus, according to the available data, profit margins continue to widen in 2004 (having started to do so in 2003) and in fact in branches particularly influential for consumer prices.[15] Additionally, on the cost side, the rate of increase in unit labour costs shows a remarkable acceleration this year, both in the whole economy and in the business sector, and continues to stand above the level which is in principle compatible with price stability, i.e. an inflation rate of below but close to 2%. It is self-evident that developments in unit labour costs in the business sector are not only an "autonomous" cost factor, but also reflect the effects of changes in demand, since excess demand affects both the enterprises' wage policies and the employees' bargaining power.

With particular regard to demand-induced inflationary pressures, it is indicative that the growth rate of private consumption has accelerated so far this year (see more details in Section 2 of this Chapter). Furthermore, according to most of the latest available estimates (see Charts III.10 and III.11),[16] the Greek economy's "output

14 See, for instance, Bank of Greece, *Monetary Policy 2003-2004*, March 2004, pp. 39-40.

15 The income statements of enterprises listed on the Athens Exchange (Athex) for the first half of 2004 confirm that both pre-tax and operating profits grew considerably (at rates in the region of 15-20%). In fact, since profits increased much faster than sales or turnover (9-10%), profit margins (both net and operating ones) widened further. Clear increases in profit margins were recorded in wholesale and retail trade, information technology, restaurants, furniture, publishing-printing, health services and metallurgy. These data are not necessarily representative of the total of enterprises. On the basis of a wider sample of 541 non-financial corporations (including *non-listed* enterprises as well), sales, gross (operating) profits and net profits rose by 9.6%, 12.5% and 16.8% respectively in the same period and thus profit margins also increased.

16 Estimates by the European Commission (*Spring 2004 Economic Forecasts*, 7 April 2004), the OECD (*Economic Outlook*, June 2004) and the Bank of Greece.

gap"[17] is positive in the 2001-2004 period[18] (i.e. actual output exceeds potential output) and follows an upward trend. Therefore, excess demand has contributed in some measure to the persistently high levels of inflation.[19]

Unit labour costs in the whole economy are estimated to be growing by 4.8% in 2004 (compared with 3.0% in 2003),[20] reflecting a 6.4% increase in average pre-tax earnings this year, compared with 5.5% in 2003 (see Table III.4),[21] and the slightly slower productivity (GDP per employee) growth, estimated at approximately 2.0%. The annual growth rate of unit labour costs in the business sector,[22] which affects price levels more directly, is also estimated to be accelerating —albeit less than in the whole economy— coming to 4.1% this year from 3.0% in 2003.[23] This sizeable differential between the rates of change in unit labour costs in the economy as a whole and in the business sector is attributable to the large increase in the central government wage bill (discussed below).

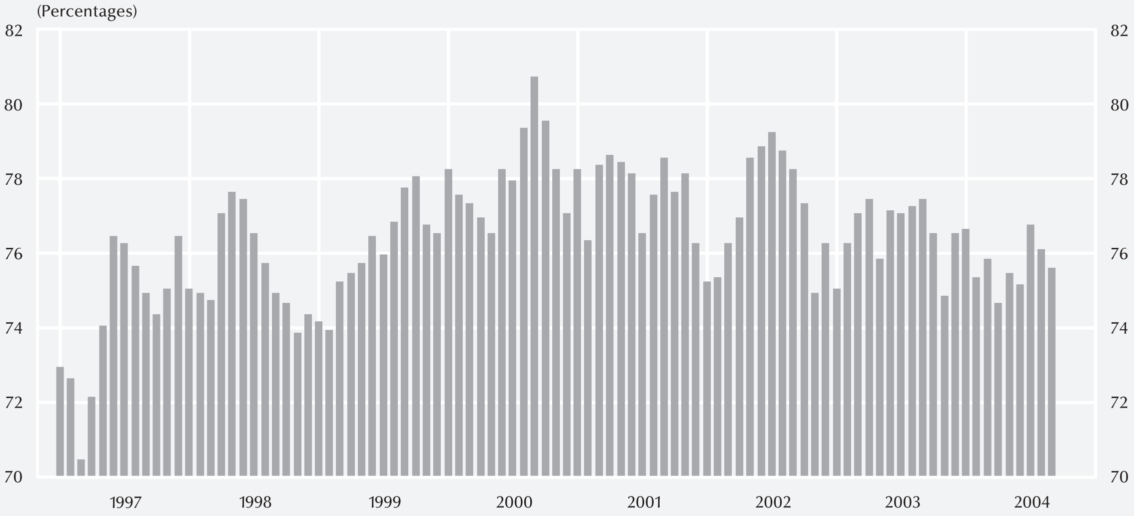
Firstly, unit labour cost growth in the business sector reflects developments in wages. Specifically, in the non-bank private sector, on the basis of the two-year (2004-2005) collective labour agreements signed this year, it is estimated that the average annual rate of increase in contractual wages (at branch level) is 5.0% (compared with 5.1% in 2003 and 5.7% in 2002). Particularly regarding minimum wages (according to the National General Collective Labour Agreement (NGCLA) signed on 24 May 2004), the average annual increase is 4.7% for unskilled blue- and white-collar workers with previous employment and 5.3% for those without previous employment, while the average increase for all NGCLA categories is estimated at 4.8%.[24] Furthermore, the average annual contractual increase is estimated to be 6.3% in public enterprises and entities[25] and 5.1% in banks.[26]

---

17 The "output gap" is defined as the difference between the level of actual output (GDP) and the country's production capacity (level of potential GDP), as a percentage of *the level* of potential GDP. It is not directly measurable but estimated using various alternative methods. Estimates of potential output and the "output gap" are surrounded by a high degree of uncertainty, frequently revised and only finalised with considerable delays (relative to the period they refer to). Furthermore, the relationship between the "output gap" and inflation is complex and may vary over time. These factors should be taken into consideration when results are assessed. A useful —and perhaps more reliable— indicator is the *change* in the "output gap" (measured in percentage points of GDP).
18 According to the OECD, the "output gap" was negative in 2001 (–1.0) and 2002 (–0.1).
19 Estimates about the Greek economy's "output gap" being positive in the last four-year period seem, at first sight, inconsistent with the fact that the unemployment rate remains high and the employment rate relatively low, but may be indicating that the utilisation of labour force reserves with a view to increasing the country's potential output is impeded by the rigidities that exist in labour and product markets. Moreover, in industry (which however accounts for only 11% of GDP), the rate of capacity utilisation —already slightly lower in 2003 (76.5) compared with 2002 (77.1)— is lower this year by almost one percentage point (see Chart III.12), which implies that there is room for a more intense capacity utilisation in this sector.
20 In these estimates, (nominal) unit labour costs are defined as the ratio of total compensation of employees to real GDP or —equivalently— as the ratio of compensation per employee to productivity (measured as GDP per employee). In National Accounts they are defined differently, i.e. as the ratio of compensation per employee to productivity (but this time measured as GDP per employed person in general, including the self-employed). The reasons for which the Bank of Greece takes into consideration the change in productivity on the basis of the change in the ratio of GDP per employee when changes in unit labour cost are measured, have been presented in previous Reports (see Bank of Greece, *Monetary Policy 2002-2003*, March 2003, Box 2, pp. 47-48 and *Annual Report 2002*, April 2003, Box IV.1, pp. 102-04).
21 Compensation per employee, which includes employers' (social security and other) contributions to employees' social security funds as well as central government outlays for pensions, is estimated to be rising this year by 6.8% compared with 5.4% in 2003.
22 The business sector comprises public and private enterprises and banks.
23 For manufacturing in particular, it is estimated that the growth rate of unit labour costs will accelerate to 4.2% this year from 3.6% in 2003.
24 For 2005, the NGCLA provides for an average annual increase of 4.7% for unskilled blue- and white-collar workers with previous employment and of 5.6% for those without, while the average increase for all categories covered by the agreement is estimated at 4.9%.
25 The two-year collective agreements (signed in May and June) provide for an average annual contractual increase of 6.9% for the Hellenic Telecommunications Organisation (OTE) employees and of 5.7% for the Public Power Corporation (DEH) employees in 2004, and of 5.5% and 6.3%, respectively, in 2005.
26 In banks, the two-year collective agreement was signed in June (and provides for an average annual contractual increase of 4.9% for 2005).

Chart III.12

Industrial capacity utilisation rate (manufacturing)
(January 1997 - September 2004)
(Percentages)



Source: Foundation for Economic and Industrial Research (IOBE).

Table III.4
Employees' earnings, productivity and labour costs (2000-2004)

(Annual percentage changes)

	2000	2001	2002	2003	2004 (estimate)
Average gross earnings *(nominal)*:					
– *whole economy*	*6.3*	*5.0*	*6.9*	*5.5*	*6.4*
– central government[1]	7.1	5.5	7.3	6.0	8.4
– public enterprises	13.7	8.2	11.2	7.0	7.8
– banks	6.8[4]	6.4	2.9[6]	3.1[6]	6.6
– non-bank private sector	5.0	5.3	6.5	5.8	5.8
Minimum earnings	4.2	3.5	5.4	5.1	4.8
Net[2] income of an employee with average earnings					
(nominal)	8.4[5]	3.7	6.6[7]	6.1	4.8
(real)	5.0[5]	0.3	2.9[7]	2.5	1.7
Total compensation of employees (including employers' social security and other contributions)[11]	**7.9**	**7.7**	**8.8[8]**	**7.6[9]**	**9.0**
Compensation per employee	**6.1**	**5.1**	**6.1[8]**	**5.4[9]**	**6.8**
GDP[10]	**4.5**	**4.3**	**3.6**	**4.5**	**4.0**
Output per person-hour in manufacturing[11]	1.7	2.5	1.6	2.2	1.5
Unit labour costs:[11]					
– *whole economy*	*3.3*	*3.3*	*5.0[8]*	3.0[9]	4.8
– business sector[3]	3.0	3.9	4.3[8]	3.0[9]	4.1
– manufacturing	3.7	2.9	4.2[8]	3.6[9]	4.2

1 Compensation per employee.
2 Gross earnings *less* employees' social security contributions *less* income tax.
3 The business sector comprises private and public enterprises and banks.
4 Excluding one major bank, where average earnings *decreased* by around 7.5% owing to the retirement of a large number of high-salaried employees (originating from a merged smaller bank), average earnings of bank employees rose by about 10%.
5 Including tax refunds (in January 2000) to wage earners (other than civil servants); also including the reduction (as from 1 September 2000) in social security contributions of minimum wage earners.
6 The relatively low rate of increase in average earnings of bank employees reflects mainly changes in the composition of personnel.
7 Including the abolition (as from 1 January 2002) of stamp duties (0.6% of gross earnings) paid by business sector employees.
8 Including the abolition (as from 1 January 2002) of stamp duties (0.6% of earnings) paid by business sector employers.
9 Including the increase (of 0.1% of gross earnings) in both employees' and employers' contribution to the Workers' Fund.
10 Revised NSSG estimates for the years 2000-2003 (September 2004). Bank of Greece estimates for 2004.
11 Revised estimates. Account was taken of the NSSG's revised data on the evolution of salaried employment in 2000-2003.
Sources: NSSG (2000-2003 GDP), Bank of Greece estimates and forecasts (for GDP in 2004 and for the other annual aggregates in 2000-2004).

Finally, in central government, taking into account the initial projections of the Government Budget for 2004, the introduction of new civil servant salary scales (Law 3205/2003), the estimates in the Draft Government Budget for 2005 regarding wage bill developments in 2004 and the change in employment,[27] it is calculated that, although on the basis of the new salary scales the average annual increase comes to 6.4%, compensation per employee will finally rise by 8.4%.[28] The fact that the estimated rate of increase in compensation per civil servant for 2004 as a whole is considerably higher than the already high rate of increase stemming from the introduction of the new salary scales reflects: (a) the retroactive payment (pursuant to court decisions) of family allowances for the years 2001-2002 to both spouses when they are both civil servants, (b) the wages paid for additional or overtime employment during the parliamentary elections and the Euro-elections, and (c) the payment of a special bonus to certain categories of personnel involved with security during the 2004 Olympic Games ("Olympic bonus"). Finally, the even higher rate of increase in government outlays when pensions are also taken into consideration is attributable to increased retroactive payments for pensions due to the implementation of the 2003 incomes policy (see also Chapter IV).

* * *

On the basis of (a) what has been discussed so far, in combination with certain assumptions regarding the world oil price outlook,[29] the exchange rate of the euro and the prices of imported goods,[30] (b) the observed developments in fresh fruit and vegetable prices and (c) the estimates presented earlier regarding unit labour costs, profit margins and demand (always in relation to the economy's production capacity), it is in principle possible to project developments in inflation until the end of the year.

At the same time, it should also be taken into consideration that, although —based on the past experience of other countries— stronger inflationary pressures, particularly in the services sectors, were anticipated during the Olympic Games, no such phenomenon was observed, a fact which must be attributed to the efforts of the Ministry of Development and the contribution of the social partners. Specifically, in order to keep inflationary pressures in check, the government (a) has announced its intention not to let the rates of public utilities increase in 2004 and

---

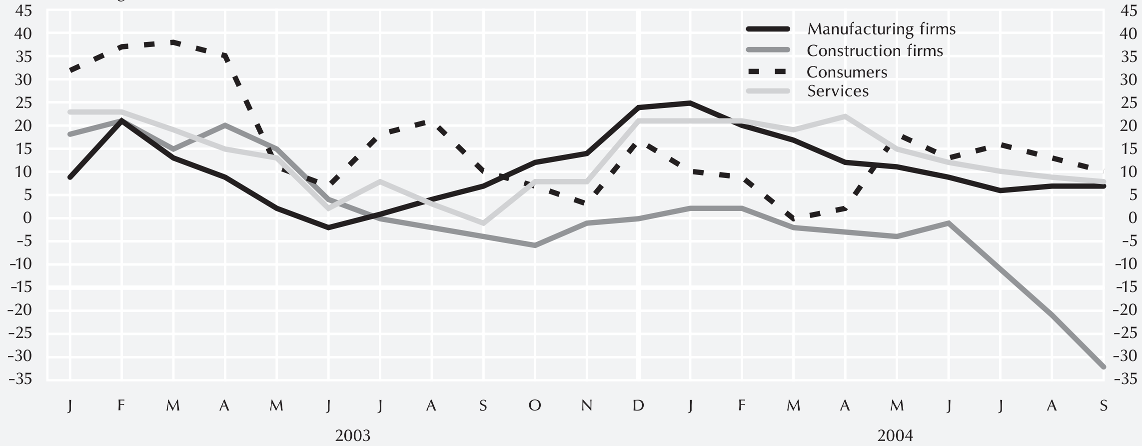
27 According to data published by the Ministry of Economy and Finance, central government outlays for personnel (net of pensions), which comprise "salaries", "additional benefits" and "salary subsidies", rose by 11.6% in the *first seven months of 2004* compared with the corresponding period of 2003. If outlays for pensions are added, this increase comes to 13.1%. Moreover, in the first half of 2004 the number of civil servants grew at an annual rate of 0.7%.

28 *For the year as a whole*, in the Draft Government Budget for 2003 it is estimated that personnel outlays will increase by 9.2% (net of pensions), compared with 7.8% in 2003, or by 10.5% (including pensions), compared with 7.4% in 2003. The number of central government personnel is projected to rise by 0.7%, compared with 1.7% in 2003.

29 For 2004 as a whole, on the basis of *the technical assumption —not a projection—* that the September levels of both the price of Brent oil in US dollars (approximately $43 per barrel) and the exchange rate of the euro vis-à-vis the US dollar (€1 = $1.222) will remain unchanged until the end of the year, it is deduced (a) that the average annual increase in the price of Brent oil will reach 23.0% in euro (compared with an average annual decrease of 5.3% in 2003) and 33.0% in US dollars, and (b) that the average annual appreciation of the euro vis-à-vis the US dollar will be in the region of 8.5%. Regarding the average annual increase in the price of crude oil in US dollars, the forecast of the International Monetary Fund (IMF, *Economic Outlook,* September 2004) as to the average of prices of three types of oil (Brent, Dubai and West Texas Intermediate) is similar (28.9%).

30 On the basis of the technical assumption —not a projection— that the exchange rates of the euro vis-à-vis the other currencies will remain at the levels prevailing in the second half of September 2004 (see Chart III.7), the average annual level of the effective exchange rate of the euro weighted on the basis of Greece's external trade will rise by 0.7% for 2004 as a whole (compared with 2.9% in 2003).

Chart III.13
Inflation expectations[1] of consumers and business firms (January 2003 - September 2004)
(Percentage balances)



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

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

2005,[31] (b) has intensified inspections of compliance with the Price Control Code (while the Competition Committee has also been quite active), and (c) came to an agreement with business associations and the social partners with a view to ensuring the smooth operation of the market and moderation of prices during the Olympic and the Paralympic Games.[32]

In light of all the above factors, it is estimated that in 2004 as a whole the average annual increase in the HICP will be 3.0% and of the CPI 2.9%, i.e. less than in 2003 (when the HICP stood at 3.4% and the CPI at 3.5%). However, this estimate does not imply that inflationary pressures are decreasing, given that core inflation is expected to rise. Specifically, it is estimated that in 2004 as a whole the average annual rate of change in the HICP excluding energy and unprocessed food will reach 3.6% (from 3.1% in 2003), and the average annual rate of change in the CPI excluding fuel and fresh fruit and vegetables will reach 3.4% (from 3.2% in 2003).[33]

---

31 "It is our policy to go for zero increases in utility rates for 2004 and 2005, whereas utility companies' profits should stem from increased productivity through operating and administrative improvements. In exceptional cases, requests for higher rates will be considered only if increases in some cost items cannot be absorbed by reductions in other cost items or by increases in revenue" (Speech by the Minister of Economy and Finance during a meeting with the Managements of Public Utility Companies on 16 June 2004).

32 See the relevant statements by the Minister of Development (on 20 July and 15 September 2004) following his meetings with more than 20 production agents and the social partners. At the same time, it is worth noting that, at least according to the business surveys of the IOBE conducted in the first nine months of the current year in the branches of manufacturing, retail trade and services (excluding retail trade and banks), the short-term inflation outlook is relatively favourable. These surveys show that the percentage of enterprises that expect price increases for their products and services in the next 3-4 months (to be exact: the positive balance between the percentage of enterprises that expect increases and that of those expecting reductions), after increasing in the first quarter of 2004, receded considerably thereafter (see Chart III.13). In contrast, developments in the balance of consumers expecting higher inflation in the next twelve months (as this is recorded by a survey conducted on behalf of the European Commission) suggests an upsurge in inflation expectations in the second and third quarters.

33 It is projected that the annual rate of change in the HICP excluding energy and unprocessed food will reach 3.8% in the last quarter of 2004 (from 3.2% in the last quarter of 2003) and the annual rate of change in the CPI excluding fuel and fresh fruit and vegetables will reach 3.5% (from 3.2% in the same period of 2003).

Chart III.14
The coincident indicator of economic activity compiled by the Bank of Greece
(Annualised monthly percentage changes)

Sources: Bank of Greece (coincident indicator, as well as GDP for 2004) and NSSG (GDP for 1999-2003).

2. Economic activity and employment: developments and prospects

According to the NSSG's latest provisional estimates, the annual GDP growth rate was 4.0% in the first quarter and 3.9% in the second quarter of 2004 (compared with 4.9% and 4.0% in the same quarters of 2003[34]). Moreover, the rise[35] in the coincident indicator of economic activity compiled by the Bank of Greece (see Chart III.14) slowed down slightly from 4.3% in the fourth quarter of 2003 to 4.2% in the first quarter of 2004, 4.0% in the second quarter and 3.9% in July. It should also be noted that Greece's economic sentiment index (compiled by the European Commission but based exclusively on business and consumer survey results), after rising from 103.5 in December 2003 to 115.4 in April 2004, showed a considerable continuous decline, to reach 93.7 in September. The fall during the May-September period reflects the deteriorating estimates and forecasts of construction firms and consumers,[36] as well as, to a lesser extent, of manufacturing firms. By contrast, the estimates and forecasts of retail and services firms (excluding banks and retail trade) remained clearly positive.

Taking into account economic developments since the beginning of the year, as well as prospects for the remainder of 2004, the Bank of Greece estimates that GDP grew at a higher annual rate in the third quarter and that its average annual growth rate for

34 The NSSG national accounts data for the 2000-2003 period were revised in September 2004.
35 Annualised monthly rates.
36 It should be pointed out, however, that consumers' estimates and forecasts are much less unfavourable than in the same period of 2003.

T a b l e III.5
Demand and gross domestic product (2002-2004)
(At constant market prices of year 1995, annual percentage changes)

	2002	2003 (estimate)	2004 (estimate)
Final consumption	3.4	3.1	3.9
Private consumption	3.0	4.4	3.6
Public consumption	5.3	–2.5	5.5
Gross fixed capital formation	5.7	13.7	5.8
Dwellings	8.8	7.3	–6.5
Other constructions	0.7	13.2	12.6
Equipment	6.9	18.3	6.5
Other fixed investment	21.0	3.4	2.0
Stocks and statistical discrepancy (percentage of GDP)	0.4	0.1	0.0
Domestic final demand	4.2	5.3	4.3
Exports of goods and services	–7.7	1.0	7.3
Exports of goods	–7.1	4.2	–10.0
Exports of services	–8.1	–1.3	20.0
Imports of goods and services	–2.9	4.8	8.3
Imports of goods	3.2	6.6	7.5
Imports of services	–26.5	–5.3	13.0
Gross domestic product at market prices	3.6	4.5	3.7

Sources: NSSG/National Accounts (September 2004) for 2002 and 2003, Ministry of Economy and Finance (Draft Budget for 2005) estimates for 2004. For *Bank of Greece estimates (for 2004), see text.*

2004 as a whole will be around 4%,[37] i.e. lower than in 2003 (4.5%[38]). On the other hand, the Ministry of Economy and Finance expects that GDP will grow by 3.7% this year.[39] As for 2005, the Bank of Greece will present its forecasts in the next Report on Monetary Policy, taking into account the new government budget. At all events, the Bank of Greece considers that a slowdown in economic growth is not inevitable,[40] provided that (a) macroeconomic stability will be ensured; (b) competitiveness will be enhanced, so that the Greek economy takes advantage of the ongoing recovery of the world economy; and (c) private and public investment in infrastructure projects —notably in the regions— will continue to grow strongly, supporting the high increase in domestic demand, which has been the main driving force of growth in recent years.

On the demand side, GDP growth in 2004 (see Table III.5) has been mainly driven by the strong rise in private consumption, the rebound in exports of services (which is mainly accounted for by the large increase in shipping receipts) and the growth of government consumption. The rise in total gross fixed capital formation has also contributed to GDP growth, but has slowed down considerably in comparison with 2003, as a result of both the completion of the public and private investment projects associated with the Olympic Games and of the halt in private residential investment growth.

Private consumption (see Table III.6) has been rising faster than in 2003, as evidenced by the

37 The 4.0% forecast is shared by both the European Commission (*Spring 2004 Economic Forecasts*, April 2004) and the OECD (*Economic Outlook*, June 2004). The IMF forecast (World Economic Outlook, September 2004) is 3.9%.
38 See footnote 34 above.
39 *Biannual Report*, May 2004, and *Draft Government Budget for 2005*, 29 September 2004.
40 For 2005, the European Commission (April 2004) forecasts a GDP growth rate of 3.3%, the OECD (June 2004) 3.5% and the IMF (September 2004) 3.0%. By contrast, the Ministry of Economy and Finance forecast is 3.9% (*Draft Government Budget for 2005*).

Table III.6
Indicators of consumer demand (2002-2004)
(Annual percentage changes)

	2002	2003	2004 (available period)
Volume of retail sales[1]	4.5	4.6	5.2 (Jan.-July)
Food-beverages-tobacco	4.5	5.4	7.9 (» »)
Clothing-footwear	2.8	1.6	–0.1 (» »)
Furniture-household equipment	4.4	4.0	5.5 (» »)
Books-newspapers-office equipment	5.2	7.5	5.3 (» »)
Retail trade business expectations indicator	1.2	9.3	7.7 (Jan.-Sept.)
New passenger car registrations	–4.2	–2.7	18.1 (Jan.-Aug.)
Piraeus Port Authority (OLP) passengers	7.6	6.3	–0.7 (Jan.-June)
Tax revenue from mobile telephony (monthly flat fees)	27.5	16.9	13.7 (Jan.-Aug.)
Outstanding balance of total consumer credit extended by banks	24.2 (Dec.)	27.2 (Dec.)	38.4 (Aug.)

1 Revised retail sales volume index (2000=100) excluding VAT.
Sources: NSSG-Eurostat (retail sales), IOBE (expectations), NSSG (cars), OLP, Ministry of Economy and Finance (tax revenue from mobile telephony) and Bank of Greece (consumer credit).

5.2% increase in the retail sales volume (excluding cars) in the first seven months of 2004 (compared with 4.6% for 2003 as a whole) and the impressive recovery in passenger car sales (the annual average increase in new passenger car registrations was 18.1%[41] in the first eight months of 2004, after a fall of 2.7% in 2003 as a whole – see Table III.7 and Chart III.15).[42] The forecast for a rise in private consumption higher than 4%[43] (compared with 4.4% in 2003, according to the NSSG) is based on the estimates of a similar increase in households' real disposable income. Underlying the latter is the estimated 3.3% growth of employees' real average pre-tax earnings, tax rebates, increased transfers to economically disadvantaged groups (pursuant to legislation passed in 2003 and 2004 and implemented now), as well as a possible stronger rise in employment than in 2003. Higher private consumption will also be supported by growth in consumer loans (which remains high, at an annual rate of 38.4% in August 2004, compared with 27.2% in December 2003). Besides, it is estimated that the rise in the market value of households' assets continues to exert a positive effect on private consumption, although the annual growth

Table III.7
Retail sales *value* index
(Percentage changes over corresponding period of previous year)

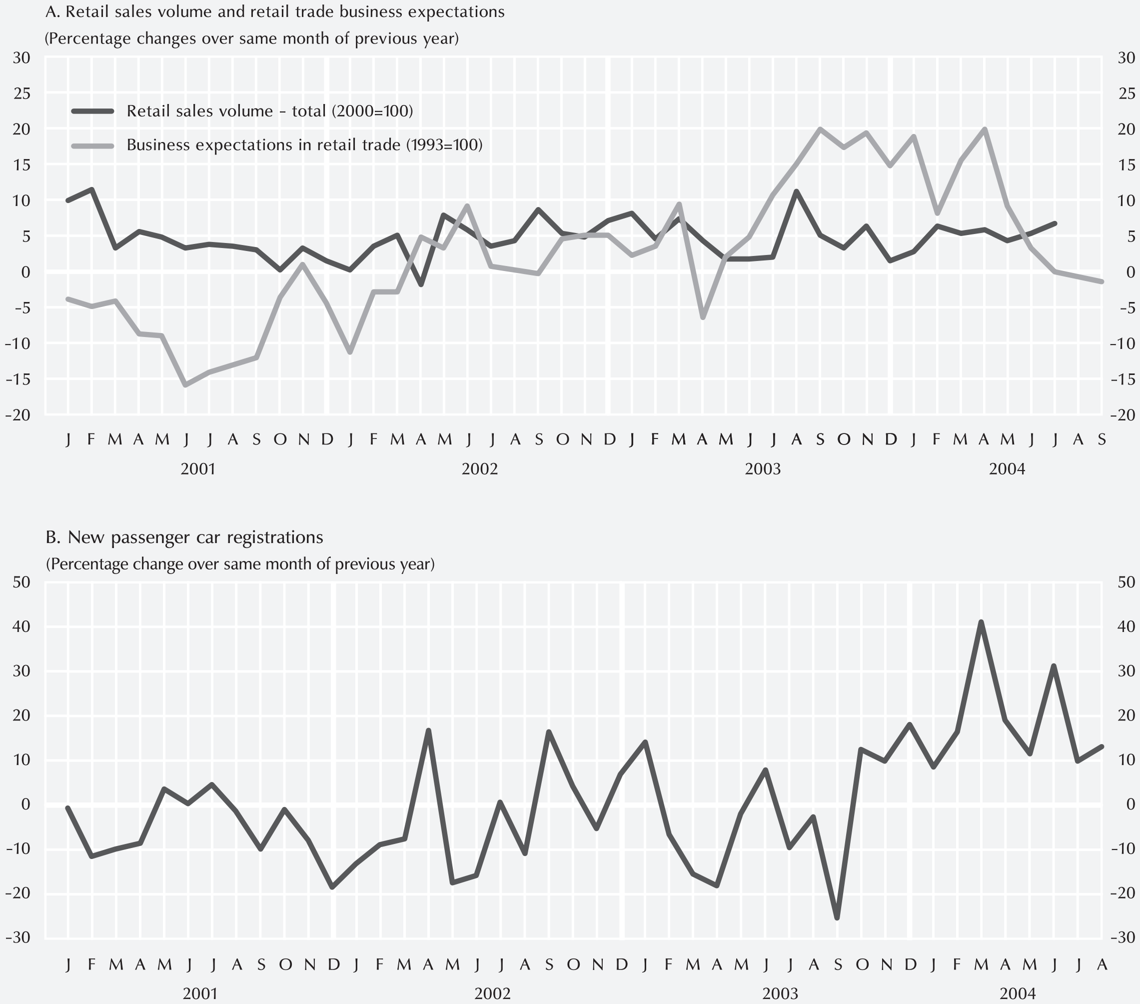
Categories	2004 (Jan.-July)
1. Big food stores	10.1
2. Department stores	8.3
3. Food-beverages-tobacco	6.8
4. Pharmaceuticals-cosmetics	7.4
5. Clothing-footwear	3.6
6. Furniture-electrical appliances-household equipment	5.6
7. Books-stationery-other goods	8.3
8. Retail sales not in stores	3.8
General retail sales *value* index	7.3

Source: NSSG.

41 The growth of sales is also confirmed by the 31.3% rise in payments for passenger car imports in the first seven months of 2004.
42 It should be recalled that expenditure for the purchase of passenger cars has a share of almost 7% in total expenditure for purchases of goods.
43 According to the NSSG provisional national accounts estimates, in the first half of 2004 private consumption grew at an annual rate of 3.9% (at constant prices).

Chart III.15

Consumer demand (January 2001 - September 2004)



Sources: NSSG - Eurostat (retail sales), NSSG (cars) and Foundation for Economic and Industrial Research - IOBE (expectations). The revised retail sales index is calculated excluding VAT. The business expectations index is based on firms' estimates of sales and stocks, as well as on their forecasts of business activity over the next six months.

of the prices of dwellings slowed down to 1.8% in the first quarter of 2004, from 9.2% in the first quarter of 2003. In particular, the rise in the prices of dwellings has come to a halt in the Athens region, but continued in the other urban centres in the second quarter (see Table III.8). The increase in the market value of households' assets also reflects the rebound in equity prices in the Athens Exchange. Specifically, the average level of equity prices rose at an annual rate of 27.5% in the January-September period, compared with a 19.2% fall over the same period in 2003.[44]

44 The rise in the growth rate of private consumption is also associated with the improvement in households' expectations about their finances. This improvement is evidenced by both the European Commission monthly survey and the ICAP annual survey (*The Greek households: estimates for 2003 and expectations for 2004*, July 2004). Although the European Commission survey shows that consumers' expectations worsened after April, they remain much less unfavourable than in 2003, as already mentioned. Besides, according to the ICAP survey, which was conducted between 15 March and 5 April 2004, "households' expectations improved substantially for the first time since 2000''. Specifically, the percentage of households that expected their finances to deteriorate fell to 30.7% (from 50.5% in 2003), while the percentage of those that expect an improvement increased to 20.5% (from 13.2% in 2003). At the same time, however, there was a small rise (from 30.2% to 34.7%) in the percentage of households that do not expect any considerable change in their finances, while the percentage of households that were not sure more than doubled (from 6.2% in 2003 to 14.2% in 2004).

T a b l e III.8
Dwelling price index

Period	Urban areas-total			Athens			Other urban areas		
	Index	Percentage changes		Index	Percentage changes		Index	Percentage changes	
	1997=100	Over previous period	Over corre-sponding period of previous year	1997=100	Over previous period	Over corre-sponding period of previous year	1993 Q4=100	Over previous period	Over corre-sponding period of previous year
1994	76.1	...	...	73.4	9.5	9.5	106.0	...	...
1995	82.6	8.5	8.5	80.1	9.2	9.2	114.3	7.8	7.8
1996	91.2	10.5	10.5	88.9	11.0	11.0	125.7	10.0	10.0
1997	100.0	9.7	9.7	100.0	12.5	12.5	134.7	7.1	7.1
1998	114.4	14.4	14.4	115.5	15.5	15.5	152.6	13.3	13.3
1999	124.5	8.9	8.9	129.6	12.2	12.2	161.5	5.8	5.8
2000	137.6	10.5	10.5	149.1	15.1	15.1	171.2	6.0	6.0
2001	157.7	14.6	14.6	175.4	17.6	17.6	190.6	11.3	11.3
2002	178.2	13.0	13.0	203.8	16.2	16.2	208.8	9.5	9.5
2003	188.4	5.7	5.7	211.9	4.0	4.0	225.2	7.9	7.9
2002 I	171.5	4.4	13.9	193.6	5.8	16.8	203.9	3.0	10.7
II	178.9	4.3	14.4	208.0	7.4	19.4	205.3	0.7	8.8
III	179.4	0.3	12.4	205.4	-1.3	14.9	209.9	2.3	9.7
IV	183.1	2.0	11.5	208.2	1.4	13.8	215.9	2.8	9.0
2003 I	187.2	2.3	9.2	214.6	3.1	10.8	219.0	1.4	7.4
II	186.9	-0.2	4.5	210.6	-1.8	1.3	223.0	1.8	8.6
III	188.6	0.9	5.1	210.6	0.0	2.6	227.1	1.9	8.2
IV	190.8	1.2	4.2	211.5	0.4	1.6	231.7	2.0	7.3
2004 I	190.7	0.0	1.8	209.7	-0.9	-2.3	233.8	0.9	6.8
II	...	...	...	...	...	...	235.3	0.6	5.5
2003 Jan.	...	...	...	212.2	2.3	13.1	...	...	...
Feb.	...	...	...	212.2	0.0	13.5	...	...	...
March	...	...	...	219.3	3.3	6.3	...	...	...
Apr.	...	...	...	213.5	-2.6	2.3	...	...	...
May	...	...		210.8	-1.3	1.5	...	...	...
June	...	...	...	207.6	-1.5	0.0	...	...	...
July	...	...	...	208.6	0.5	1.9	...	...	...
Aug.	...	...	...	211.9	1.6	4.1	...	...	...
Sept.	...	...	...	211.5	-0.2	1.7	...	...	...
Oct.	...	...	...	210.7	-0.4	2.5	...	...	...
Nov.	...	...	...	211.2	0.3	-0.1	...	...	...
Dec.	...	...	...	212.7	0.7	2.5	...	...	...
2004 Jan.	...	...	...	212.7	0.0	0.2	...	...	...
Feb.	...	...	...	207.1	-2.6	-2.4	...	...	...
March	...	...	...	209.5	1.1	-4.5	...	...	...
Apr.	...	...	...	208.0	-0.7	-2.6	...	...	...
May	...	...		211.5	1.7	0.3	...	...	...

Sources: For the other urban areas: Bank of Greece (quarterly data). For Athens: calculations based on data from "Danos and Associates" (1993-97) and "Property Ltd" (monthly data for 1997-03). For the total of urban areas: weighted index based on the housing stock in Athens and other urban areas.

Data on government budget implementation for the January-July period (released by the Ministry of Economy and Finance) *prima facie* suggest a considerable increase in government consumption.[45] Besides, the number of civil servants grew at an annual rate of 0.7% in the first half of the year. However, according to the provisional quarterly estimates of the NSSG on a national accounts basis, general government consumption

45 See Chapter IV.

T a b l e III.9
Indicators of investment demand (2002-2004)
(Annual percentage changes)[1]

	2002	2003	2004 (available period)
Capital goods output	–5.1	–3.8	–1.8 (Jan.-July)
Investment expenditure (at current prices) of private industrial firms [2]	–21.5[3]	–8.0[4]	–5.9[4]
Capacity utilisation rate in the capital goods industry	(79.4)	(78.9)	(79.3) (Jan.-Sept.)
Outstanding amount of loans to non-financial corporations with a maturity of over one year	16.0 (Dec.)	20.1 (Dec.)	18.5 (Aug.)
Disbursements out of the public investment budget	–9.4	19.6	2.2 (Jan.-Sept.)
Volume of private construction activity (on the basis of permits issued)	9.5	1.5	–9.1 (Jan.-May)
Cement production	–2.3	3.6	1.9 (Jan.-July)
Construction business expectations indicator	0.1	0.8	–21.3 (Jan.-Sept.)
Outstanding balance of total bank credit to housing	35.6 (Dec.)	25.0 (Dec.)	23.1 (Aug.)

1 With the exception of capacity utilisation, which is expressed in percentages.
2 Estimates of firms participating in the IOBE investment survey.
3 Estimate of the March-April 2003 survey.
4 Estimate or forecast of the March-April 2004 survey.
Sources: NSSG (capital goods output, volume of private construction activity, cement production), IOBE (investment expenditure, capacity utilisation rate, business expectations indicator), Bank of Greece (loans to non-financial corporations, disbursements out of the public investment budget, housing loans).

only rose by 6.4% at current prices and 1.3% at constant prices in the first half of 2004 (relative to the same period in 2003). Finally, in the Draft Budget for 2005 it is estimated that general government consumption will grow by 5.5% at constant prices in 2004. (According to the recently revised NSSG estimates, general government consumption declined by 2.5% at constant prices in 2003.)[46]

Total gross fixed capital formation (see Table III.9) is expected to rise by almost 6% at constant prices (compared with 13.7% in 2003, according to the NSSG).[47]

Specifically, as estimated in the Draft Budget for 2005, general government investment will grow by 9.4% at constant prices in 2004 (compared with 11.7% in 2003, according to the NSSG). On the basis of the accruals data released by the Ministry of Economy and Finance, Public Investment Budget (PIB) expenditure rose (at current prices) at an annual rate of 12.2% in the first seven months of 2004. According to Bank of Greece data, disbursements out of the PIB grew at an annual rate of 12.4% over that period, but of only 2.2% in the January-September 2004 period.

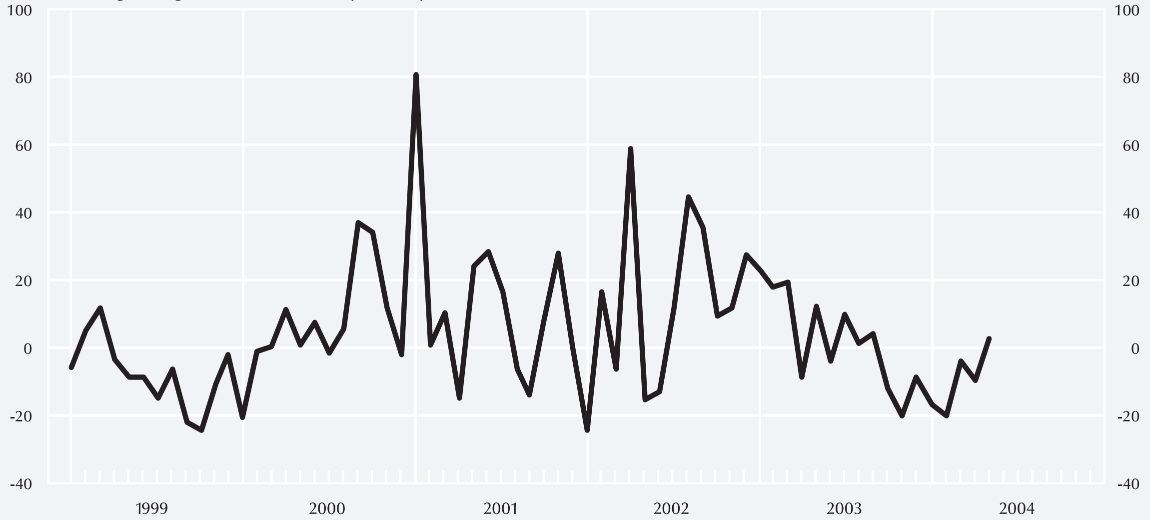
Private residential investment growth is estimated to have come to a halt this year (compared with a 7.3% increase in 2003, according to the NSSG). The volume of private construction activity on the basis

46 The revised NSSG estimates of government consumption have been influenced by the revision of defence expenditure figures for the period 2000-2003. According to the new estimates, government consumption (at constant prices) declined by 3.1% in 2001, grew by 5.3% in 2002 and dropped by 2.5% in 2003 (compared with –1.0%, +5.8% and +2.9%, respectively, according to the previous estimates).
47 According to the provisional quarterly estimates of the NSSG on a national accounts basis, in the first half of 2004 total investment (at constant prices) grew by 5.1%.

Chart III.16

Volume of new buildings and extensions on the basis of permits issued (January 1999 - May 2004)

(Percentage change over same month of previous year)



Source: NSSG.

of permits issued, which is a leading indicator, has shown a considerable decrease since the fourth quarter of 2003 (annual average rate: –13.5% in the last quarter of 2003, –9.1% in January-May 2004 – see Chart III.16).[48] However, the annual growth of the outstanding balance of housing loans remains high (at 23.1% in August 2004, compared with 25.0% in December 2003). This reflects on the one hand the time lag between the issuance of a building permit and the execution of the project concerned and, on the other hand, the fact that housing loans are used to finance the purchase of existing (old or newly built) dwellings. In this connection, it should be noted that, according to the IOBE survey in the construction sector, the firms' assessments of their *current* dwelling construction business were negative only in the first quarter of 2004 and clearly positive in June and July, before turning slightly negative in September.[49]

Finally, investment by public and private enterprises is expected to slow down substantially, after a 16.2% increase at constant prices in 2003, according to the NSSG. Specifically, the 2004 Budget forecasts a mere 7.3% rise (at current prices) in public enterprises' investment in 2004, compared with 28.4% in 2003.[50] Moreover, private business investment in the telecommunications, hotel, coastal shipping and other services sectors is estimated to have grown appreciably in 2003 and in the first months of 2004 (in anticipation of the Olympic Games), but their average growth will inevitably slow down for 2004 as a whole. Furthermore, according to the IOBE investment survey conducted in March and April 2004, private industrial firms forecast a 5.9% decline (at current prices) in their investment

48 The estimate that private residential investment remains stagnant in 2004 takes account of the time lag between the issuance of a building permit and the execution of the project concerned. Characteristically, in the first nine months of 2003 (i.e. before the volume of construction activity on the basis of permits issued started to decline), this indicator increased at an annual average rate of 7.5%.

49 From June onwards the survey recorded a considerable deterioration in these firms' forecasts about employment.

50 According to the 2004 Budget, the decrease in the growth rate is accounted for by the budgeted decline, in absolute terms, in investment by the Athens-Piraeus Electric Railway (HSAP), the School Buildings Organisation (OSK), the Greek Horse Races Organisation (ODIE) and the Greek Public Real Estate Corporation (KED).

expenditure, which, however, is lower than the estimated decrease for 2003 (–8.0%). According to another joint survey conducted in the same period by the Federation of Greek Industries (SEB) and ICAP on a different sample of firms,[51] investment expenditure per firm (excluding the oil processing sector) is forecast to decline by 4.2% in 2004 (compared with an estimated 20.7% fall in 2003).[52]

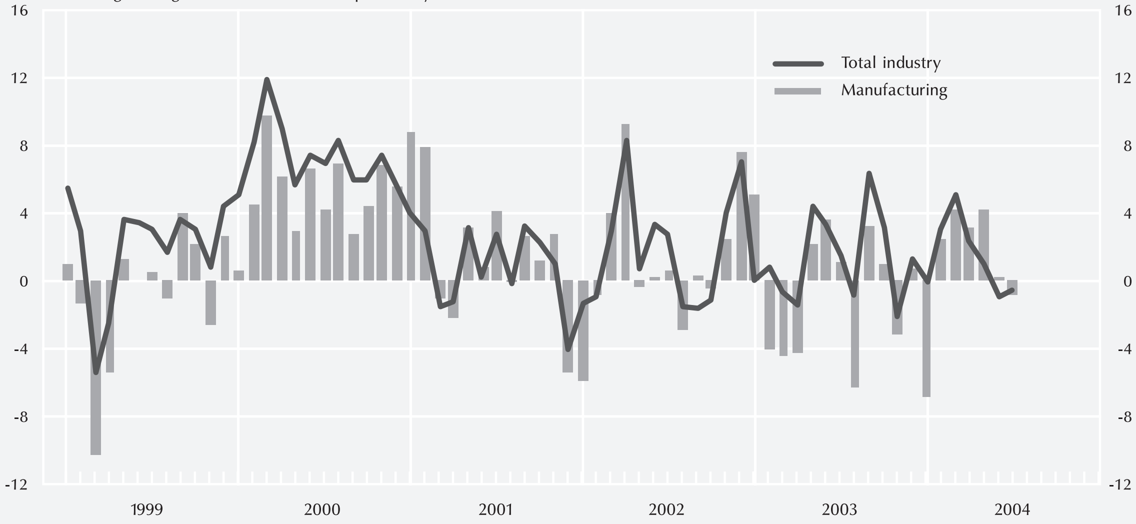
The change in the real external balance on a national accounts basis[53] is expected to have a negative contribution to GDP growth also in 2004, almost equal to that in 2003 (1.3 percentage points, as calculated according to the NSSG revised national accounts estimates of GDP, imports and exports). This reflects an assessment that exports of goods and services will rise by 6-7% this year, compared with a very small increase in 2003 (1.0%, according to the NSSG), and that imports of goods and services will grow by around 8% (compared with 4.8% in 2003, according to the NSSG).[54]

Specifically, the performance of exports of goods is expected to be flat or to improve minimally (by around 1%) at constant prices, although this estimate should be treated with caution, as there are considerable differences between the Bank of Greece balance of payments statistics and the NSSG trade statistics.[55] Besides, exports of services should definitely rise strongly, mainly due to the very large increase in transport (mainly shipping)[56] receipts and although expectations of a big rise in tourist receipts (as a result of the Olympic Games) did not come true.[57] Finally, payments for imports of both goods and services are rising strongly, according to all the available data (see Section 3 of this chapter).[58]

On the supply side, as already mentioned, construction activity has risen at a slower pace and retail trade activity at a faster one. Moreover, activity in the telecommunications sector continues to rise strongly.[59] Besides, total industrial output[60] grew at an average annual rate of 1.3% in the first seven months of 2004 (compared with a 1.3% rise for 2003 as a whole), while manufacturing output recovered and grew by 1.0%, after declining by 0.4% in 2003 as a whole

51 *Greek manufacturing: estimates for 2003 and expectations for 2004* (published in June 2004).
52 If the oil processing sector is included, investment expenditure per firm is forecast to increase by 18.6% in 2004 (compared with an estimated 5.3% decline in 2003).
53 Defined as the difference between exports and imports of goods and services, at constant prices.
54 However, according to the provisional quarterly estimates of the NSSG on a national accounts basis, exports of goods and services (at constant prices) declined at an annual rate of 6.5% in the first quarter of 2004, but rose by 6.0% in the second quarter. Imports of goods and services increased by 0.8% in the first quarter and by 4.0% in the second quarter of 2004. Overall, in the first half of 2004 exports of goods and services (at constant prices) decreased by 0.2% and imports of goods and services grew by 2.4% year-on-year.
55 These differences are partly accounted for by the fact that the available NSSG data for 2004 are provisional (see also footnote 69 in Section 3 of this chapter). The NSSG data point to a decrease in the value of non-oil exports (at an average annual rate of 3.7% in the first half of 2004), while the Bank of Greece data suggest that (a) if exports of used ships are included, non-oil export receipts rose by 13.2% in the January-July 2004 period; and (b) if exports of used ships are excluded, non-oil export receipts remained unchanged (–0.4%, see also Section 3 of this chapter). It should be noted, however, that, according to the SEB/ICAP survey mentioned earlier, manufacturing (other than oil processing) firms forecast that exports per firm will rise this year (at current prices) by 5.1% (which translates to around 1% at constant prices). If the oil processing industry is included, the forecast increase rate is much higher (15.6% at current prices).
56 These receipts rose at an average annual rate of 40.7% in the first seven months of 2004, according to Bank of Greece data, while total receipts from travel, transport and ''other'' services increased by 24.5%. For the reasons underlying the rise in receipts from shipping services, see Section 3 of this chapter, as well as the *Annual Report 2003*, April 2004, Box IX.2, pp. 242-6.
57 On the basis of the available data and indications about tourist bookings, arrivals and the estimated average expenditure per visitor, it is estimated that gross travel receipts will finally rise by around 5% in 2004 as a whole (which translates to a very small increase at constant prices). In the first seven months of 2004, they rose by 3.8%.
58 According to the NSSG, the value of non-oil imports rose at an average annual rate of 17.7% in the first half of 2004, while according to Bank of Greece data the non-oil import bill grew by 11.7% in the January-July 2004 period.
59 Tax revenue from mobile telephony (flat montly fee per connection) rose at an average annual rate of 13.7% in the first eight months of 2004.
60 Comprising mining-quarrying, manufacturing and electricity, as well as natural gas and water distribution.

Chart III.17
Industrial production (January 1999 - July 2004)
(Percentage changes over same month of previous year)



Source: NSSG.

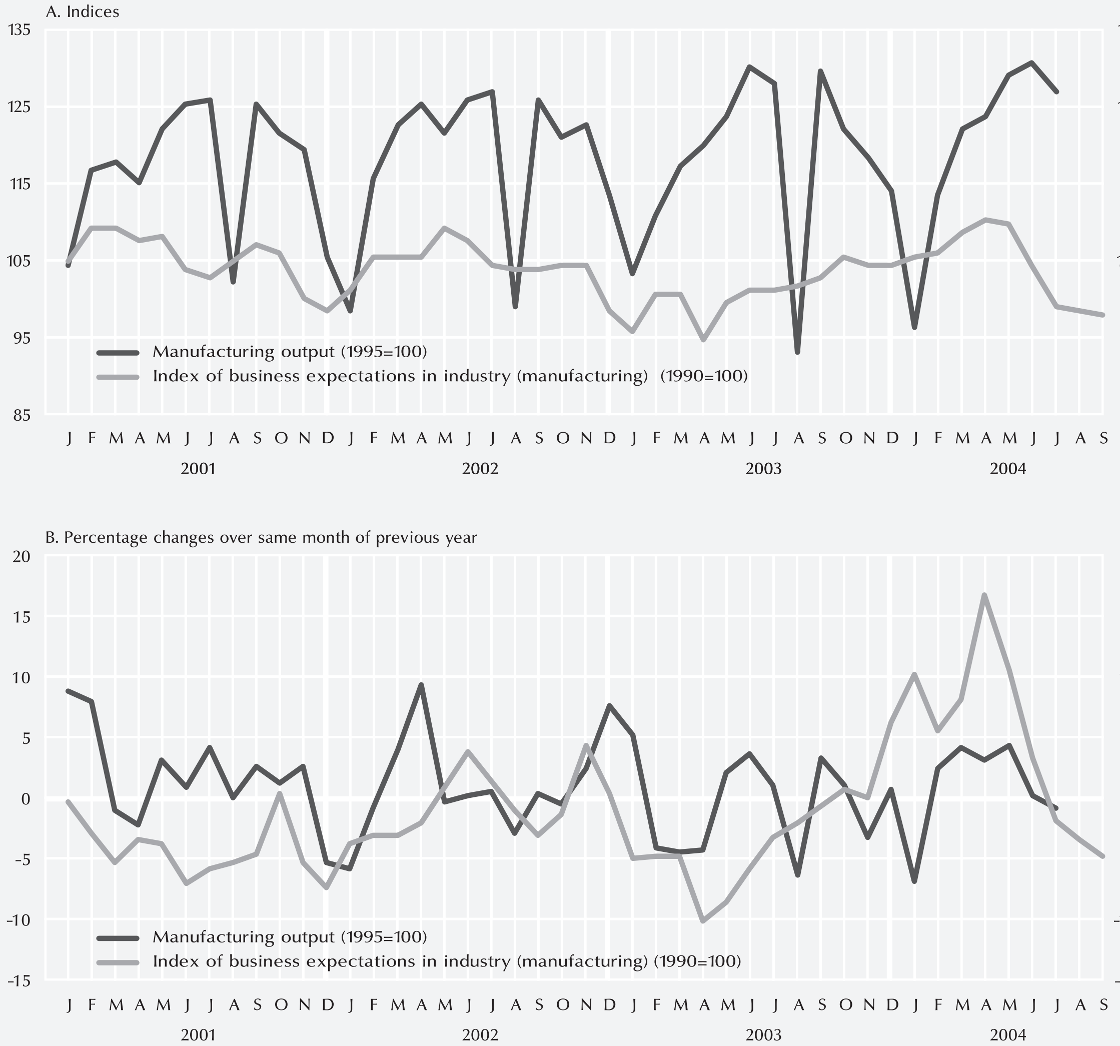
(see Charts III.17 and III.18). It should be noted that the rebound in manufacturing output is broadly based across all the categories of goods other than capital goods, i.e. intermediate goods and consumer durables and non-durables. These developments are confirmed by the Purchasing Managers' Index (PMI), which implies that manufacturing output, being almost stagnant in January 2004, rose continuously in the following months, albeit at a slower pace in the third quarter (when the PMI fell to 52.2 in July, 52.6 in August and 51.7 in September, from 53.9 in June[61] – see Chart III.19). Finally, the SEB/ICAP survey mentioned earlier records the forecast of manufacturing firms (excluding the oil processing sector) that sales per firm (at current prices) will rise by 8.0% in 2004, compared with a mere 2.8% in 2003.[62]

No adequate data are so far available on developments in *employment*, since the results of the NSSG labour force survey for 2004 have not been released yet[63] (for developments in past years, see Charts III.20 and III.21).

According to the data currently available from other sources, the number of employees in the private non-bank sector appears to be rising faster this year than in 2003. Specifically, the IOBE survey (see Chart III.22) points to a clear improvement in the firms' forecasts on employment in manufacturing, services (excluding retail trade and banks) and (from April onwards) retail trade. By contrast, the forecasts of construction firms deteriorated sharply in the third quarter, reflecting the forecasts of firms engag-

61 It should be recalled that an index value above 50 suggests an increase in activity, while an index value below 50 suggests a decrease.
62 If the oil processing sector is included, a 9.5% increase is forecast for 2004, compared with 4.4% in 2003.
63 According to a NSSG press release, data collection for the first and the second quarter of 2004 started on 8 July 2004. This delay is explained by the fact that the survey was redesigned to take into account the data of the 2001 national population census and to use a larger sample, which will cover around 30,000 households all over Greece (urban, semi-urban and rural areas). (It should be recalled that already since February 2004, when the NSSG released the data for the third quarter of 2003, the survey had been adjusted to the results of the 2001 national population census, but only as regards the breakdown of the population by regions. The adjustment of the survey as regards the breakdown by gender and age had not been completed yet. See also *Annual Report 2003*, April 2004, Box III.6, pp. 121-3.)

Chart III.18
Output and business expectations in manufacturing (January 2001 - September 2004)



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

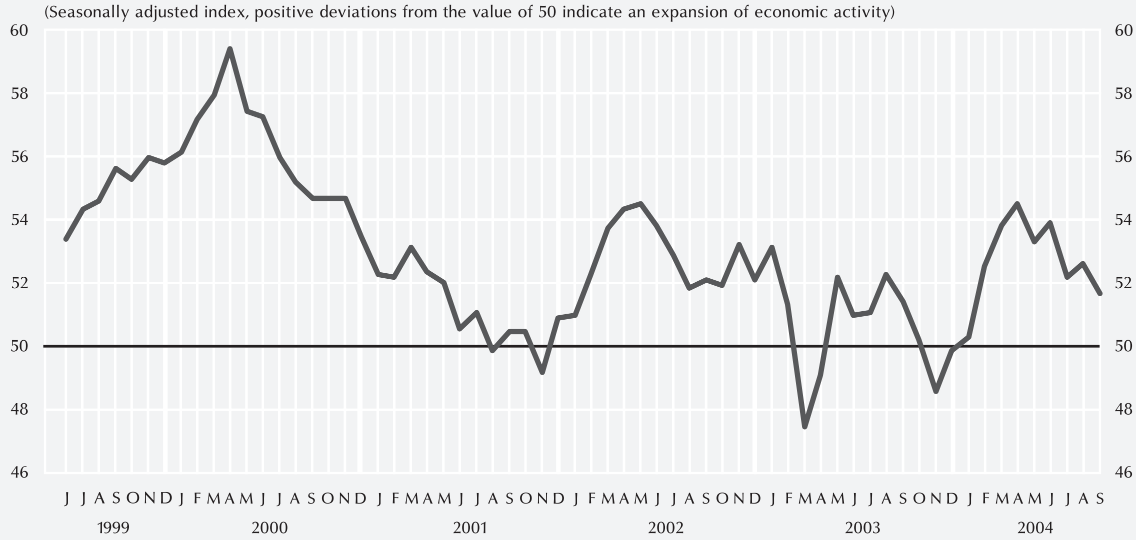
ing both in the construction of public projects and ''other buildings'' and in the construction of dwellings. The PMI survey data clearly suggest a recovery in manufacturing employment this year.[64] Moreover, as regards retail trade, the NSSG has constructed a new indicator (which covers all employed persons, in addition to employees), which shows that employment in this sector increased at an annual rate of 3.7% in the first half of 2004.[65] Besides, the available Manpower Employment Organisation (OAED) data on employment flows suggest increasingly faster job creation in the private sector. Specifically, in the first half of 2004 new job registrations rose by 19,000 persons (or 3.6%), labour contract terminations (layoffs) dropped slightly (by 700 persons or 0.3%) and voluntary quits increased by 4,000 (or 2.2%) over the same period in 2003. Thus, the net employment

64 The employment sub-index of the PMI averaged 50.7 in the January-September 2004 period, compared with 49.2 in the same period of 2003.
65 On the basis of the new indicator, total employment in retail trade rose by 1.8% in 2001, 5.2% in 2002 and 2.2% in 2003.

Chart III.19

Purchasing Managers' Index (PMI) for manufacturing (June 1999 - September 2004)

(Seasonally adjusted index, positive deviations from the value of 50 indicate an expansion of economic activity)

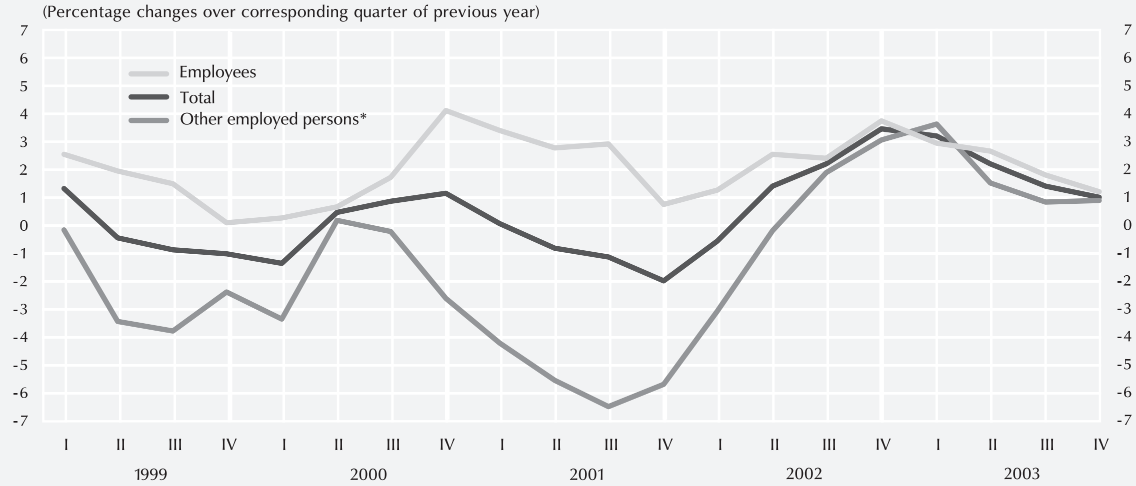


Sources: Hellenic Purchasing Institute and NTC Research.

Chart III.20

Employment (1999 - 2003)

(Percentage changes over corresponding quarter of previous year)



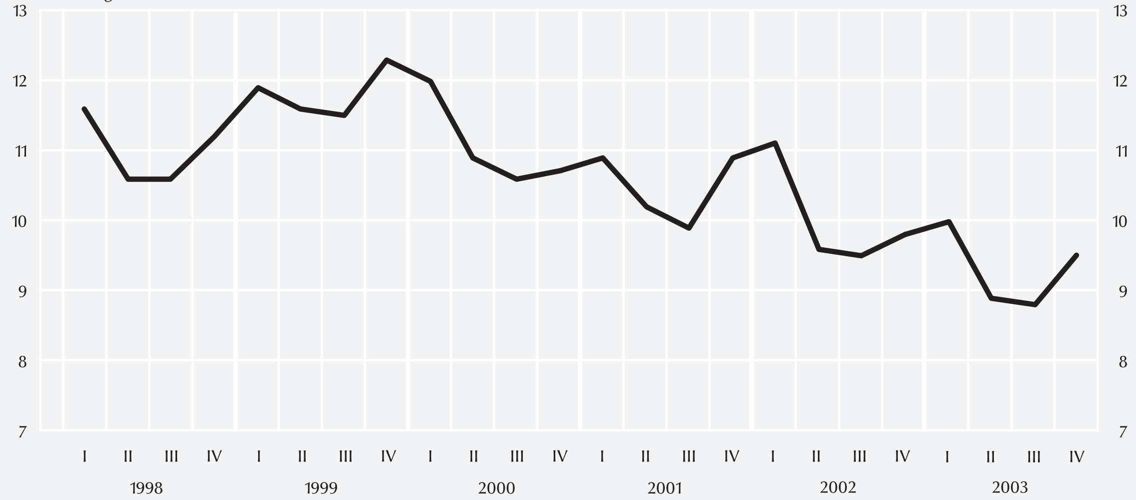
* Other employed persons= Self-employed with staff (employers)+Self-employed without staff + Assistants in family businesses.

Source: NSSG, Labour Force Surveys. Revised data, based on the partial adjustment of the survey results taking into account the 2001 national population census data.

flow (net job creation) rose to 100,000 in the first half of 2004, from 84,000 in the first half of 2003.[66] On the other hand, according to data from the OAED Employment Observatory (released by the Ministry of Employment and Social Protection on 20 September 2004), the number of the registered jobless shows an average increase of 10.7% (or 51,000 persons) in the

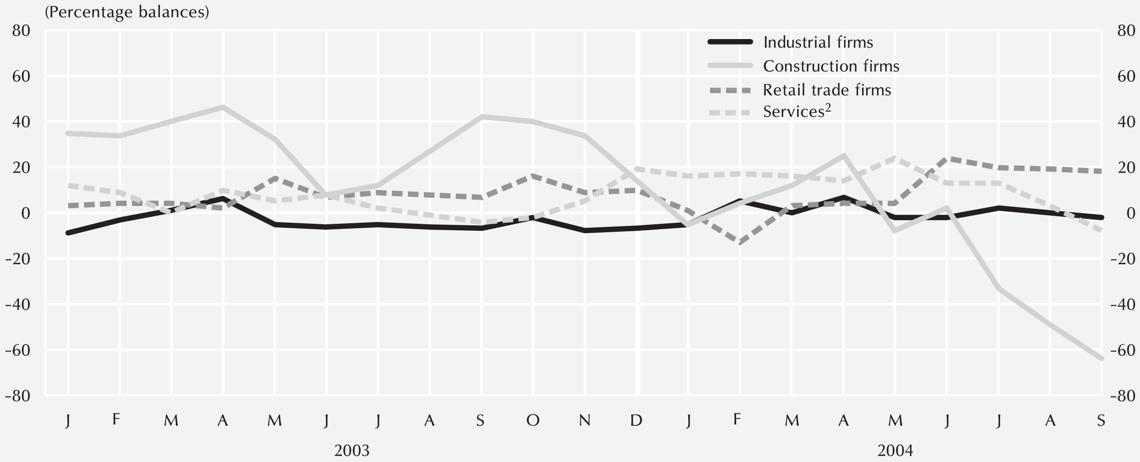
66 It should be recalled that the net employment flow (new job registrations minus layoffs and voluntary quits) should be treated with caution, because voluntary quits are not accurately recorded.

Chart III.21
Total unemployment rate (1998 - 2003)
(Percentages of labour force)



Source: NSSG, Labour Force Surveys. Revised data, based on the partial adjustment of the survey results taking into account the 2001 national population census data.

Chart III.22
Business forecasts[1] for employment
(January 2003 - September 2004)
(Percentage balances)



1 Firms were asked to assess the prospect of an increase in their number of employees over the coming period.
2 Excluding banks and retail trade firms.

Source: IOBE, Business Surveys.

January-August 2004 period relative to the same period of 2003.[67]

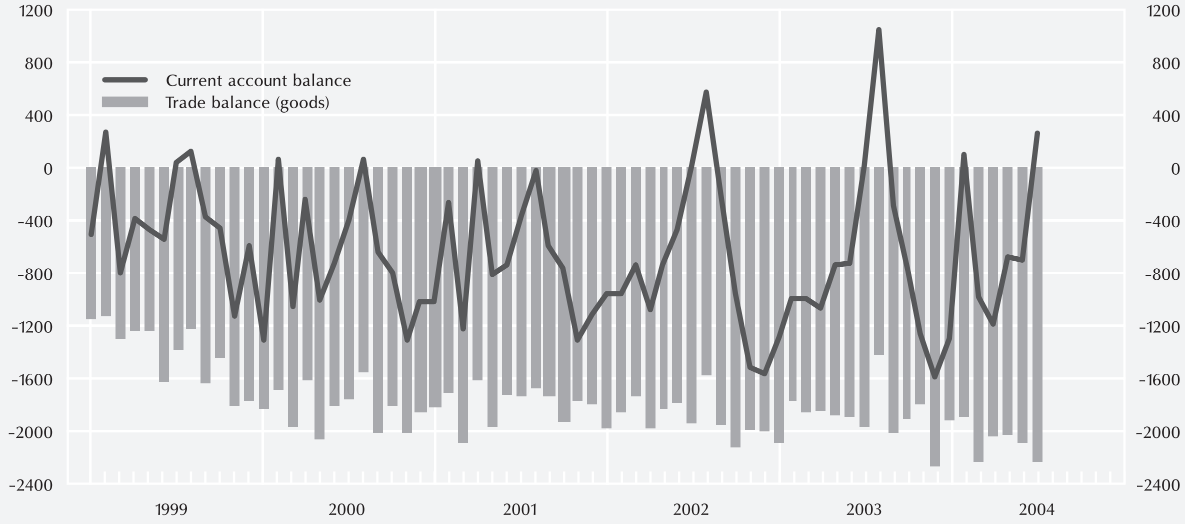
As already mentioned, the number of civil servants grew by 0.7% in the first half of 2004, while the number of staff in public enterprises fell by around 2% (according to data for the first quarter of 2004).

67 As explained in the past, OAED data on the registered jobless are not the most representative ones on unemployment and should be treated with caution, although they are a useful indication (see Bank of Greece, *Annual Report 2003*, April 2004, Box III.6, pp. 121-3).

Chart III.23

Trade balance and current account balance (January 1999 - July 2004)

(Million euro)



Source: Bank of Greece.

3. Developments in the current account during the first seven months of 2004 and outlook for the year as a whole

3.1. Current account

In the last five years, the current account deficit initially widened to about 6% of GDP, but in 2003 and 2004 it narrowed, albeit remaining at high levels (2003: 5.7% of GDP, 2004: about 5% of GDP). As noted in previous Reports of the Bank of Greece, the deterioration of the current account deficit may to some extent be considered normal for an economy in the process of real convergence. Indeed, from the standpoint of rational intertemporal allocation of resources, the widening of the current account deficit allows a country to fund increased investment —in the expectation of earning high returns— or to smooth out consumption over time. It has been observed that countries with per capita income below the OECD average and fixed investment-to-GDP ratio above the respective OECD average tend to run larger current account deficits.[68] However, the widening of the current account deficit may also reflect structural weaknesses of the economy and loss of competitiveness, signalling the need for reforms aimed at increasing productivity and strengthening competitiveness.

During the first seven months of 2004, the current account deficit was significantly reduced (by €1,295 million, compared with the corresponding period of 2003) and came to €4,480 million (see Chart III.23 and Table 5 of the Statistical Appendix). This development is the result of: (i) mainly the considerable rise in the services surplus, especially in receipts from shipping, (ii) secondarily, the increase in the transfers surplus and, finally, (iii) the small decline in the income account deficit. These factors together more than offset the widening of the trade deficit.

68 See M. Bussière, M. Fratzscher and G.J. Mueller, "Current account dynamics in OECD and EU acceding countries – an inter-temporal approach", ECB Working Paper No. 311, February 2004.

The relative stagnancy of goods imports during 2001-2003 (despite the fast growth of domestic economic activity), as evidenced by Bank of Greece data, gave way in 2004 to a strong increase, attributable to the infrastructure projects related to the Olympic Games. This has led to the widening of the non-oil trade deficit, given that the large increase in the import bill more than offset the rise in total export receipts in absolute terms. Thus, despite the small decline in the net oil import bill, the overall trade deficit widened.

The services surplus grew considerably, mainly because of the large increase in net transport receipts, which stemmed from the rise in sea transport freight rates and in world sea trade volume. Even though the spectacular rise in freight rates stopped after February 2004, increased demand for the transport of raw materials and semi-manufactured products helped maintain freight rates at high levels. This demand, which came as a result of the recovery of the US economy and the rapid growth of the Chinese economy, is expected to remain high. A positive contribution to current account developments came from the increase in the transfers balance, mainly because of the rise in net EU transfers to general government.

Regarding the outlook for 2004, on the basis of the latest available data and a number of reasonable assumptions about the course of domestic economic activity and key aggregates of the world economy that affect the country's current account balance, the deficit is expected to reach a level slightly higher than €8 billion or about 5% of GDP, compared with 5.7% in 2003. This incorporates the assessment that the reduction of the deficit in the following months of the year should be limited, because of high world crude oil prices and a deceleration in transport receipt growth.

Trade balance[69]

During the first seven months of 2004, the trend of non-oil exports observed in 2003 continued. In particular, non-oil export receipts rose considerably (€739 million or 13.2%) compared with the same period of 2003. This rise stems from the sale (export) of ships —mainly used ships— as part of a trend towards commercial fleet renewal. Excluding these receipts, non-oil exports receipts were unchanged in the period under review (–0.4%). The fact that no change was recorded despite the deterioration in the price competitiveness of Greek exports is attributed to the acceleration of world trade growth. Moreover, the non-oil import bill showed a significant increase (€1,916 million or 11.7%), after remaining broadly unchanged in 2003.[70] The increase in imports, as already mentioned, was expected. These developments led to the widening of the non-oil trade deficit by €1,177 million. By contrast, the oil balance improved somewhat (the net oil import bill was reduced by €53 million). The improvement in the oil balance comes from the decrease in crude oil imports (given that during the first seven months of the year the average crude oil price in euro was 8.5% higher than in the same period of 2003). Thus, the trade deficit widened by €1,124 million or 8.5%.

According to detailed Bank of Greece data on the breakdown of non-oil imports and exports (see Table III.10), in the period January-July 2004 there was an increase in export receipts from certain products, i.e. metallurgical products, means of transport (excluding ships) and chemicals. By contrast, receipts from exports of agricultural products

69 The differences between Bank of Greece and NSSG trade statistics arise for many reasons, the chief one being that the former relate to receipts and payments mainly through the domestic banking system, while the latter are based on customs data (for transactions with non-EU countries) and tax data (INTRASTAT) (for intra-EU transactions) and remain provisional for a long time.
70 Excluding payments for ship imports, the import bill increased by 11.6%.

T a b l e III.10
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		
	2001	2002	2003	2003 Jan.-July	2004 Jan.-July	2002/2001	2003/2002	2004/2003
Agricultural products	17.1	19.4	22.7	23.8	19.3	6.4	20.2	–19.3
Chemicals, plastics	8.0	11.0	12.8	13.0	13.5	30.0	19.3	3.9
Manufacturing (excluding metallurgy)	17.7	19.2	20.7	21.0	21.2	1.7	10.8	0.8
Metallurgy	9.5	8.7	8.2	7.5	9.9	–14.4	–3.3	32.2
Machinery, appliances	5.6	5.4	7.5	8.0	6.2	–9.5	42.2	–22.6
Means of transport (excl. ships)	0.4	0.3	0.7	0.6	1.1	–24.4	124.8	95.8
Unclassified goods[1]	41.7	35.9	27.4	26.2	28.7	–19.2	–21	9.2
Total (excl. ships)	100.0	100.0	100.0	100.0	100.0	–6.2	2.9	–0.4
Total (incl. ships)						–5.9	5.6	13.2

B. Import bill

	Percentage share of each product category in total import bill					Percentage change in import bill		
	2001	2002	2003	2003 Jan.-July	2004 Jan.-July	2002/2001	2003/2002	2004/2003
Agricultural products	14.2	14.8	14.5	14.4	14.2	4.0	–2.6	10.1
Chemicals, plastics	15.1	16.8	16.0	15.9	14.5	10.6	–5.2	2.2
Manufacturing (excluding metallurgy)	21.9	22.0	22.1	22.2	21.5	0.5	0.1	8.4
Metallurgy	7.9	8.2	8.9	9.3	9.7	3.1	8.5	15.9
Machinery, appliances	22.5	21.6	21.4	21.4	20.4	–4.1	–1.4	6.7
Consumer durables	4.1	3.6	3.6	3.7	3.5	–14.3	1.7	7.3
Capital goods	13.0	13.1	13.3	13.3	12.8	0.6	1.6	7.1
Computers	3.0	2.3	1.9	1.9	1.7	–23.5	–16.1	–3.5
Fixed-voice and mobile telephony	2.3	2.6	2.4	2.5	2.5	12.3	–7.6	11.7
Means of transport (excl. ships)	11.6	12.2	14.2	14.6	15.5	4.8	16.0	18.8
Passenger cars	6.4	7.1	8.4	7.1	8.4	11.3	17.8	31.3
Other goods	0.7	0.4	0.3	0.3	0.3	–47.9	–13.6	21.4
Unclassified goods[1]	6.1	4.0	2.6	1.9	3.7	–33.4	–37.2	117.2
Total (excl. ships)	100.0	100.0	100.0	100.0	100.0	–0.2	–0.5	11.5
Total (incl. ships)						0.0	–0.3	11.7

1 Products for which no code number has been reported.
Source: Bank of Greece.

and machinery-appliances declined. On the import side, there was a rise in payments for all goods, both consumer and capital ones (excluding PCs). Means of transport (comprising passenger cars and all other means of transport) had the largest contribution to the overall rise in the import bill.

Regarding the geographical breakdown of exports, the latest available NSSG data for the first half of 2004 (see Table III.11) show an increase in the proportion of exports to EU countries and a corresponding decrease in the proportion of exports to OECD countries (particularly the United States). This came about although economic recovery in the main destination countries (Germany, Italy) is slower than recovery in other OECD countries. Furthermore, exports to Northern Africa and the Middle East have increased considerably, but their contribution to the total figure remains low. The geographical breakdown of imports has also

Table III.11
Breakdown of Greece's external trade by geographical area

A. Exports

	Percentage share in the value of total exports						Percentage change in the value of exports			
	2000	2001*	2002*	2003*	2003* Jan.-June	2004* Jan.-June	2001/00	2002/01	2003/02	2004/03
European Union (15)	47.3	42.0	43.5	46.7	48.7	50.2	–18.9	–3.3	16.4	–1.4
Euro area	38.5	32.3	35.2	37.8	39.2	40.4	–23.4	1.6	16.6	–1.2
New Member States	7.6	9.2	8.8	8.5	7.8	7.7	14.9	–13.5	4.4	–6.0
Other OECD countries[1]	5.4	5.5	5.3	14.3	14.3	12.6	–15.1	–10.6	25.9	–15.4
USA	8.0	6.9	6.4	6.6	7.3	5.0	–7.7	–9.3	33.1	–35.1
Balkan countries[2]	14.7	18.4	16.6	16.4	15.9	15.7	13.9	–15.6	6.9	–5.5
Commonwealth of Independent States	3.2	4.3	4.3	3.5	3.0	2.7	22.2	–5.8	–10.5	–15.4
Northern Africa & Middle East countries[3]	6.8	6.7	7.1	5.5	5.0	6.7	–10.4	–1.2	–16.0	27.1
China & Southeastern Asia	6.8	6.7	7.1	1.6	1.6	1.6	15.4	4.9	–20.1	–5.8
Other countries	7.0	7.3	7.9	3.6	3.7	2.9	–19.7	8.6	–25.1	–23.9
Total	100.0	100.0	100.0	100.0	100.0	100.0	–8.6	–6.7	8.5	–4.2

B. Imports

	Percentage share in the value of total imports						Percentage change in the value of imports			
	2000	2001*	2002*	2003*	2003* Jan.-June	2004* Jan.-June	2001/00	2002/01	2003/02	2004/03
European Union (15)	61.0	54.5	52.2	54.5	54.5	55.9	–21.6	–0.5	25.6	8.8
Euro area	52.0	47.3	46.3	48.3	48.0	49.1	–20.2	1.6	25.5	8.5
New Member States	1.8	2.0	2.0	1.8	1.7	2.1	–2.2	4.0	9.1	27.4
Other OECD countries[1]	13.9	13.8	17.9	18.9	18.8	17.1	–13.0	35.1	26.9	–3.5
USA	3.2	3.5	4.7	5.0	3.2	5.6	–5.3	40.3	28.2	84.1
Balkan countries[2]	2.8	3.6	2.7	2.7	2.7	2.6	14.0	–21.2	17.7	3.6
Commonwealth of Independent States	4.2	6.8	9.3	7.3	8.1	5.6	44.2	42.5	–6.1	–26.7
Northern Africa & Middle East countries[3]	9.8	10.4	7.0	7.2	6.5	8.0	–6.3	–30.6	24.0	30.3
China & Southeastern Asia	4.0	5.2	5.0	4.7	4.8	5.3	12.7	1.0	12.4	18.2
Other countries	2.6	3.7	3.8	2.8	3.0	3.4	25.0	7.7	–11.3	23.3
Total	100.0	100.0	100.0	100.0	100.0	100.0	–12.3	3.9	20.1	6.1

1 The OECD Member States not included in any other category (except for Mexico and South Korea).
2 Albania, Bulgaria, Romania and former Yugoslavia countries (Bosnia, Croatia, FYROM and New Yugoslavia).
3 Greece's major trading partners in Northern Africa and the Middle East.
* Provisional data.
Source: NSSG.

undergone changes. In particular, the proportion of imports from the EU, the United States, Southeastern Asia and China increased, while the proportion of imports from the Commonwealth of Independent States and OECD countries (excluding the United States and EU countries) declined.

Services balance

The services surplus reached €7,789 million during the seven months January-July 2004, growing by a substantial 31.3% compared with the same period of 2003. This rise came as a result of the very large increase (62.7%) in net transport receipts (especially from sea transport), reflecting the high growth rate of world trade and the large increase in freight rates in the international market, which peaked in early 2004.[71] Net travel receipts remained unchanged, given that receipts increased by €175 million and payments by €177 million. The stagnancy of net travel receipts (despite the recovery trend of tourist traffic internationally) is attributable almost exclusively to the deterioration of competitiveness of domestic tourist services. This development is not only due to prices but also to the quality of services offered, as well as to shortcomings in the promotion of the Greek tourist product.

Income balance

The income account deficit declined slightly compared with the same period of 2003, mainly due to lower net payments for interest, dividends and profits. These include interest payments on Greek government bonds, which burden considerably the income account, due to the large amounts of funds invested by non-residents in such securities.

Transfers balance

In the first seven months of 2004, the transfers surplus increased by €516 million compared with the corresponding period of 2003, reaching €3,881 million. This resulted mainly from the €486 million rise in net transfers from the EU to general government.

In more detail, the increase in net transfers from the EU (receipts minus payments) was mainly due to the higher inflows from Structural Funds under CSF III. This trend is expected to continue in the following months of this year, given that it is sought to speed up the absorption of funds under CSF III[72] through the faster and more effective utilisation of both Community and national resources.

3.2 Financial account

The factors that in 2003 contributed to the creation of a climate of uncertainty internationally continued to affect developments in the first months of 2004 as well, albeit to a lesser degree. In particular, net financial investment (inflows minus outflows) in the first half of 2004 reached €4,079 million, against €3,524 million in the second half of 2003 and a mere €1,731 million in the first half of 2003.

Moreover, in the seven-month period January-July 2004, financial investment, i.e. the sum of direct investment, portfolio investment and "other" investment, showed a net inflow of €4,214 million, compared with a net inflow of €1,919 million in the same period of 2003. This was mainly due to a net inflow (€6,846 million) under portfolio investment (first seven months of 2003: €10,520 million); it also reflected, to a lesser extent, the reversal in direct investment to a net inflow of €435 million, from a net outflow of €580 million in the same period of 2003, which, however, was partly offset by a net inflow (€3,068 million) under "other" investment (first seven months of 2003: €8,022 million).

Purchases of Greek government bonds by foreign investors continue to be the main source of the

71 It should be noted that the daily average revenue of oil tankers (which in 2001 amounted to $27,963, in 2002 to $16,362 and in 2003 to $29,351) reached $37,097 in the first eight months of 2004. The corresponding figures for dry cargo vessels are: 2001: $8,064, 2002: $7,133, 2003: $14,379 and $26,711 in the first eight months of 2004.
72 Until August 2004 the absorption rate reached 28% of funds available under CSF III and efforts are made towards a 35-37% rate until the end of the current year (Ministry of Economy and Finance, 5th CSF III Monitoring Committee, 8 June 2004).

considerable net inflow under portfolio investment. In particular, non-residents' investment in Greek bonds during January-July 2004 amounted to €12.1 billion, i.e. it decreased compared with the same period of 2003 (€14.7 billion). At the same time, residents' investment in foreign bonds was also significant (€6.6 billion), having increased compared with the first seven months of 2003 (€4.9 billion). It should be noted that a considerable share of residents' investment in foreign bonds pertains to euro area bonds purchased by the Bank of Greece, which reduced its reserve assets by a corresponding amount. In particular, during January-July 2004 the Bank of Greece purchased euro area bonds totalling €3,190 million, compared with €3,730 million in the corresponding period of 2003.

Net inflows under direct investment amounted to €435 million in the first seven months of 2004, as non-residents' investment (€748 million) in Greece (compared with a disinvestment of €163 million in the same period of 2003) exceeded outflows (€312 million) for residents' investment abroad (first seven months of 2003: €416 million). The most important foreign direct investments (FDIs) in Greece relate to three acquisitions: (i) of Panafon Hellenic Telecommunications Company SA by Vodafone (the process continued in January 2004), (ii) of Geniki Bank by Société Générale (in March) and (iii) of "Delta Singular Outsourcing Services" (a subsidiary of "Delta Singular") by the US company "First Data". The continuously decelerating course of FDIs internationally remains (in addition to domestic shortcomings that have repeatedly been pointed out) an important impediment to FDI in Greece. However, it should be pointed out that inflows for direct investment in the first seven months of the year are already in excess of 2003 total inflows (€586 million).

Under "other" investment, the net outflow was the result of a €7,561 million increase in residents' external assets, which, however was largely offset by a €4,494 million rise in residents' external liabilities. The rise in assets during the period under review is attributable almost exclusively to the increase in residents' investments in deposits and repos (€7.5 billion, compared with €3.4 billion in 2003), whereas the rise in liabilities came as a result of the increase in non-residents' corresponding holdings (€5.3 billion, compared with an €1.9 billion decline over the same period of 2003).

Finally, the country's reserve assets decreased by €1,131 million during the first seven months of the current year and stood at €3.5 billion at end-July 2004. As already mentioned, the decrease in reserve assets is mainly due to the restructuring of the Bank of Greece's portfolio. This restructuring started in early 2003, when the Bank began to reduce its holdings of non-euro area currencies, which are included in reserve assets, and increase its higher-yield or euro-denominated assets, which are not included in reserve assets. Thus, given that there is less need to maintain high reserves in foreign currency, this policy enables the Bank of Greece to improve the return on its investments. (It should be recalled that, since Greece's entry into the euro area in January 2001, reserve assets —as defined by the European Central Bank— include only monetary gold, the reserve position in the International Monetary Fund, special drawing rights and the Bank of Greece's claims on non-euro area residents denominated in foreign currency. By contrast, they do not include claims on non-euro area residents denominated in euro, claims on euro area residents denominated in euro or foreign currency, and the Bank of Greece participation in the capital and reserves of the ECB.)

IV. Fiscal data revisions and fiscal developments

1. Brief overview of fiscal data revisions for the period 2000-2004

During 2004, fiscal data and estimates were submitted four times by the Greek authorities to the Statistical Office of the European Communities (Eurostat).

The first notification took place on 27 February 2004, in the context of the "Excessive Deficit Procedure"[1] (EDP) set out by the Maastricht Treaty and the Stability and Growth Pact. According to those data, the general government[2] deficit for 2003 was estimated at 1.7% of GDP and was projected to decline to 1.2% of GDP in 2004, while general government debt was estimated at 102.4% of GDP in 2003 and would fall to 97.7% of GDP by end-2004. In its News Release on 16 March 2004, Eurostat noted that "due to ongoing discussions with the statistical authorities in Greece, notably on the surplus of social security organisations, the notified figures for debt and deficit are to be considered as provisional and could be revised".[3]

On 30 March 2004, *in the context of the "fiscal audit" announced by the new government*,[4] revised provisional data were notified. These reported a general government deficit of 2.95% of GDP for

1 Under this procedure, all the Member States of the EU submit data to Eurostat twice a year (in spring and autumn).
2 "General government" comprises "central government" and, in addition, public entities, i.e. social security organisations, local authorities, public hospitals and other legal persons in public law. Data on general government are compiled by the National Accounts Division of the National Statistical Service of Greece (NSSG) only, in accordance with the European System of Accounts (ESA 95), and are on a national accounts basis. So far, only annual figures are available. "Central government" corresponds to the *state budget* and includes the Presidency of Democracy, the Parliament, ministries and some other government agencies.
3 Eurostat, News Release 38/2004.
4 In his inaugural speech in Parliament on 20 March 2004, the Prime Minister said: "One of our first priorities is to conduct a thorough fiscal audit in cooperation with EU authorities (as required)."

2003, projected at 2.9% for 2004, and a general government debt-to-GDP ratio of 103.0% as at end-2003, declining to 98.3% by the end of 2004. Following consultations with Eurostat, the general government deficit figure for 2003 was revised to 3.2% of GDP, while the other figures remained unchanged. These revised data were submitted on 3 May 2004 and were published on 7 May 2004 by Eurostat. However, Eurostat noted that "The reasons for which Eurostat is not in a position to fully certify the deficit and debt figures for 2003, and possibly for previous years, are the following: underestimation of government expenditure for the procurement of military equipment, lack of reliable information for recent years, concerning the surplus notified for the sub-sector Social Security Funds. Eurostat has asked the Greek authorities to make the necessary efforts to clarify these outstanding issues, so as to be in a position to certify the data notified by the Greek authorities in the context of the next September EDP official notification".[5]

In response to that request, on 31 August 2004 new revised figures were notified, which were made public by the Greek government on 22 September 2004.[6] The new figures referred to the 2000-2004 period and were certified by Eurostat on 23 September 2004.[7] These reflected substantial upward revisions of both the deficit and the debt of general government as percentages of GDP for all the years of the period 2000-2004 (Tables IV.1 and IV.2 show the *total* revision for the whole period 2000-2004 of the deficit and debt figures – a comparison between the EDP notification of 27 February 2004 and the notification of 31 August 2004 – see p. 76 and p. 78). It is worth mentioning that the general government deficit turned out to be 4.6% of GDP in 2003 and is projected to rise to 5.3% of GDP in 2004, while general government debt reached 109.9% of GDP at the end of 2003 and should rise to 112.1% of GDP at the end of 2004.[8]

This last revision, which was carried out by the NSSG, addressed the issues raised by Eurostat (in its News Release of 7 May 2004, as mentioned above) with regard to expenditure on the procurement of military equipment and the surplus of social security organisations. The new recording of expenditure on military equipment *on a cash basis* and the revised estimate of the surplus of social security organisations were the *main* factors behind the upward revision of the general government deficit for the years 2000, 2001 and 2002. For 2003, these factors were in effect responsible for the entire amount of the revision *in relation to the estimates that had been published on 7 May 2004*. The May estimates, however, *were different from the estimates submitted on 27 February 2004* (and published on 16 March 2004), mainly because of a downward revision of revenue of the ordinary budget and the public investment budget (mainly reflecting a reclassification of revenue from 2003 to 2004 – see Section 2 of this chapter), as well as because of the reclassification of a transfer by the Postal Savings Bank to the state budget as a financial transaction (according to Eurostat) rather than an accumulated dividend payment (see Section 2 of this chapter and Table IV.1).

Regarding 2004, the upward revision of the general government deficit (in relation to both the February and the May estimates) was due to:

---

5 Eurostat, News Release 62/2004.
6 See the speech of the Minister of Economy and Finance in the Joint Meeting of the Committee of Finance and the Committee of European Affairs of the Parliament on 22 September 2004.
7 News Release 117/2004.
8 Before 2004, an important revision of Greek fiscal data took place in 2002 and concerned the deficit and debt for 2000, 2001 and 2002. See Eurostat, News Releases 132/13.11.2002 and 30/17.3.2003, and Bank of Greece, *Annual Report 2002*, April 2003, pp. 218-9.

(a) the upward revision of the estimate of the *central government budget*[9] deficit on the basis of new data on public expenditure (mainly referring to expenditure related to the Athens 2004 Olympic Games,[10] personnel outlays and social transfers), as well as on revenue; and (b) a new estimate of spending on imports of military equipment and a new estimate of the surplus of social security organisations.

The upward revision of data on the *general government debt-to-GDP ratio* (see Table IV.2) for the years 2000-2003 was due to: (a) a downward revision of the estimated "intra-governmental debt" (i.e. the volume of government securities held by social security organisations and other public entities of the non-financial sector); and (b) the inclusion in debt of the capitalisation of interest that referred to the period prior to 2000. For 2004 in particular, the debt revision was also due to a decline in the primary surplus of general government and to higher government borrowing.[11]

As has been repeatedly noted in the past, the Bank of Greece bases its analysis of fiscal developments on the official annual national accounts data which are compiled by the NSSG and certified by Eurostat. Complementarily, the Bank of Greece also uses detailed monthly fiscal data published by the Ministry of Economy and Finance (State General Accounting Office) and, of course, its own monthly data on a cash basis.[12]

2. Detailed account of fiscal data revisions

For a complete understanding of the revision of fiscal data for 2000-2004, which was carried out in the context of the fiscal audit announced in the Prime Minister's inaugural speech in Parliament on 20 March 2004, it would be useful to take a closer look at the revision of fiscal data for 2003, together with brief references to the other years of that period (the factors responsible for the revision of the general government deficit over the period 2000-2004 are summarised in Table IV.1). More specifically:

2.1 Revision of general government deficit

The revision of the general government deficit for 2003 stemmed from the following factors:

- ***First, the revised estimates of the central government deficit.***

For 2003, the main reasons for the revision of these estimates were:

— **(a)** *The reversal, by the new government, of legislation passed by the previous government that had shifted VAT revenue received in early 2004 to the 2003 budget.*

More specifically, Law 3052/2002 ("Simplification of the Code of Accounting Books and Documents, VAT payment and other provisions"), passed in *September 2002*, changed the frequency of provisional VAT returns for firms required to keep accounting books of category B from two months to three months, aiming at the simplification of transactions. Thus, provisional VAT returns submitted in January 2004 would refer to VAT collected in *October, November and December* 2003 and not only in November and December 2003,

9 See footnote 2 above.
10 For 2004, the total overruns in expenditure in the ordinary budget and the public investment budget relating to the Olympic Games are estimated at 0.2% and 0.5% of GDP respectively (making a sum total of 0.7% of GDP, see Section 4 of this chapter).
11 On increased borrowing, see footnote 47.
12 For the various sets of data on the fiscal deficit and the relevant measurement methods, see Bank of Greece, *Monetary Policy, Interim Report 2003*, October 2003, Box 5, pp. 105-8.

Table IV.1
Revision of the general government deficit: 2000-2004
(In percentage points of GDP)

	2000	2001	2002	2003	2004*
1. Deficit figures notified on 27 February 2004	2.0	1.4	1.4	1.7	1.2
2. Deficit figures notified on 31 August 2004	4.1	3.7	3.7	4.6	5.3
Difference (2–1)	**2.1**	**2.3**	**2.3**	**2.9**	**4.1**
– Revision of the central government deficit	–	–	0.4	1.4	3.1[1]
Revenue				**1.4**	**0.9**
– Changes in the time of recording VAT revenue	–	–	–	*0.9*	–
– Changes in the time of recording revenue from EU Structural Funds	–	–	–	0.4	–
– Reclassification of a transfer from the Postal Savings Bank	–	–	–	*0.2*	–
Expenditure	**–**	**–**	**–**	**–**	**2.2**
– New recording of expenditure on military equipment	1.9	1.2	1.7	0.7	0.4
– New estimate of the surplus of public entities	–	1.0	0.3	0.4	0.3
– Other	0.2	0.1	–0.1	0.4	0.3

1 According to the Draft Budget for 2005.
* Forecasts.
Source: Official EDP notifications to Eurostat of 27 February 2004 and 31 August 2004.

as would have been the case under the old regime. Hence, the receipts of VAT revenue of this category *over the course* of 2003 would concern 11 months only (the November 2002 – September 2003 period). Subsequently, under Law 3220/2004 (passed on 15 January 2004), it was originally decided to transfer to 2003 all VAT revenue that would be received in January 2004 on the basis of provisional VAT returns. Under this arrangement, VAT receipts from firms keeping books of category B would now cover 14 months (the November 2002-December 2003 period). *The relevant revenue was taken into account in the estimate for the general government deficit of 1.7% of GDP, which was notified to Eurostat on 27 February 2004*. In mid-March 2004, by a decision which was later ratified by Law 3259/2004, this arrangement was reversed, contributing to the revision, on 30 March 2004, of the general government deficit to 2.95% of GDP. This reversal implied that, finally, VAT receipts (based on the provisional VAT returns of businesses keeping category B books) over the course of 2003 corresponded to 11 months, precisely because of the implementation of Law 3052/2002.

It should be noted that the *original* —under Law 3220/2004— transfer to 2003 of VAT revenue that would be received in January 2004 corresponded to an amount of the order of €1,450 million (0.9% of GDP), which was higher than the *estimated* loss of VAT revenue from 2003 to 2004 that would occur because of the change in the frequency of submitting provisional VAT returns (under Law 3052/2002). The *cancellation* of the transfer in March 2004 (under Law 3259/2004) implied, eventually, the transfer of VAT revenue from 2003 to 2004 (because of the new quarterly frequency in the submission of VAT returns), amounting to about €250 million (0.2% of GDP).

— **(b)** *The reversal of the previous government's decision to treat EU transfers received in early 2004 as delayed payment pertaining to 2003 CSF III spending*. The relevant amount is estimated to be of the order of €550-600 million, corresponding to 0.4% of GDP.[13]

— **(c)** *The reclassification of a transfer of €345 million by the Postal Savings Bank to the state (arising from a reduction in the equity capital)*[14] *from "above the line" (an accumulated dividend payment according to the State General Accounting Office) to "below the line" (a financial transaction according to Eurostat*[15]*).* Given that under ESA 95 financial transactions do not affect the deficit on a national accounts basis, this reclassification resulted in an upward revision of the general government deficit for 2003 by 0.2% of GDP.[16] If this amount had been collected in instalments as annual dividend, it would have been classified as budget revenue for past years.

Regarding 2004, the revision of the estimates of the Ministry of Economy and Finance for the deficit of central government stemmed from an overrun in expenditure amounting to 2.2% of GDP (expenditure associated with the Olympic Games, personnel outlays and social transfers, as mentioned above), as well as a shortfall in revenue — both tax receipts and transfers from EU Structural Funds— by 0.9% of GDP (see Table IV.1).

- ***Second, a new estimate of expenditure for the procurement of military equipment.***

With respect to defence expenditure, the European Commission, in its Report on Greece,[17] noted that, according to ESA 95, "in principle, military equipment should be recorded as government expenditure at the time of delivery, irrespective of payments that can take place when the equipment is ordered, during construction, upon delivery or even at a later stage. However, given that information on the delivery of military equipment is classified, the NSSG has not been able to record all purchases as government expenditure, and expenditure on military equipment has been underreported. The NSSG has committed itself to trying to get from the Greek Ministry of Defence complete information on equipment deliveries by June 2004. If this is not possible, then expenditure will be imputed in the reporting due by September 2004 on the basis of known cash payments. In any case, available evidence suggests that government expenditure and hence deficits will have to be revised considerably upwards".[18] Thus, the data notified on 31 August 2004 included a new estimate of defence expenditure (mainly imports), based on cash payments. This new estimate led to an increase of €1,129 million (0.7% of GDP) in the general government deficit for 2003. Moreover, the new estimate of military expenditure was the main factor behind the revision of

13 The 2003 Budget (November 2002) projected that Public Investment Budget revenue from the EU would reach €4,000 million in 2003. In November 2003, this figure was revised to €2,845 million. Further downward revisions followed (on 27 February 2004, 30 March 2004 and 31 August 2004). According to the latest estimate (which has been included in the Draft Budget for 2005 made public on 29 September 2004), this revenue was €1,744 million in 2003.
14 On 10 December 2003, in an extraordinary general shareholder meeting of the Postal Savings Bank, it was decided to reduce its equity capital from €900 million to €555 million and to transfer in cash the resulting balance (€345 million) to the ordinary budget. This amount was used by the government for early debt retirement. Specifically, following a decision of the Deputy Minister of Economy and Finance on 17 December 2003, the Treasury repurchased, with effective date 18 December 2003, floating-rate government bonds of a total value (principal and interest) of €345 million, which were previously held by the Postal Savings Bank.
15 See Eurostat News Release 62/7.5.2004, citing as one of the reasons for the upward revision of the deficit figure (compared with the previous estimate) the "reclassification for 2003 of a payment from the Postal Savings Bank to government as a financial transaction").
16 This reclassification affected the general government deficit only, and not the level of general government debt or the deficit of the *state budget on an administrative basis* (as estimated by the State General Accounting Office).
17 European Commission, "Report from the Commission: Greece – Report prepared in accordance with Article 104(3) of the Treaty", ECFIN/233/04-EN, 19.05.2004, page 8.
18 It is self-evident that, over the period between the placing of the order and full payment, the expenditure recorded on the basis of delivery times is equal to the one recorded on the basis of cash payments, provided that full data on making possible the use of either method are available.

Table IV.2
Revision of general government debt: 2000-2004
(In percentage points of GDP)

	2000	2001	2002	2003	2004
General government debt (figures notified on 27 February 2004)	106.2	106.9	104.7	102.4	97.7
Revised general government debt (figures notified on 31 August 2004)	114.0	114.7	112.5	109.9	112.1

Source: Official EDP notifications to Eurostat of 27 February 2004 and 31 August 2004.

deficit figures for the previous three years: by 1.9% of GDP in 2000, 1.2% in 2001 and 1.7% in 2002. Also, according to official estimates, it increased the 2004 general government deficit by 0.4% of GDP. Previously, this expenditure affected the size of public debt only.[19]

- ***Third, a new estimate of the surplus of social security organisations and other public entities.***

In August 2004 (prior to the notification of 31 August 2004) the NSSG completed a survey on the size of the surplus of social security organisations, local authorities and other public entities of the non-financial sector, which resulted in a downward revision of their annual surplus, compared with earlier estimates. This led to an increase of 0.4% of GDP in the general government deficit for 2003, 1.0% of GDP for 2001 and 0.3% for 2002 and an estimated 0.3% for 2004. The survey, the conduct of which was decided in 2003 following an agreement between the NSSG and Eurostat, was the first to be carried out and covered all public entities of the non-financial sector, i.e. more than 2,000 legal persons (social security organisations, local authorities, public hospitals and other legal persons in public law). Prior to the survey, the annual surplus of these entities was estimated by the NSSG using sample data on the main social security organisations, combined with data (on a cash basis) published by the Bank of Greece.[20]

2.2 The revision of general government debt

The revision of the general government debt-to-GDP ratio[21] (see Table IV.2) was due to the following factors:

- ***First, new estimates of intra-government debt.***

Following the aforementioned survey[22] on public entities, their holdings of government securities were determined to be lower than previously estimated. Thus, intra-governmental debt was revised downwards by €3.9 billion for 2000, €5.0 billion for 2001, €5.3 billion for 2002 and €5.7 billion for 2003. It should be noted that government paper holdings *are deducted* from central government debt, so as to derive the *consolidated* debt of general government.

19 It should be noted that in 2003 Eurostat set up a Task Force with the mandate to further investigate some other issues related to the recording of national defence expenditure (operating lease, suppliers' credit), which are not fully covered by ESA 95. When the findings and recommendations of the Task Force become public, it will be possible to draw conclusions as to whether these will lead to a further revision of the size of national defence expenditure (in either direction).
20 Bank of Greece data refer to the liabilities and (deposit) assets of social security organisations and all other legal persons in public law vis-à-vis the banking system, as well as investments (in the form of government securities) by those public entities that participate in the Common Fund managed by the Bank of Greece. Their other investments, effected without the intermediation of the Bank of Greece, are not included. However, *these investments also* affect the surplus of public entities.
21 Consolidated debt of general government, according to the definition of the Maastricht Treaty.
22 In addition to the operating balance of public entities, the scope of that survey included the recording of their financial assets.

- ***Second, the inclusion in general government debt of state liabilities in the form of "interest-bearing coupons".***

These liabilities essentially constitute the capitalisation of *interest concerning the period prior to 2000*. They ranged between €5.2 billion and €5.6 billion in the 2000-2003 period, dropping to €3.8 billion in 2004.[23]

For the period 2000-2003, the debt increase stemmed mainly from these two factors. By contrast, for 2004, it is estimated that only 38% of the increase is due to these factors (for the other factors, see Section 4.4 below).

3. The initiation of the Excessive Deficit Procedure and the Recommendation of the ECOFIN Council to Greece

As already mentioned, on 3 May 2004 the Ministry of Economy and Finance notified revised data for 2003, which included a provisional estimate of 3.2% of GDP for the general government deficit. Since this deficit exceeded the reference value laid down in the Maastricht Treaty, the European Commission initiated the Excessive Deficit Procedure (EDP).[24] In this context, on 19 May the Commission issued a Report (under Article 104(3) of the Treaty) on the deficit of Greece, which, among other things, discussed in detail the problems of fiscal statistics.[25] On 2 June, the Economic and Financial Committee (EFC) concluded that in 2003 Greece had violated both the deficit and the debt criteria of the Maastricht Treaty (as these are defined in Article 104(2) of the Treaty). Against this background, on 24 June 2004 the Commission delivered an Opinion (under Article 104(5) and recommended to the Council to decide on the existence of an excessive deficit and to make recommendations to the Greek authorities with a view to bringing this situation to an end. On 5 July, the ECOFIN Council adopted a Decision on the existence of an excessive deficit in Greece. *At the same time*, the Council issued a Recommendation, calling upon the Greek authorities to take corrective measures in order to reduce the government deficit. As required by the relevant Regulation,[26] these measures need to be formulated and notified to the Commission within four months of the date of adoption of the Council Recommendation and in the case of Greece no later than 5 November 2004.

In its Recommendation, the Council called upon the Greek authorities to take corrective measures amounting to at least 1% of GDP cumulated over 2004 and 2005, preferably equally distributed between the two years (0.5% of GDP annually), so as to ensure correction of the excessive deficit situation by the end of 2005.[27] Moreover, according to the Recommendation, the Greek authorities should ensure that the debt-to-GDP ratio diminishes sufficiently and approaches the reference value (60% of GDP) at a satisfactory pace. Finally, the Greek authorities should improve the quality of their budgetary statistics.

23 In this respect, the Minister of Economy and Finance stated the following (speech in Parliament, 22 September 2004, also see footnote 6): "In 1995, the government's interest payment liabilities, stemming primarily from the "economic consolidation loans", were exceptionally high. For this reason, a partial restructuring was decided, by the issuance of 'new coupons' of equal value rather than cash payments." In the same speech, the Economy and Finance Minister gave data on the amounts involved in the downward revision of intra-governmental debt.
24 For the importance of the provisions of the Stability and Growth Pact for the operation of a monetary union, see the Appendix to this chapter.
25 See footnote 17 above.
26 Article 3, paragraph 4, of Council Regulation 1467/97,which is part of the Stability and Growth Pact.
27 The deficit figure notified in May (3.2% of GDP) was provisional and the Commission expected it to increase further, following the completion of the survey on the surplus of social security organisations and the other public entities, as well as the inclusion of national defence expenditure.

In the light of recent developments, the following points can be made: (a) a 1% of GDP reduction in the deficit ratio is no longer sufficient for this ratio to fall below the Treaty reference value by the end of 2005; and (b) according to the assessment of the Greek government, even a small reduction in the deficit will not be feasible by end-2004; on the contrary, the 2004 deficit is expected to rise. In any case, the ECOFIN Council will discuss the revised figures for Greece at its meeting on 21 October 2004. It should be noted that, according to the Treaty, the correction of the excessive deficit by the country concerned has to be completed in the year following its identification. In the case of Greece, the excessive deficit was identified in 2004, thus Greece will have to reduce its deficit below 3% of GDP by the end of 2005. The government has already announced its intention to reduce the deficit ratio by 2.5 percentage points (compared with 2004), so as to contain it to 2.8% of GDP in 2005.

4. Fiscal developments in 2004 and general remarks on the fiscal policy stance

The analysis of 2003 data and of developments so far in 2004 indicates a further relaxation of fiscal policy. This is evident from the evolution of all relevant indicators.

First, with regard to 2003, the general government deficit, following successive revisions, reached 4.6% of GDP, as already mentioned, and exceeded significantly the reference value of the Maastricht Treaty (3% of GDP). The European Commission initiated the Excessive Deficit Procedure for Greece (see Section 3 of this chapter) in May 2004 (when the 2003 deficit was estimated at 3.2% of GDP). Apart from the revisions of the national accounts fiscal magnitudes which are not included in the central government budget but affect the general government balance, the deterioration of fiscal conditions in 2003, which continued into the first seven months of 2004, was another factor that led to the revision of the official forecast for the general government deficit in 2004 from 2.9% to 5.3% of GDP. The deterioration of the fiscal situation is suggested by data on an administrative basis published by the State General Accounting Office[28] covering the January-July 2004 period, as well as by Bank of Greece cash data, indicating that the net borrowing requirement of central government on a cash basis rose to 6.1% of GDP in the January-August 2004 period, from 4.5% in the respective period of 2003.[29] The same conclusion about the fiscal situation is suggested by the reversal of the *state budget* balance from a primary surplus to a primary deficit in 2003, as well as by the estimated decline in the general government primary surplus to virtually zero in 2004 (see Chart IV.1A).

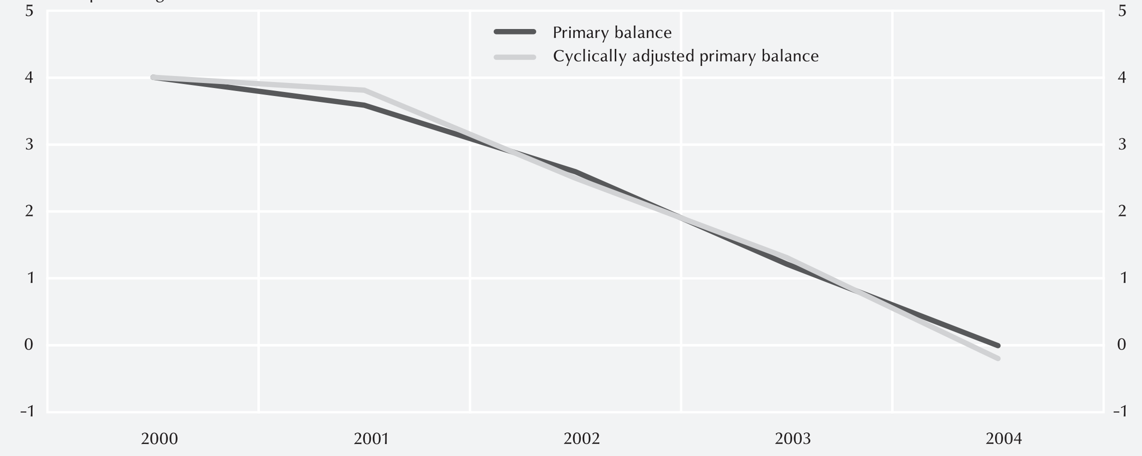
The deficit widened under conditions of strong economic growth. Thus, the cyclically adjusted deficit is estimated to have been increasing by 1.0% of GDP in 2004, following an increase of 0.7% of GDP in 2003 (see Charts IV.2A and IV.2B), while the initial target had been to reduce it by 0.2% of GDP this year. The cyclically adjusted primary balance (surplus),[30] which is a better indicator of the fiscal effort, decreased by 1.2% of GDP in 2003 and should drop by a further 1.5% of GDP in 2004. This surplus has been declining since 2001, which reveals a continuous relaxation of the fiscal effort (see Chart IV.1B). After the recent reductions, the cyclically adjusted primary surplus of general government, which amounted to about 4% of GDP in

28 See Ministry of Economy and Finance, State General Accounting Office, *Budget Implementation Bulletin*, No. 7, July 2004.
29 See Bank of Greece, *Bulletin of Conjunctural Indicators*, August-September 2004, Table V.6.
30 This indicator is widely used by international organisations, but also at a national level, for the evaluation of the fiscal effort. A brief description of this indicator is provided in Box IV.1.

Chart IV.1

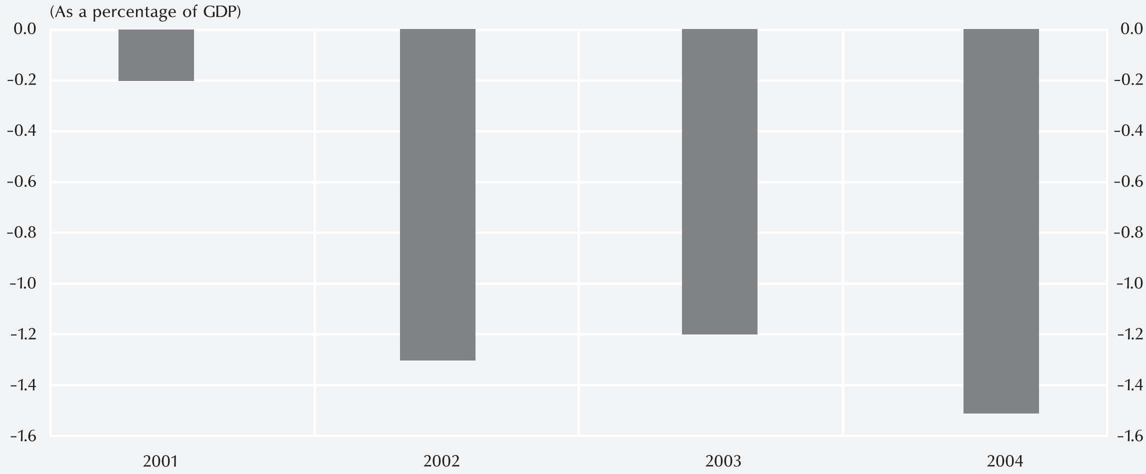
A. General government primary balance and cyclically adjusted primary balance*

(As a percentage of GDP)



B. Annual changes[1] in the cyclically adjusted primary balance*

(As a percentage of GDP)



1 Positive changes indicate a tightening of fiscal policy; negative changes indicate a relaxation of fiscal policy, while no change corresponds to neutral fiscal policy.

* Revised data (Excessive Deficit Procedure definition).

Source: Bank of Greece estimates, based on the model of the European Central Bank.

2000,[31] is expected to be around zero in 2004 (more precisely, a reversal to a primary deficit of 0.2% of GDP is anticipated).

In more detail, the *state budget* deficit[32] for the period of January-July 2004 rose to €9,054 million or 5.5% of GDP, compared with 4.8% of GDP for the respective period of 2003 (see Table IV.3). It is worth mentioning that, by the end of July this deficit had already overshot the initially budgeted deficit of 3.8% of GDP for the year as a whole. On the basis of all available data and information, at the end of August the official forecast for the annual deficit of the *state budget* was revised upwards to 6.9% of GDP (this revised forecast has been included in the Draft Budget for 2005).

A further indication of deteriorating public finances in Greece is provided by the evolution of

31 To put this in context, it should be mentioned that the primary surplus was 6.5% of GDP in both 1998 and 1999 (under the earlier method for calculating fiscal balances).

32 Monthly data on the general government deficit on a national accounts basis are not available.

B O X I V.1

Main indicators of the fiscal policy stance

In assessing the fiscal policy stance, it is a common practice to rely on certain economic indicators, which are used for summarising, in a single measure, the combined effects exerted on the economy by the numerous decisions relating to budget revenue and expenditure, i.e. fiscal policy.

The fiscal balance (the deficit or surplus of the budget) is one of these indicators. However, the shortcoming of this simple indicator is that it cannot isolate *the impact of the budget on the economy from the impact of the economy on the budget*. The latter impact stems from fluctuations in economic activity, which influence employment, income, private investment etc. and ultimately, through automatic stabilisers,[1] government revenue/expenditure and the fiscal balance.

The *cyclically adjusted* fiscal balance does not incorporate the impact of cyclical fluctuations in economic activity on the budget balance and, therefore, enables the evaluation of the impact of fiscal policy on the economy only. To construct this indicator, we need to estimate the impact of cyclical fluctuations on the budget balance. This is the *cyclical component* of the balance, which is then subtracted from the fiscal deficit or surplus to derive the *cyclically adjusted balance*.[2] The change in the cyclically adjusted balance from year to year is the most widely used indicator of the fiscal policy *stance* (see Chart IV.2B in the main text).

For countries with a high level of public debt and with substantial interest payments, it is useful to estimate also the *cyclically adjusted primary balance*, especially when one seeks to evaluate the *current fiscal effort*. This indicator is estimated by deducting interest payments from the cyclically adjusted balance. In the case of Greece, for example, the drastic decline in interest rates, in the context of participation in Economic and Monetary Union, led to a substantial drop in interest payments and to a commensurate fall in the cyclically adjusted fiscal deficit up to 2001. This, however, does not necessarily reflect intensive fiscal consolidation efforts. On the contrary, both indicators point to a relaxation of the fiscal policy stance since 2002: the cyclically adjusted deficit has been rising and the cyclically adjusted primary surplus has been falling – in fact in 2004 it is estimated at nearly zero levels (see Charts IV.1 and IV.2 in the main text).

1 Automatic stabilisers are those features of the tax and spending regime which tend to smooth total output over a business cycle. For example, in a period of an economic upturn, incomes will rise, the result being that, in an progressive tax system, tax revenue increases more than proportionally, while unemployment falls and so does public expenditure for unemployment benefits. Thus, the fiscal deficit will decline or switch to a surplus, thereby reducing the contribution of the budget to aggregate demand. In a period of an economic downturn, exactly the opposite is the case. Therefore, over a business cycle, fluctuations in aggregate demand and economic activity are smoothed.

2 The cyclically adjusted fiscal balance —also called "structural balance"— represents the level at which the fiscal balance would stand if the rate of economic growth were equal to the potential rate of growth. Therefore, the estimation of the cyclical component of the fiscal balance is based on the estimation of the potential level of output or of other key macroeconomic variables. Two of the most common methods for estimating potential output are the production function approach, which is used by the European Commission, and the estimation of the trend of key macroeconomic variables (by means of the Hodrick-Prescott filter), which is used by the European System of Central Banks. Irrespective of the method used, any estimate of potential levels (which are not directly observable) is unavoidably surrounded by some degree of uncertainty. The uncertainty associated with the estimation of the cyclical component of the fiscal balance/position is further increased by the fact that one also needs to estimate the output elasticity of the fiscal balance (or its elasticity to output components), using econometric methods.

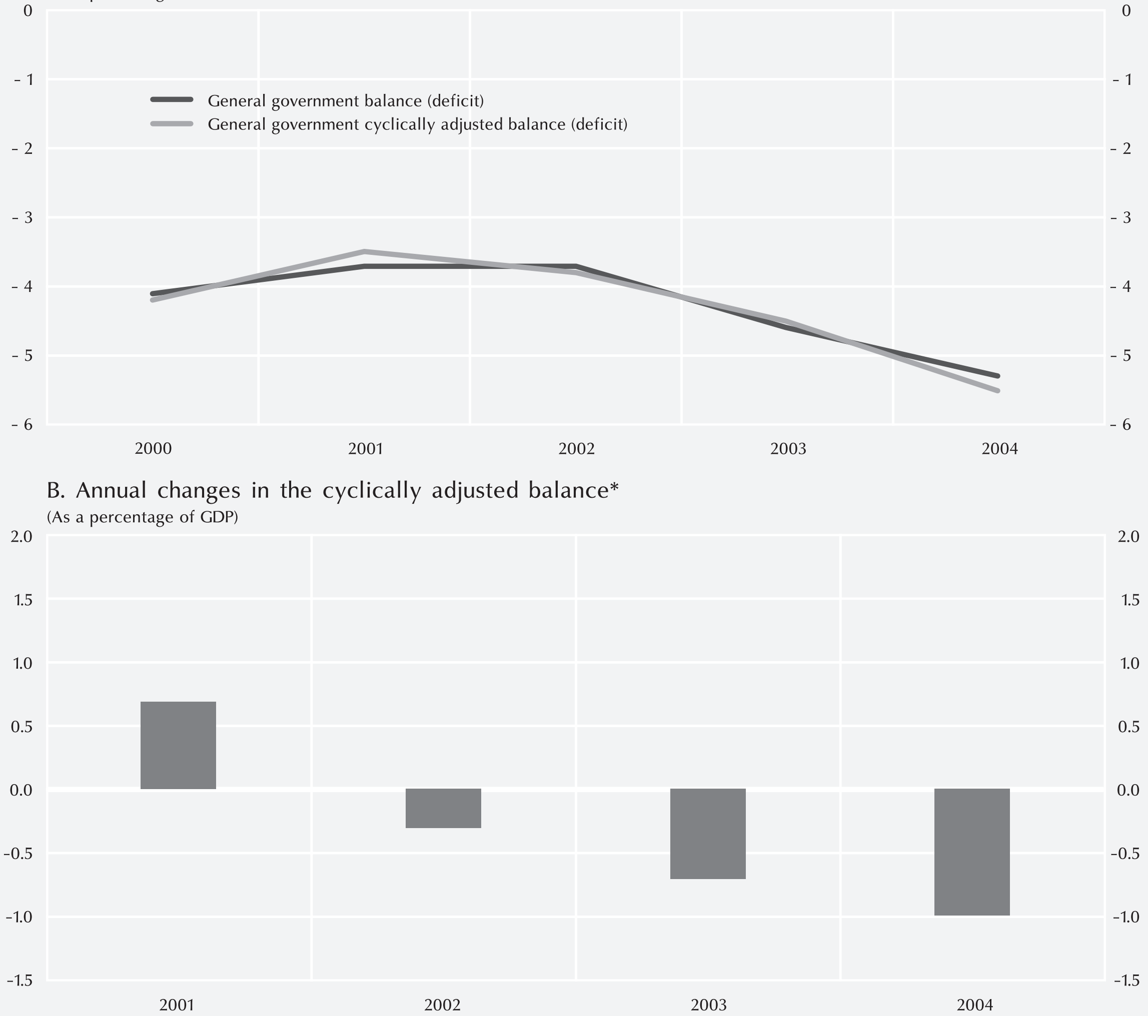
the primary balance of the *state budget*, which increased from a small primary deficit of €94 million in January-July 2003 to a significant primary deficit of €1,493 million in the respective period of the current year.

It should be noted that the state budget deficit for the January-July 2004 period would have been higher, had the deficit of the *public investment* budget not been reduced by 0.2% of GDP year-on-year (January-July 2004: 2.2% of GDP,

Chart IV.2

A. General government balance and cyclically adjusted balance*

(As a percentage of GDP)



* Revised data (Excessive Deficit Procedure definition).

Source: Bank of Greece estimates, based on the model of the European Central Bank.

January-July 2003: 2.4% of GDP). Therefore, the increase in the state budget deficit stemmed exclusively from the *ordinary budget*, in particular a large overrun in *ordinary budget* expenditure and, to a lesser extent, a shortfall in revenue, as discussed below.

4.1 Ordinary budget expenditure

In the January-July period of 2004, ordinary budget expenditure[33] grew by 10.5%, relative to the corresponding period of 2003, to reach €29,748 million (see Table IV.3). This rate of increase is almost three times as high as the original forecast of 3.8% for the entire year.[34] The acceleration in the growth rate is essentially due to primary expenditure, as interest payments increased by 4.1% in the seven-month period under review,

33 Including tax refunds.

34 It should be noted that the 3.8% increase refers to the comparison of the amount included in the 2004 Budget *for 2004* with the amount for 2003 implied by the *most recent* estimates of outcomes *for 2003* (and not by the estimated outcomes for 2003 included in the 2004 Budget).

broadly in line with the original budget forecast of 3.5% for 2004 as whole.

Among the individual categories of expenditure,[35] the most marked increases were recorded in personnel outlays, grants and restitution of revenue collected on behalf of third parties.

Over the first seven months of 2004, personnel outlays[36] grew by 11.7%, compared with a budget forecast for a 3.7% rise for the entire year. The largest increases[37] within this category were recorded in additional benefits to civil servants (29.5%), pensions (18.0%) and salaries (11.5%).

The substantial increase in additional benefits is attributable to extraordinary remuneration (overtime) of civil servants employed during the parliamentary elections of March 2004 and the European Parliament elections. The rise in pension outlays was due partly to across-the-board pension rises as from 1 January 2004 and partly to retroactive payments of last year's rises in pensions. Finally, the increased expenditure on salaries is associated with the introduction of a new salary scale for civil servants as from 1 January 2004, as well as with the retroactive payment of family allowances (when both spouses are civil servants) for the years 2001-2002. It should be noted that the special bonus payable to members of the police force and the military involved in the security of the Olympic and Paralympic Games in August and September will be recorded in expenditure for the August-December 2004 period.

A considerable rise (22.2%) was also seen in outlays for grants[38] over the first seven months of 2004, compared with a budgeted increase of 7.6% for the entire year. This development is associated with grants to social security organisations for the payment of increased pensions as of 1 January 2004 (most notably Farmers' Insurance Fund – OGA – pensions and the Pensioners' Social Solidarity Allowance – EKAS), as well as higher grants to public transport organisations.

Restitution of revenue collected on behalf of third parties[39] also rose considerably (23.1%) in the seven-month period under review (overshooting the budgeted annual increase of 2.3%), owing to increased payments to local authorities. Over the last ten years, this category of ordinary budget expenditure, which mostly consists of revenue collected on behalf of local authorities, has shown a significant upward trend.

It should be noted that part of the observed increases in personnel outlays and grants is associated with the implementation, as from 1 January 2004, of measures announced on 2 September 2003.

4.2 Ordinary budget revenue

Over the January-July 2004 period, ordinary budget revenue grew at a relatively slow pace (4.7%), compared with a budgeted annual rise of 9.4% (see Table IV.3). A breakdown of data is available for the January-April period only and indicates that this development was mainly due to a shortfall in direct tax receipts. In the Draft Budget for 2005, it is estimated that the growth rate of receipts will

35 The published monthly breakdowns of expenditure follow a different classification from the annual data. The differences, however, are rather small and do allow for conclusions to be drawn when deviations from the budget forecasts are sizable.
36 Personnel outlays, including travelling expenses, health care costs and civil servants' pensions, constitute the largest category of expenses, accounting for about 39% of the total ordinary budget expenditure in recent years. Interest payments form the second largest category, with a share of about 21% in total ordinary budget expenditure.
37 For these data, see footnote 28.
38 Expenditure for grants is the third largest category of expenditure, after personnel outlays and interest payments, accounting for 16-17% of total ordinary budget expenditure.
39 These constitute the fourth largest category of expenditure and have a share of 8% in total ordinary budget expenditure.

Table IV.3
State Budget results for the January-July period[1]
(Million euro)

	January - July					Percentage changes			
	2000	2001	2002	2003	2004*	2001/00	2002/01	2003/02	2004*/03
I Revenue[2]	**20,751**	**21,550**	**22,306**	**23,920**	**25,575**	**3.9**	**3.5**	**7.2**	**6.9**
1. Ordinary budget	20,164	21,509	22,076	23,167	24,254	6.7	2.6	4.9	4.7
2. Public investment budget	587	41	230[4]	753	1,321	–93.0	461.0	227.4	75.4
— Own revenue	53	38	...	...	...	–28.3	–	–	–
— Revenue from the EU	534	3	...	...	...	–	–	–	–
II. Expenditure[2]	**23,877**	**24,738**	**26,260**	**31,276**	**34,629**	**3.6**	**6.2**	**19.1**	**10.7**
1. Ordinary budget	20,170	21,418	23,599	26,924	29,748	6.2	10.2	14.1	10.5
— Interest payments[3]	6,559	6,582	6,550	7,262	7,561	0.4	–0.5	10.9	4.1
— Ordinary budget primary expenditure	13,611	14,836	17,049	19,662	22,187	9.0	14.9	15.3	12.8
2. Public investment budget	3,707	3,320	2,661	4,352	4,881	–10.4	–19.8	63.5	12.2
III. Net deficit (–)/surplus (+)	**–3,126**	**–3,188**	**–3,954**	**–7,356**	**–9,054**	. . .	. . .	. . .	. . .
Percentage of GDP	**–2.6**	**–2.4**	**–2.8**	**–4.8**	**–5.5**				
1. Ordinary budget	–6	91	–1,523	–3,757	–5,494	. . .	. . .	. . .	. . .
2. Public investment budget	–3,120	–3,279	–2,431	–3,599	–3,560	. . .	. . .	. . .	. . .
IV. Primary deficit (–)/surplus (+)	**3,433**	**3,394**	**2,596**	**–94**	**–1,493**	. . .	. . .	. . .	. . .
Percentage of GDP	**2.8**	**2.6**	**1.8**	**–0.1**	**–0.9**				
Amortisation payments[3]	7,410	8,193	11,898	15,827	14,588	10.6	45.2	33.0	–7.8

1 Until 2001, the extension of the fiscal year applied. In 2002, this practice was discontinued and revenue and expenditure of the state budget are recorded more in line with cash flows.
2 To ensure comparability, tax refunds are included in expenditure and have not been deducted from revenue.
3 Including respective payments on the national defence debt. Excluding amortisation payments related to short-term commercial paper.
4 The low level for January-July 2002 is due to the different methodology used that year by the State General Accounting Office between seven-month and annual data. Using the same methodology as for annual data, this figure would have been €1,973 million.
* Preliminary data.
Source: State General Accounting Office, Budget Implementation Bulletins.

accelerate by the end of 2004, owing to one-off receipts from the new provisions regarding the settlement of pending tax cases and the collection of tax arrears.

4.3 The public investment budget

As mentioned above, the deficit of the public investment budget in the January-July period of the current year declined to 2.2% of GDP, from 2.4% in the respective period of 2003, thus contributing to the containment of the state budget deficit.

The decline in the public investment budget deficit reflected higher transfers from EU funds, part of which were expected in 2003 but finally materialised in early 2004. By contrast, public investment expenditure rose by 12.2%, compared with a budget forecast of 8.3% on an annual basis (see Table IV.3).

The acceleration in the growth rate of investment expenditure is associated with the need to ensure timely completion of the Olympic projects (see Section 4.4 below).

4.4 Annual estimates for 2004 included in the Draft Budget for 2005

The following forecasts (estimates) for 2004 fiscal aggregates are included in the Draft Budget for 2005 (see Table IV.4):

The state budget deficit is expected to reach €11,267 million or 6.9% of GDP, compared with 6.5% of GDP in 2003, overshooting by 3.1 percentage points of GDP the original forecast of the 2004 Budget (3.8% of GDP). The *primary deficit* will also rise to 1.1% of GDP, from 0.3% in 2003. This deterioration is exclusively due to the *ordinary budget*, the deficit of which should increase to 2.9% of GDP in 2004, from 2.1% in 2003. In contrast, the public investment budget deficit should fall to 4.0% of GDP in 2004 from 4.4% of GDP in 2003, in spite of the overrun in expenditure on the Olympic Games projects in 2004.

The deterioration of the ordinary budget balance is mainly due, according to the Draft Budget, to an overrun of €3,391 million or 2.1% of GDP in primary expenditure[40] and, to a lesser extent, to a shortfall of revenue by €420 million or 0.3% of GDP. It is worth noting that the rate of increase in primary expenditure in 2004, relative to the previous year, is expected to reach 13.9%, while the original 2004 budget forecast was only 3.9%. The most notable increases are recorded in four expenditure categories: personnel outlays[41] (10.0% increase, against a forecast of 3.7%[42]), grants (17.7% increase, against a forecast of 7.6%[43]), "other consumption expenditure" (17.0% increase, against a forecast reduction of 4.9%[44]) and restitution of revenue collected on behalf of third parties (7.6% increase, against a forecast of 2.3%[45]). The main factors underlying these deviations have been explained in the discussion of developments in the January-July period of 2004.

Regarding expenditure directly related to the preparation and hosting of the Olympic Games, the relevant appropriation under the *ordinary*

40 Including tax refunds.
41 Including expenditure on health care.
42 See also footnote 34. Taking as a basis for comparison the initial estimates of outcomes for 2003 (included in the Introductory Report on the 2004 Budget), the 2004 Budget forecast an increase of 6.7% in personnel outlays.
43 Taking as a basis for comparison the initial estimates of outcomes for 2003, the 2004 Budget forecast an increase of 12.2% in grants.
44 Taking as a basis for comparison initial estimates of outcomes for 2003 (in the Introductory Report on the 2004 Budget), the 2004 Budget forecast a fall of 2.8% in consumption expenditure.
45 Taking as a basis for comparison the initial estimates of outcomes for 2003 (in the Introductory Report on the 2004 Budget), the 2004 Budget forecast an increase of 6.3% in restitution of revenue collected on behalf of third parties.

Table IV.4
State Budget results on an annual basis[1]
(Million euro)

	2000	2001	2002	Budget 2003	Outcome 2003	Budget 2004	Estimated outcome 2004	Percentage changes 2001/00	2002/01	Outcome 2003/02	Budget 2004/03	Estimated outcome 2004/03
I Revenue[2]	**37,522**	**39,368**	**41,051**	**45,150**	**41,706**	**47,740**	**46,247**	**4.9**	**4.3**	**1.6**	**14.5**	**10.9**
1. Ordinary budget	34,257	36,573	39,048	41,050	39,879	43,620	43,200	6.8	6.8	2.1	9.4	8.3
2. Public investment budget	3,265	2,795	2,003	4,100	1,827	4,120	3,047	–14.4	–28.3	–8.8	125.5	66.8
— Own revenue	145	137	14	100	83	100	100	–5.5	–89.8	492.9	20.5	20.5
— Revenue from the EU	3,120	2,658	1,989	4,000	1,744	4,020	2,947	–14.8	–25.2	–12.3	130.5	69.0
II. Expenditure[2]	**42,734**	**44,578**	**46,412**	**50,453**	**51,647**	**54,000**	**57,514**	**4.3**	**4.1**	**11.3**	**4.6**	**11.4**
1. Ordinary budget	35,313[4]	36,736[4]	39,398	41,535	43,109	44,750	47,914	4.0	7.2	9.4	3.8	11.1
— Interest payments[3]	9,914	9,711	9,134	9,400	9,416	9,750	9,523	–2.0	–5.9	3.1	3.5	1.1
— Ordinary budget primary expenditure	25,399	27,025	30,264	32,135	33,693	35,000	38,391	6.4	12.0	11.3	3.9	13.9
2. Public investment budget	7,421[5]	7,842	7,014	8,918	8,538	9,250	9,600	5.7	–10.6	21.7	8.3	12.4
III. Net deficit (–)/surplus (+)	**–5,212**	**–5,210**	**–5,361**	**–5,303**	**–9,941**	**–6,260**	**–11,267**	**. . .**	**. . .**	**. . .**	**. . .**	**. . .**
Percentage of GDP	**–4.3**	**–4.0**	**–3.8**	**–3.5**	**–6.5**	**–3.8**	**–6.9**					
1. Ordinary budget	–1,056	–163	–350	–485	–3,230	–1,130	–4,714	. . .	. . .	. . .	. . .	. . .
2. Public investment budget	–4,156	–5,047	–5,011	–4,818	–6,711	–5,130	–6,553	. . .	. . .	. . .	. . .	. . .
IV. Primary deficit (–)/surplus (+)	**4,702**	**4,501**	**3,773**	**4,097**	**–525**	**3,490**	**–1,744**	**. . .**	**. . .**	**. . .**	**. . .**	**. . .**
Percentage of GDP	**3.9**	**3.4**	**2.7**	**2.7**	**–0.3**	**2.1**	**–1.1**					
Amortisation payments[3]	13,859	12,777	20,860	21,626	22,651	20,045	21,472	–7.8	63.3	8.6	–11.5	–5.2

1 Until 2001, the extension of the fiscal year applied. In 2002, this practice was discontinued and revenue and expenditure of the state budget are recorded more in line with cash flows.
2 To ensure comparability, tax refunds are included in expenditure and have not been deducted from revenue.
3 Including respective payments on the national defence debt. Excluding amortisation payments related to short-term commercial paper.
4 Including expenditure of €70 million and €59 million in 2000 and 2001, respectively, for relief to earthquake victims.
5 Including expenditure of €258 million for relief to earthquake victims.
Source: State General Accounting Office.

T a b l e IV.5

Decomposition of changes in the general government debt-to-GDP ratio[1]

(In percentage points of GDP)

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000*	2001*	2002*	2003*	2004*
General government debt ratio	79.6	82.2	87.8	110.1	107.6	108.7	111.3	108.2	105.8	105.2	114.0	114.7	112.5	109.9	112.1
Annual percentage changes in the debt ratio	10.6	2.6	5.6	22.3	–2.5	1.1	2.6	–3.1	–2.4	–0.6	8.8	0.7	–2.2	–2.6	2.2
– Effect of primary surplus	6.5	3.0	2.1	2.2	–2.7	–2.6	–4.6	–5.6	–6.5	–6.5	–4.0	–3.6	–2.6	–1.2	. . .
– Effect of GDP changes and interest rate changes	–4.0	–7.8	–1.7	–0.4	–1.1	0.3	1.5	–1.5	0.0	1.5	–0.3	–1.4	–2.1	–2.9	. . .
– Stock-flow adjustment[2]	8.1	7.4	5.2	20.5	1.3	3.4	5.7	4.0	4.1	4.4	13.1	5.7	2.5	1.5	. . .

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

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

where, D_t = general government debt
PB_t = primary balance
Y_t = GDP at current prices
g_t = nominal GDP growth rate
i = average nominal interest rate on government debt
SF_t = stock-flow adjustment

2 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.

* According to revised data notified to Eurostat on 31 August 2004.

Source: Bank of Greece calculations.

budget was €140 million. According to estimates included in the Draft Budget for 2005, this amount will increase to €437 million, implying an overrun of €297 million or 0.2% of GDP. However, the largest part of the budgetary burden entailed by the hosting of the Olympic Games is associated with construction projects and appears in the *public investment budget*. For the whole year, the relevant appropriation in the public investment budget was €1.4 billion, but, according to estimates included in the Draft Budget for 2005, the related expenditure will reach €2.25 billion or 1.4% of GDP, which represents an overrun of €850 million or 0.5% of GDP. Of this overrun, 60% was offset by a cut in other expenditures of the public investment budget.

4.5 Public debt

Following the revision of general government debt figures in August 2004, the official forecast for the consolidated debt of general government in 2004 stands at €184,336 million or 112.1% of GDP, compared with 109.9% of GDP in 2003. The persistence of debt at high levels in recent years (see Table IV.5) occurred despite the fact that developments in all major determinants of the debt-to-GDP ratio were particularly favourable (declining interest rates, stronger growth rates and existence of primary surpluses), while, at the same time, proceeds from privatisation rose substantially.[46] The envisaged increase in the debt ratio by 2.2 percentage points of GDP during 2004 in comparison with 2003 is attributable, apart from the revision of statistical data, to a rise in government borrowing and a contraction in the primary surplus of general government.[47]

It should be noted that the primary balance of the state budget turned from a surplus in 2002 to a small primary deficit in 2003 (€523 million), which substantially widened further (to €1,493 million) during the January-July period this year. Similarly, the primary surplus of *general government*, which stood at 4.0% in 2000, has declined gradually ever since and is expected to be virtually zero this year.

This development reinforces the dynamics of growth of the debt-to-GDP ratio and must be checked, in order for the debt-to-GDP ratio to "...diminish sufficiently and approach the reference value at a satisfactory pace", as it is required by the Recommendation of the ECOFIN Council to Greece.

4.6 The "stock-flow-adjustment"[48]

Following the revision of fiscal data and the reporting of higher deficits for the 2000-2004 period, the stock-flow-adjustment for the years 2001-2003 declined (see Table IV.5). However, as, in addition to the deficit level, the level of debt was also revised, the decline in the stock-flow-adjustment was rather modest.

Regarding 2000 (first year of the revision), it should be taken into account that debt data are not com-

46 Privatisation proceeds in the 1997-2003 period are estimated at 7.8% of the 2003 GDP.

47 Increased borrowing partly reflected an obligation arising from the agreement on the securitisation of CSF III receipts. Under this agreement, some of these receipts shall be deposited, at the time of collection, with a bank abroad, so that the relevant amortisation payments can be made as they fall due. Since the beginning of this year, an amount of €1,020 million (0.6% of GDP) has been deposited abroad and will be used on *31 January 2005* for the amortisation payment due on that date. For this reason, the corresponding receipts from CSF III, although they have been recorded as revenue in the budget and, as such, they reduce the deficit for 2004, are not actually available, which necessitated additional borrowing of an equal amount. It should be noted that borrowing for the refinancing of public debt will correspondingly fall in 2005 by €1,020 million.

48 For the concept of "stock-flow-adjustment" see footnote 2 in Table IV.5 and Bank of Greece, *Annual Report 2003*, April 2004, page. 74, footnote 2.

parable to those referring to previous years and for this reason the debt ratio *appears* to have increased significantly (by 8.8 percentage points of GDP), thereby driving upwards the "stock-flow-adjustment". For the years 2001 to 2003, the stock-flow-adjustment declined by an average of 1.6% of GDP annually in comparison with the estimates prior to the revision of fiscal data.[49]

49 Before the revisions, the stock-flow adjustment was 7.1% for 2001, 4.3% for 2002 and 3.2% for 2003. See Bank of Greece, *Annual Report 2003*, April 2004, page 37, Table II.1.

Appendix to Chapter IV

Fiscal policy in a monetary union

Fiscal actions constitute one of the main tools of macroeconomic policy.[1] In the euro area, where monetary policy decisions are taken centrally by the ECB, fiscal policy provides governments with an instrument of macroeconomic policy at the national level. In this Appendix, we explain the role that fiscal policy plays in an economy and discuss how the role assigned to fiscal policy has changed over the years. Currently, most economists believe that, while situations may arise in which countries will need the freedom to use fiscal policies for accommodating more permanent negative shocks, the unsustainability of these policies limits their effectiveness. This, along with the need for an appropriate mix of monetary and fiscal policy that ensures monetary stability, leads to the view that in a monetary union the conduct of fiscal policies has to be disciplined by explicit rules on the size of budget deficits and the amount of debt. In the light of this analysis, this Appendix considers the appropriateness of the relevant articles of the Maastricht Treaty and the Stability and Growth Pact.

From the perspective of macroeconomic policy, fiscal policy has two main roles. First, over the longer term, it influences potential growth. Second, it can contribute to stability, as —among other things— it can help to smooth economic cycles by influencing prices and stabilising expectations. In this way, it creates an environment where the preservation of price stability can be ensured by the application of the appropriate monetary policy. This second role becomes all the more significant in a monetary union. Since the centralised monetary policy can respond only to average conditions throughout the monetary union and not to country-specific factors, national fiscal policies can play a part in countering the impact of so-called asymmetric shocks, that is, shocks which affect one or more, but not all, countries of the union.

The effect of fiscal policy in influencing potential growth arises from the positive role that government spending and tax policies can play in creating the conditions for successful economic performance. Attention should be paid to incentive and distortionary effects when designing tax systems. *Taxes* create a wedge between the returns generated by a particular activity (be it work, production, physical or financial investments) and the actual amount received by the individual or organisation engaging in the activity. This wedge can act as a disincentive to engage in activities that raise the potential growth rate of an economy. Moreover, differences in the wedge could cause distortions in the economy, as one activity is favoured over another. *Government expenditure* can also affect growth prospects. Spending on infrastructure and education can help to provide important inputs of both physical and human capital to the production process and raises the quality of those factors of production that already exist.

From the 1930s until the early 1970s, discretionary fiscal policy was seen to have an important role in stabilising the economy or smoothing out the impact of business cycles. Discretionary fiscal policy involves actively increasing government expenditure or reducing taxes at times of economic downturns. According to this view, such moves, which increase the budget deficit when economic growth slows, will have an expansionary impact on demand and hence output and employment. The impact on prices should be limited, provided there is plenty of spare capacity that allows producers to increase production in response to rising demand rather than raise prices.

This view that discretionary fiscal policy could help to smooth economic fluctuations has come under increasing criticism in recent years. This criticism includes the following elements:

— First, there is the issue of timing. Inevitably, there are lags in the operation of discretionary policy, often

1 Fiscal policy has many other roles to play, including the redistribution of income, the provision of collective or public goods, etc. In this Appendix, our focus is on its macroeconomic role.

leading to pro-cyclical policies. That is, by the time the increase in government spending or reduction in taxes has its effect, the economy has already moved out of recession, with the result that the discretionary fiscal policy merely operates to strengthen the boom.

— Second, increases in government spending tend to raise long-term interest rates, crowding out private investment, and lower confidence, undermining potential growth. Moreover, governments sometimes spend money on items (e.g. subsidies) that produce less economic growth than does private investment.

— Third, as demonstrated by the experiences of a number of countries, large budget deficits used for offsetting negative shocks frequently lead to unsustainable debt dynamics, from which countries find it hard to extricate themselves.

— Fourth, it has been argued that it makes no difference whether government spending is financed by current taxes or by borrowing against future tax revenues, since taxpayers know that they will have to pay additional taxes in the future to enable repayment of a growing public debt They will therefore attempt to increase their savings in anticipation of future tax payments, which will lead to a reduction in private consumption in the present. Although only partly supported by the empirical evidence, this theory, combined with the other criticisms of countercyclical fiscal policy, has contributed to a less sanguine view of the effectiveness of such policy than existed in the 1970s and 1980s.

— Finally, a new phenomenon was observed which turned on its head the theory that discretionary fiscal policy can help smooth economic cycles. In recent years, fiscal consolidation has often appeared to be accompanied by *expansionary* effects, rather than the contractionary effects which that theory would have predicted.[2] Greece's fiscal consolidation from the mid-1990s onwards provides a clear-cut example.

These criticisms have led increasingly to the view that fiscal policy should play its stabilising role in the economy only through the operation of automatic stabilisers, *provided that the fiscal position is balanced or in surplus on average over the cycle*, and that discretionary policy measures should be discouraged. The fact that both government expenditure and tax revenues are automatically sensitive to the economic cycle provides the rationale for the view that allowing the full operation of automatic stabilisers should help to smooth economic fluctuations. Income-sensitive components of government expenditure include social transfers (such as unemployment benefits). Tax revenues are more income-sensitive. Thus, as the economy moves into recession, the budget deficit automatically increases since expenditure rises and tax revenues fall, and this helps to soften the recession. In upturns the opposite occurs, that is the budget deficit automatically declines[3] (indeed it should move into surplus if the budget is in balance over the whole economic cycle).[4] In this way, fiscal policy automatically operates in a countercyclical fashion.[5]

2 See Giavazzi F. and Pagano M. (1990) "Can Severe Contractions be Expansionary? Tales of Two Small European Countries", NBER *Macroeconomics Annual*, Vol. 5, pp. 75-111, for the original paper in this area; a more recent survey of evidence is provided in Guidice G., Turrini A. and In't Veld J. (2004) "Non-Keynesian Fiscal Consolidation in the EU? Ex Post Evidence and Ex Ante Analysis", CEPR Discussion Paper No. 4388, May.

3 Of course, if the fiscal position is in surplus, the surplus would decline during the downturn and rise during the upturn.

4 It has been estimated that automatic stabilisers reduced cyclical fluctuations of activity in OECD countries by one fourth, on average, in the 1990s. See Van den Noord (2000), "The size and role of automatic fiscal stabilisers in the 1990s and beyond", OECD, Economics Department Working Paper No. 230.

5 If business cycles were completely synchronised across countries and were of similar magnitude, then national fiscal policy would not be necessary. Views differ as to whether closer monetary and economic integration will make business cycles more similar. Krugman P. (1992) ("Lessons of Massachusetts for EMU" in Torres, R. and F. Giavazzi (eds) *Adjustments and Growth in the European Monetary Union*, CUP, CEPR) has argued that greater integration leads to regional specialisation and this will make asymmetric shocks more likely and hence business cycles less similar. By contrast, if increased integration is associated with greater intra-industry trade, then business cycles will become more similar (see Frankel J. and Rose A.K., 1998, "The endogeneity of the Optimum Currency Area criteria", *Economic Journal*, V. 108, pp. 1009-25). The empirical literature gives a mixed picture and, even if there does seem to be some tentative evidence that cycles have become more similar since the formation of the euro area, they are still far from identical. Thus national fiscal policy still has an important role to play.

The intertemporal approach to fiscal policy, which has garnered considerable support in recent years, has important implications for monetary policy and inflation. In this connection, the simple accounting fact that government expenditure has to be financed by either taxation, borrowing and/or money creation implies that fiscal policy and monetary policy are not independent policy instruments. For example, loose fiscal policies contribute to conditions of excess demand and tend to be associated with larger borrowing by governments from monetary financial institutions and hence higher M3 growth rates.[6] In this way, loose fiscal policies can easily begin to undermine price stability. Therefore, if monetary policy is to fulfil its fundamental role of providing price stability, it needs to be accompanied by a consistent and prudent fiscal policy over the medium term. Otherwise, an increase in interest rates will be unavoidable.

How can fiscal policy best fulfil its roles? The above discussion about the merits of discretionary and automatic fiscal policies points very strongly in the direction of the need for fiscal rules to guide policy. Rules have a number of advantages over discretion. They can be used to ensure the longer-term sustainability of fiscal policy. As discussed above, continuous deficits generate increasing debt and can raise interest rates. In addition, under certain conditions, they can destabilise expectations, as economic agents become increasingly worried about the ability of the government to repay the obligations generated by the debt. Ultimately, both effects of continuous deficits can have a negative impact on economic growth, and doubts about the sustainability of fiscal policy can reduce its effectiveness. Moreover, such rules can also trigger mechanisms that automatically correct a growing fiscal problem and in this way can contribute to stabilising expectations and creating an environment where long-term planning in the private sector is made easier.

In a monetary union where fiscal policy is still conducted at the national level, rules aiming at ensuring fiscal discipline in individual countries have the advantage of limiting the negative externalities that can arise because of "free-rider" problems. These problems have to do with the fact that there are incentives for any small member of the monetary union to increase its deficit and debt, since this will have little impact on interest rates throughout the monetary union, and the umbrella of the monetary union usually implies that access to finance, at any price, will not be cut off.[7]

Finally, fiscal rules can help to avoid the potential for a mix of fiscal and monetary policy that would be inappropriate for the achievement and maintenance of price stability. Some monetary unions, such as the United States or Australia, are also federal states and hence have a federal budget. This helps facilitate the creation of the appropriate policy mix. The euro area is not a federal state and there is only a relatively small centralised budget (that operated by the European Commission), financed by Member State contributions not exceeding (at present) 1.27% of the EU's GDP. The potential for individual countries running loose fiscal policies is thus much greater.

Seen in this light, the fiscal rules contained in the Maastricht Treaty and the Stability and Growth Pact have a clear rationale. Under the Maastricht Treaty and as part of the criteria to be met for euro area entry, reference values were set for both general government deficits (which must not exceed 3% of GDP) and general government debt (which must not exceed 60% of GDP or must be sufficiently diminishing and approaching the reference value at a satisfactory pace). The Stability and Growth Pact (SGP) was introduced in

6 This is true even if direct monetary financing of the deficit by the central bank is precluded, as is the case in the euro area. See "Fiscal policy influences on macroeconomic stability and prices", ECB, *Monthly Bulletin,* April 2004, pp. 45-57.
7 The existence of no-bail out clauses whereby the union as a whole explicitly states that it will not bail out individual members in the event of default is not easily made credible. If one member were to default or experience debt servicing difficulties, the incentives for other members to provide help would be great, irrespective of what declarations had been made previously.

order to ensure that these reference values would continue to apply within EMU. In addition, the SGP seeks both to *prevent* lax fiscal policies and to *deter* them by clarifying the various steps of the excessive deficit procedure (EDP). *Prevention* works through improved surveillance and methods for coordinating economic policies. *Deterrence* is provided for by the possible imposition of fines should the recommendations of the ECOFIN Council for the correction of the deficit not be implemented.

The SGP states that member countries of the euro area are required to aim for a medium-term budgetary position of close to balance or in surplus. Only in exceptional circumstances will deficits above 3% not be considered excessive, namely if there has been an annual fall in GDP of at least 2%.[8] Should an excessive deficit be considered to exist, then the ECOFIN Council will issue a recommendation to the Member State concerned and call upon it to take measures for correcting its deficit. If the Member State fails to comply, then there is the possibility of imposing sanctions (including the fines prescribed in the Pact).

The rationale for the institutional framework surrounding the operation of fiscal policy in the euro area is clearly evident from the discussion above. The rules seek to prevent "free-rider" behaviour and to ensure that countries have ample room to allow automatic stabilisers to operate without risking a breach of the 3% limit. They also play an important role in the goal of maintaining price stability. Excessive deficits can increase demand pressures and are also usually associated with excessive monetary growth. Both put upward pressure on prices and lead to the danger of a possible inappropriate policy mix.

Over the longer run, the rules are designed to maintain sustainable fiscal policies, that is, prevent the accumulation of a large debt burden. Such considerations are all the more important in the face of the budgetary pressures brought about through population ageing. If debt levels are still high when increased pension liabilities become due, then governments will have little room for manoeuvre and the option of distributing the burden between generations through an increase in debt will simply not be available.

* * *

On 24 October 2002, the Governing Council of the European Central Bank made the following statement on the Stability and Growth Pact:

Statement of the Governing Council of the ECB on the Stability and Growth Pact – 24 October 2002

The principle of budgetary discipline enshrined in the Treaty and the Stability and Growth Pact are indispensable for Economic and Monetary Union (EMU)

EMU, with a single monetary policy and 12 governments responsible for budgetary policies, needs a fiscal institutional framework. The framework must be simple and enforceable and ensure that fiscal policies in Member States are sound and sustainable. Such a framework of fiscal policies fosters sustainable growth and employment, is conducive to economic stability and is a necessary complement of a monetary policy geared to price stability.

The Stability and Growth Pact has been successful in promoting sound public finances and fiscal convergence.

Since agreement was reached on the fiscal rules in the Maastricht Treaty, generally fiscal balances have improved significantly in the Member States. Public debt ratios have been coming down in a sustained man-

8 An annual fall in GDP of less than 2% can be considered as exceptional if evidence can be presented that points to an abrupt downturn or a large accumulated loss of output relative to past trends.

ner since the mid-1990s for the first time in decades. As a result, most Member States have now reached budget positions which are "close to balance or in surplus". These developments have supported, rather than hampered, growth in employment and real GDP.

The Stability and Growth Pact is in the interest of Member States.

The main commitment of Member States under the Stability and Growth Pact is that the fiscal policies should result in medium-term budgetary positions which are "close to balance or in surplus". This, in conjunction with the Maastricht Treaty obligation to avoid excessive deficits and to apply appropriate implementation procedures, secures the sustainability of public finances and provides scope for dealing with the expected fiscal challenges caused by population ageing. Moreover, and contrary to the claims of its critics, the Stability and Growth Pact also provides sufficient flexibility after "close to balance or in surplus" positions have been reached, as automatic stabilisers can then operate fully. Problems have arisen not because the rules are inflexible, but as a result of some countries' unwillingness to honour their commitment to respect the rules.

The results of fiscal policy in several countries are very disappointing. In this context it is important to recall that the main reason why countries are in budgetary difficulties at present is because they have not used the situation of higher growth to substantially improve their fiscal position.

We continue to support the initiative of the Commission that all countries with remaining imbalances should commit themselves to implement a clear consolidation strategy with four key elements:

(i) a credible adjustment path, which requires the continuous adjustment of the underlying balance by at least 0.5% of GDP per year, (ii) realistic assumptions about the economic environment, (iii) well-specified measures to attain the objective and (iv) rigorous accounting rules and strict monitoring procedures for the implementation of the consolidation strategies. These commitments have to be honoured by rapid and decisive action.

The Stability and Growth Pact supports price stability.

By ensuring sustainable public finances and by providing enough flexibility for the full operation of automatic stabilisers in periods of economic weakness as well as strength, the Stability and Growth Pact also has a favourable effect on macroeconomic stability. This facilitates achieving price stability and fosters confidence in the euro area's economic prospects.

Respecting the provisions of the Treaty and the full implementation of the Stability and Growth Pact remain fundamental to Monetary Union and to each individual Member State. Full compliance with the fiscal framework will also send an important message to accession countries."

* * *

In a more recent statement (13 July 2004), the European Central Bank noted: "The ECB remains convinced that there is no need for changes to the Treaty and the Stability and Growth Pact and that the implementation of the Stability and Growth Pact could be further improved."

In a Communication issued on 3 September 2004, the European Commission submitted proposals to the Council of Ministers and the European Parliament on "strengthening economic governance and clarifying the implementation of the Stability and Growth Pact" (COM(2004)581 final). In his testimony before the Committee on Economic and Monetary Affairs of the European Parliament on 22 September 2004, the President of the European Central Bank Mr Jean-Claude

Trichet stated the following: "As regards the European fiscal framework, the Governing Council is convinced that, whilst substantial improvements in the implementation of the Stability and Growth Pact are welcome, there is no need for changes to the text of the Treaty and of the Pact itself, namely the regulations concerned. The Pact is a very important and pertinent framework for dealing with countries' fiscal developments on a level playing-field, particularly within the single currency area. At the same time, we consider that improvements could be introduced in its implementation. There seems to be some common ground on elements to improve the implementation of the preventive arm, and the need for a stronger focus on public debt and sustainability. As regards the corrective arm of the Pact, the ECB's main message is that the nominal anchor of the framework, namely the 3% deficit-to-GDP reference value should not be undermined. Therefore, proposals that would allow for a loosening of the excessive deficit procedure, such as suggestions put forward with regard to the definition of exceptional circumstances and the time frame for the correction of excessive deficits, and proposals to introduce country-specific elements are not contributing to the solidity and soundness of EMU in our view."

V. Money, credit and capital markets in Greece

1. Monetary developments in Greece

During the first half of the current year, the growth rate of the Greek contribution to euro area M3[1] (excluding currency in circulation) remained practically unchanged from its levels in the last quarter of 2003, while it accelerated slightly in the July-August period. However, throughout these eight months, this rate was higher in Greece than in the euro area. Divergent M3 developments in Greece compared with the euro area are associated with shifts of non-financial sector[2] portfolios from assets not included in M3 (government securities, shares/units of mutual funds other than money market funds) to deposits, at a time when in the euro area investors gradually shifted to assets not included in M3.[3]

The individual components of the Greek contribution to the euro area M3 recorded divergent trends in the period under review. The relatively low opportunity cost of holding money (due to the low interest rates on deposits) as well as expectations of a future increase in euro area interest rates contributed to a considerable acceleration of the growth rate of short-term (overnight) deposits. In contrast, the growth rate of time deposits with an agreed maturity of up to two years fell substantially, as investors avoided tying up their funds for relatively long periods. An even greater deceleration was seen in the growth rate of money market fund shares/units, while the rate of decline in investment in repos weakened considerably.

1 The Greek M3, as well as that of any other euro area country, can no longer be calculated accurately, as quantities of euro banknotes and coins put in circulation by one euro area country may be held by residents of other euro area countries (and/or residents of third countries). Therefore, due to the technical problems with the calculation of currency in circulation in each euro area country, developments are discussed with respect not to the Greek M3 but only to its key components (excluding currency in circulation).
2 Comprising all sectors of the economy excluding central government and MFIs.
3 See Chapter II.3.

Table V.1
Greek contribution to the key monetary aggregates of the euro area
(Not seasonally adjusted data)

	Outstanding balances on 31.08.04 (million euro)	Annual percentage changes[1]				
		2003		2004		
		Q3[2]	Q4[2]	Q1[2]	Q2[2]	August[3]
1. Overnight deposits	84,947	3.9	6.8	11.7	13.4	14.9
1.1 Sight deposits and current account deposits	17,704	14.3	17.7	19.3	18.0	9.8
1.2 Savings deposits	67,243	1.3	4.1	9.7	12.2	16.3
2. Time deposits with an agreed maturity of up to 2 years	33,206	31.2	29.8	20.3	14.8	3.9
3. Deposits redeemable at notice of up to 3 months[4]	2,094	3.3	2.3	3.4	1.7	3.7
4. Total deposits (1+2+3)	**120,247**	**10.5**	**12.2**	**13.4**	**13.0**	**11.1**
5. Repurchase agreements (repos)	9,620	–44.3	–47.7	–45.9	–41.3	–21.3
6. Money market fund units	15,797	76.9	68.0	24.6	7.5	0.5
7. Bank bonds with a maturity of up to 2 years[5]	435	. . .	. . .	. . .	. . .	. . .

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 No rates of change are shown, as they are very high, owing to the very low base of calculation.
Sources: Bank of Greece and ECB.

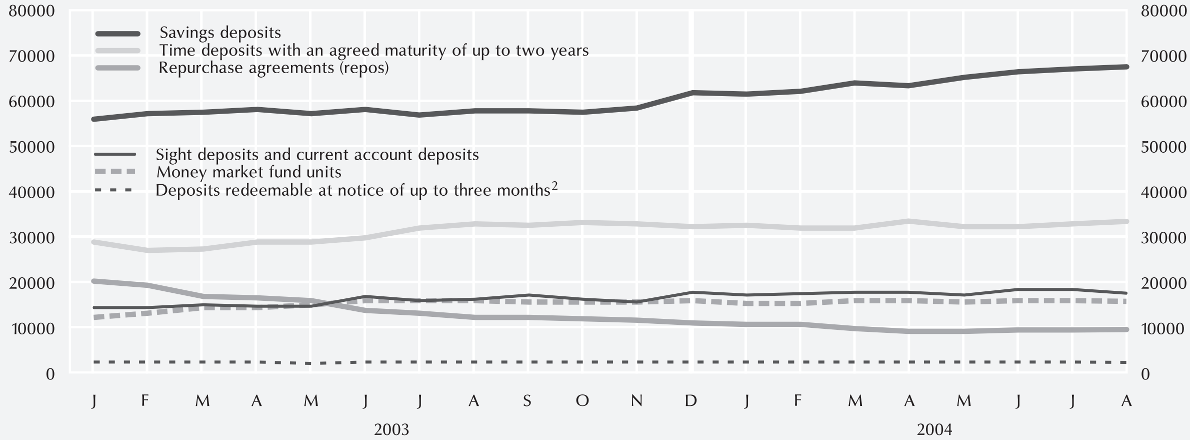
In more detail, the annual growth rate of deposits which according to the ECB's definition are included in M3 picked up slightly in the first half of this year, rising from 12.2% in the fourth quarter of 2003 to 13.0% in the second quarter of 2004, while in the July-August period it moderated somewhat (August 2004: 11.1%, see Table V.1). In particular, the growth rate of overnight deposits[4] accelerated considerably in the first eight months of 2004, standing at 13.4% in the second quarter of the year (up from 6.8% in the fourth quarter of 2003), and strengthened further in the July-August period (August 2004: 14.9%). This development in overnight deposits reflects the faster growth of savings deposits. Specifically, the growth rate of savings deposits accelerated gradually in the period under review, from 4.1% in the fourth quarter of 2003 to 12.2% in the second quarter of the current year, while in the July-August period it rose to an even higher level (August 2004: 16.3%), partly reflecting a base effect. The fast growth of savings deposits is associated with the continuing decline in repos, as well as with a fall in government paper yields in the first eight months of the current year, both of which boosted demand for more liquid assets. It should be noted that non-financial sector holdings of government securities in the first eight months of 2004 were markedly lower than in the corresponding period of the previous year (January-

4 It should be recalled that, as from 2003, savings deposits are included in overnight deposits along with sight deposits and current account deposits (for comparability reasons, data on previous years have been adjusted accordingly). Savings deposits (as mentioned in previous Governor's Annual Reports and Monetary Policy Reports) have broadly similar characteristics with current account deposits, since they are redeemable on demand (without penalty) and enable depositors to effect payments to third parties (e.g. standing payment orders and fund transfers through cards).

Chart V.1

Deposits, repurchase agreements and money market fund units in Greece[1] (January 2003 - August 2004)

(End-of-period balances, in million euro)



1 These aggregates concern deposits, repos and money market fund units which, according to the ECB definition, are included in M3 and therefore constitute the Greek contribution to the corresponding euro area aggregates.
2 Including savings deposits in currencies other than the euro.

Source: Bank of Greece.

August 2004: €311 million, January-August 2003: €3,618 million). Moreover, developments in deposits were also favoured, as mentioned above, by the relatively low opportunity cost of holding money as well as expectations of a future increase in euro area interest rates that turned savers towards more liquid deposits. In addition, sight and current account deposits also increased at a quick pace in the same eight-month period (second quarter of 2004: 18.0%, fourth quarter of 2003: 17.7%), although in the July-August period their growth rate decelerated (August 2004: 9.8%). The strong growth of such deposits in the first eight months of 2004 is associated, to a certain extent, with the increased value of transactions in the Athens Exchange (Athex) in the same period.[5]

The annual growth rate of time deposits with an agreed maturity of up to two years decelerated considerably in the first eight months of the current year, falling from 29.8% in the fourth quarter of 2003 to 14.8% in the second quarter of 2004 and to an even lower level in the July-August period (August 2004: 3.9%). This slowdown in the annual growth rate of time deposits with an agreed maturity of up to two years is associated, as already mentioned, with the preference of savers for more liquid assets amid expectations of higher interest rates in the euro area.

Among the other main components of M3, holdings of repos dropped further in the first eight months of 2004 (see Chart V.1), although their rate of decline decelerated gradually from 47.7% in the last quarter of 2003 to 41.3% in the second quarter of 2004, and further in the July-August period (August 2004: 21.3%). Apart from the taxation of repo yields, this development is also associated with the extensive restructuring of credit institution portfolios (by reducing holdings of Greek government securities and correspondingly increasing loans to the private sector, which earn them a higher interest income). Finally, in the first eight months of 2004 holdings of

5 The average monthly value of stock exchange transactions stood at €2,859 million in the period from January to August 2004, compared with €2,598 million in the corresponding period of 2003.

Table V.2
Total credit expansion in Greece
(Annual percentage changes)

	2003		2004		
	Q3[1]	Q4[1]	Q1[1]	Q2[1]	August[2]
1. Total credit expansion	3.6	3.2	3.8	8.6	7.8
2. Credit expansion to general government	–16.1	–15.9	–15.5	–6.2	–5.6
3. Credit expansion to enterprises and households	18.4	17.1	16.9	17.4	15.0
3.1. Credit expansion to enterprises	13.2	11.0	10.9	10.5	6.9
3.2. Credit expansion to households	28.2	28.2	27.5	28.9	28.4
3.2.1 Housing loans	28.7	27.1	24.5	24.7	23.1
3.2.2 Consumer loans	22.7	24.8	29.2	34.5	38.4

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.

money market fund shares/units remained broadly unchanged from July 2003 and their growth rate slowed down substantially, from 68.0% in the last quarter of 2003 to 7.5% in the second quarter of 2004 and just 0.5% in August. This development is associated with the narrowing of the spread between the yields of money market fund shares/units and savings deposits, as the former were negatively affected by a drop —in the first eight months of the current year— in bond yields, which represent a sizeable share of mutual funds portfolios, while the interest rate on savings deposits remained practically unchanged in the same period.

2. Credit expansion

The year-on-year growth rate of total credit extended by Monetary Financial Institutions (MFIs) to the whole economy strengthened considerably in the first eight months of 2004, particularly after the first quarter, and came to 7.8% in August from 3.2% in the fourth quarter of 2003. This acceleration is attributable to developments in MFI financing to general government,[6] which continued to decrease in the first eight months of 2004, but at a much slower pace than in 2003. The rate of credit expansion to enterprises and households decelerated slightly, but remains at high levels (see Table V.2).

In more detail, the year-on-year rate of decline in MFI financing to general government fell to 5.6% in August 2004 from 15.9% in the fourth quarter of 2003. This development reflects the fact that holdings of Greek government paper by credit institutions and money market funds continued to drop in the first eight months of 2004, but the decline was smaller than in the corresponding period of 2003 (January-August 2004: €–2,045 million, January-July 2003: €–7,796 million), and this was the main factor behind the acceleration recorded in total credit expansion. Moreover, a significant drop was observed in the first eight months of

6 MFI financing to general government comprises loans to government and total government paper held by the central bank, credit institutions and money market funds.

Table V.3
Breakdown of credit to enterprises and households in Greece

	Outstanding balances on 31.08.04 (million euro)	Annual percentage changes			
		2003	2004		
		Q4[1]	Q1[1]	Q2[1]	August[2]
A. Enterprises	**64,948**	**11.0**	**10.9**	**10.5**	**6.9**
1. Agriculture	3,376	3.3	2.6	5.5	8.8
2. Industry[3]	15,740	10.4	10.2	7.5	0.4
3. Trade	18,063	4.0	4.5	7.6	8.2
4. Tourism	3,842	24.4	18.6	19.4	18.0
5. Shipping	4,571	2.3	4.0	7.0	3.4
6. Non-monetary financial institutions	2,956	–3.2	–2.2	6.0	–1.0
7. Other	16,400	26.5	25.6	18.5	12.1
B. Households	**46,957**	**28.2**	**27.5**	**28.9**	**28.4**
1. Housing loans	30,244	27.1	24.5	24.7	23.1
2. Consumer loans	15,328	24.8	29.2	34.5	38.4
– Credit cards	7,132	27.8	24.8	23.3	22.9
– Other consumer[4] loans	8,196	21.8	33.9	46.9	55.4
3. Other	1,385	135.7	119.2	87.5	50.4
TOTAL	**111,905**	**17.1**	**16.9**	**17.4**	**15.0**

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.
3 Comprising manufacturing and mining/quarrying.
4 Comprising personal loans and loans against supporting documents.
Source: Bank of Greece.

2004, as in the corresponding period of 2003, in the outstanding balance of total credit extended by MFIs to general government (January-August 2004: €–1,065 million, January-August 2003: €–1,250 million). However, the borrowing requirements of central government on a cash basis were particularly high in the first eight months of 2004, standing at €10,066 million compared with €6,920 million in the corresponding period of 2003. These borrowing requirements were covered exclusively by capital inflows from abroad. In particular, non-residents' holdings of government paper rose by €18,057 million in the first eight months of 2004, while direct government borrowing from abroad also rose, by €299 million. Moreover, in the same period, the amount of government paper held by the domestic non-financial sector increased by €311 million.

Bank lending to enterprises and households

The annual rate of increase in bank loans to enterprises and households in August 2004 was slightly lower than at the end of 2003 (August 2004: 15.0%, fourth quarter of 2003: 17.1%).

In more detail, the annual growth rate of loans to enterprises fell to 6.9% in August 2004 from 11.0% in the fourth quarter of 2003. However, it should be noted that from the last quarter of 2003 onwards, MFIs and particularly credit institutions started to increase considerably their holdings of corporate bonds, as several enterprises launched bond issues, which were not sold to the wider public but remained in credit institutions' portfolios. In August 2004, MFI holdings of bonds issued by domestic enterprises amounted to

€4,162 million (December 2003: €2,641 million), which represents 6.4% of total loans to enterprises. The annual rate of increase in total MFI claims on enterprises (loans and bonds) stood at 11.2% in August 2004 (December 2003: 13.9%), i.e. well above the projected annual growth of nominal GDP for 2004 (7.4%).

Supplementary information on developments in loans to enterprises are provided by data on new loans, which however only include euro-denominated loans to non-financial corporations and are available from September 2002 onwards along with the corresponding interest rates. These new loans stood at an average monthly level of €2,621 million in the first eight months of 2004, compared with €2,241 million on average in 2003 as a whole. Therefore, new loans[7] increased by 16.9% in 2004 relative to 2003.

The sectoral breakdown of credit to enterprises (see Table V.3) in the first eight months of 2004 reveals an acceleration in credit expansion to trade, shipping, agriculture and other (non-MFI) financial institutions, which was however offset by a slowdown in credit expansion to industry and, particularly, the "other" sectors of the economy.

Specifically, the annual growth rate of loans to industry slowed down gradually after the first quarter of 2004, falling to 0.4% in August from 10.4% in the fourth quarter of 2003. This deceleration is associated with enterprises' increased recourse to alternative sources of financing. In this respect, it should be noted that fund-raising by industrial firms through the Athex expanded in the first eight months of 2004 (€97 million, compared with €47 million in the same period of 2003), while an additional €113 million were raised via corporate bond issues (compared with €65 million in the corresponding period of 2003).

Among the sectors that had a positive contribution to faster credit expansion, it is worth mentioning developments in bank credit to trade, where the annual growth rate came to 8.2% in August 2004 from 4.0% in the fourth quarter of 2003. Throughout 2003, credit expansion to trade remained at historically low levels, but showed a considerable upward trend as from the second quarter of 2004. The share of trade in total credit expansion to enterprises rose to 39% in the first eight months of 2004, from 14% in 2003. This suggests that commercial enterprises become once again a major category of bank borrowers. Finally, it should be noted that the slowdown observed in credit expansion to "other" sectors (August 2004: 12.1%, fourth quarter of 2003: 26.5%) is largely attributable to the financing of construction companies —included in this category— as their borrowing requirements decreased once the Olympic Games projects were completed, while they also turned to alternative types of financing, raising €103 million through bond issues.

Credit expansion to households persisted at high levels in the first eight months of 2004, and in August its annual rate stood at 28.4%, approximately the same as in the fourth quarter of 2003 (28.2%). This development reflects a considerable slowdown in the growth rate of housing loans and a high and accelerating growth rate of consumer loans.

In more detail, the annual growth rate of housing loans fell to 23.1% in August 2004, from 27.1% in the fourth quarter of 2003. This development is associated with the securitisation of housing

7 Almost all these new loans are loans with a floating rate or an initial rate fixation of up to one year. It should also be noted that in the first eight months of 2004 a greater increase was recorded in the category of relatively small loans (i.e. up to €1 million), the share of which in total new loans rose to 39.9% from 37.1% in 2003.

BOX V.1

The growth of consumer credit in Greece

Consumer credit developments in Greece and in other euro area countries

Following the deregulation of the financial system in Greece, bank lending to households has increased substantially. Consumer credit, in particular, has grown impressively over the last few years. Bank loans to households (other than housing loans) rose at an average annual rate of 34.7% in the 1999-2003 period. This strong growth brought the share of these loans in total bank assets to 6.4% at the end of 2003, from 2.4% at the end of 1998 and their outstanding balance to 8.9% of GDP from 2.8% in 1998 (see the table below).

The main factors accounting for this development are the following:

i. *The gradual financial deregulation process.*[1] This process has enabled access to bank financing by a significant part of households which until recently was practically excluded from such financing, due to the numerous regulatory restrictions applying to consumer credit.[2] Consumers can now choose the borrowing terms that best fit their interests, by exploiting the opportunities offered by a free market, and can thus strike a better balance between their needs and resources over time. Thus, a part of the pent-up demand for this type of bank credit was satisfied, while at the same time the structure of financial intermediation changed, with a shift from indirect household borrowing (through industrial and commercial firms) to direct borrowing from banks, which enhanced the transparency and effectiveness of the financial system. Moreover, household demand for loans also grew, supported by rising household incomes and by a more favourable outlook for future incomes.

ii. *The drastic declines in both nominal and real interest rates.* The bank financing costs of households have reached historically low levels. Specifically, the average interest rate on consumer loans fell to about 12% in 2003 from over 20% in 1999, while the real interest rate stood below 9% in 2003, compared with almost 18% in 1999.

iii. *Increased competition in the financial system.* Although the available data on interest rates applying to consumer credit do not suggest that increased competition has to any significant extent placed pressure on banks' margins for this type of loans, there are also some aspects of competition other than those directly related to the pricing of loans. For instance, new lending products have been developed that better match the preferences and financial means of households (e.g. loans with a grace period etc.) and new financial services have been introduced, alongside traditional lending, both resulting in more extensive household recourse to bank loans.

iv. *Increased liquidity in the banking system following the downward adjustment of reserve ratios.* In the context of harmonisation with the reserve requirement framework of the Eurosystem, the reserve ratio for drachma-denominated deposits was lowered to 2% in June 2000 from 12%. The reserve ratio applying to certain types of foreign exchange deposits was also set at 2%, compared with ratios of up to 60%. These reductions led to gradual increases in banking system liquidity: between July 2000 and July 2003, reserve holdings totalling €13.5 billion were released stepwise by the Bank of Greece, making more liquidity available to banks.[3] ➔

---

1 Financial deregulation was implemented in almost all advanced economies earlier than in Greece, in most cases during the 1980s, although its scope differed widely across countries.

2 According to the results of an empirical study for the United Kingdom, while prior to financial deregulation about 60% of households were not able or willing to have access to bank loans, following the deregulation this percentage fell to about 30% (see T. Bayoumi, "Financial Deregulation and Consumption in the United Kingdom", *The Review of Economics and Statistics,* Vol. 75, No. 3, August 1993, pp. 536-9).

3 It should be noted that in the period under review the Greek banking system raised additional liquidity through increased interbank borrowing from abroad.

Bank loans to households except housing loans[1]

(As a percentage of GDP)

Country	1998	1999	2000	2001	2002	2003	2004 [2] 1st half
Belgium	14.1	12.7	10.9	10.5	9.8	8.9	8.4
France	12.8	13.0	13.0	12.9	12.8	12.8	12.5
Germany	27.4	25.1	25.0	24.1	23.6	23.1	22.4
Greece	*2.8*	*3.4*	*4.6*	*6.2*	*7.3*	*8.9*	*9.7*
Ireland	8.7	10.0	9.9	10.5	10.4	10.8	11.7
Italy	11.9	12.8	12.7	12.8	11.9	12.0	11.9
Netherlands	8.4	8.6	9.0	8.1	9.1	9.2	9.3
Portugal	12.0	13.5	15.6	15.1	14.2	14.0	14.3
Spain	15.0	16.4	16.8	16.2	17.0	17.9	18.3
Euro area	*17.5*	*17.2*	*17.1*	*16.4*	*16.1*	*16.0*	*15.9*

1 Consumer and other loans to households except housing loans.
2 Based on Eurostat and ECB estimates for 2004 GDP.
Sources: ECB, euro area NCBs and Eurostat.

➔ As banks typically enjoy higher gross margins on consumer loans relative to alternative types of lending, they used a considerable part of this liquidity to expand their consumer loan portfolios.

It should be noted that similar rates of increase in households' borrowing (for purposes other than house purchase) exceeding household income growth were also witnessed in other euro area countries over the same period. In this respect, for the 1999-2003 period the average annual growth rate of consumer and other (non-housing) loans to households was 11.1% in Spain, 9.2% in Portugal and as much as 16.6% in Ireland. Although these rates were lower than the respective Greek figure, it should be recalled that Greece joined the euro area two years later than the other members of the euro area, saw much more marked declines in nominal interest rates and inflation and completed its deregulation of consumer credit only recently.[4] Therefore, part of the difference in the growth rates can be attributed to the comparatively low starting levels of consumer loan balances. Furthermore, the high growth rates of consumer loans recorded in the aforementioned countries have started to decelerate since 2000-2001, which might herald a similar development in Greece, although the outstanding balance of these loans, as a percentage of GDP, for Greece is one of the lowest among the euro area countries and well below the euro area average (see the table above).

Is there any scope for the Bank of Greece to contain consumer credit?

Following its entry into the euro area, Greece has adopted the single monetary policy which is formulated by the European Central Bank (ECB) taking into account the monetary conditions prevailing in the euro area as a whole rather than in individual countries. In this context, both the interest rate policy and the reserve requirement ratios are determined by the ECB. Thus, the Bank of Greece is no longer able to use any of the monetary policy instruments traditionally available to central banks for controlling credit expansion.

Moreover, financial institutions in Greece, as in the rest of the euro area, now operate within an open economy environment with free competition, which precludes the use of administrative measures for intervention in credit developments. Consequently, credit ➔

4 The abolition of restrictions on consumer credit was completed in June 2003 (by Bank of Greece Governor's Act 2523/12 June 2003).

➔ expansion is determined by the specific conditions that shape supply and demand for credit in each country.

Still, the Bank of Greece does have some scope for influencing credit expansion, but only indirectly and marginally. Through the special provisioning requirements on banks that it has imposed as the supervisory authority, it can influence the pricing of credit risk and offset any competition-induced relaxation of credit standards. With particular regard to consumer loans, the provisioning ratios are up to 84%, compared with a maximum ratio of 60% applying to business loans. At the same time, however, these provisioning requirements can affect the international competitiveness of banks and, within an increasingly integrated banking market, cross-country differences in the resulting cost, insofar as the provisions exceed the credit risk assumed by banks, could have a significant impact on the activity and profitability of banks operating in individual countries. This is a factor which a central bank should take seriously into account when designing its policy regarding banks' provisions. Thus, the effectiveness of this instrument in containing credit expansion is limited.

In addition, the Bank of Greece may impose a higher capital adequacy ratio to individual credit institutions, following an evaluation of the level of risk they have assumed, based on their respective portfolio structures and overall efficiency. This additional capital requirement could have a dampening effect on the credit expansion of the banks concerned. However, it cannot affect the consumer credit growth of banks with strong capital adequacy, as these have also more scope for "cross-subsidising" certain types of loans, with a view to expanding their shares in the corresponding segment of the banking market.

Lastly, the Bank of Greece has established a framework requiring banks to provide key information to their customers. This includes information about risks, in particular interest rate risks.[5] The purpose of this framework is, among other things, to prevent inaccurate or misleading advertisement of consumer credit products. Except for cases of non-compliance with these requirements, the central bank cannot, in an environment of an open market, restrict the advertising initiatives by which banks seek to influence demand for these loans.

Conclusions

The observed significant growth of bank lending to households is partly associated with the fact that consumers can now under free market conditions determine their borrowing behaviour in such a way as to strike a balance between their needs and their available resources over time. Moreover, the indebtedness of Greek households from consumer and other bank loans (other than housing loans) as a percentage of GDP is, as already mentioned, significantly lower (8.9% for 2003) than the respective figure for the euro area as a whole (16.0%) and one of the lowest in the euro area (see table in this box).[6,7]

It should be noted, however, that the rising indebtedness of Greek households, given that the majority of consumer and housing loans carry floating rates, would suggest that households are more vulnerable to changes in interest rates, meaning that a larger number of households would face difficulties in servicing their debt in the event of an increase in interest rates, especially if such an increase were to be unexpected. In addition, in the event of a cyclical downturn in household incomes, a larger number of households would be likely to default on their debt obligations.[8]

The implications of increased household borrowing will depend on the level of such borrowing as well as on its distribution across households. A survey ➔

5 The key information which banks are required to provide to their customers is described in Bank of Greece Governor's Act 2501/31 October 2002.

6 This holds even if housing loans are also included, as the total household indebtedness-to-GDP ratio in Greece was 26.2% at the end of 2003, compared with 48.5% in the euro area.

7 It should be noted, however, that this comparison should be treated with caution, as data may not be fully comparable across countries, reflecting different definitions of "households". Thus, in some countries "other lending to households" includes lending to self-employed persons and non-incorporated businesses, which in Greece comes under business loans. This problem has also been identified by the ECB, see "Developments in private sector balance sheets in the euro area and the United States", *Monthly Bulletin*, February 2004, pp. 57-67.

8 See G. Debelle, *Macroeconomic implications of rising household debt,* BIS Working Paper No. 153, June 2004.

→ conducted on behalf of the Bank of Greece in 2002-2003 did not provide any evidence supporting the notion that Greek households had overborrowed or that debt servicing was not in line with the income of borrowers,[9] as 49.8% of respondent households reported that they did not have any outstanding debt from any bank or non-bank loan, while 79.4% of the outstanding household debt was accounted for by households with an annual income of over €15,000. However, more complete information about the concentration of household borrowing should become available in due course, as the Teiresias credit database is increasingly enriched with data on household indebtedness. In any case, the continued high growth rates of household borrowing and the extension of this trend to lower-income households necessitate close monitoring by the Bank of Greece. Consumer loans in arrears have already increased, although these are largely covered by banks' provisions for bad loans. Against this background, and also in view of the new capital adequacy framework formulated by the Basle Banking Supervision Committee (Basle II),[10] the Bank of Greece has called upon credit institutions to enhance their credit rating systems.

9 See Bank of Greece (2003), *Monetary Policy 2002-2003*, Annex to Chapter VI, p. 88.
10 The new framework is expected to be phased in starting from 2006.

loans[8] by some banks in November 2003 and June 2004. If the reduction of housing loans due to these securitisations is not taken into consideration, the year-on-year rate of increase in housing loans stood at 27.0% in August 2004, i.e. roughly the same as in the fourth quarter of 2003 (27.1%). Indeed, as shown by data on new euro-denominated loans —available along with the new series of bank interest rates— the monthly level of such loans in the first eight months of 2004 stood at €592 million, i.e. very close to the respective figure for the last quarter of 2003 (€608 million).

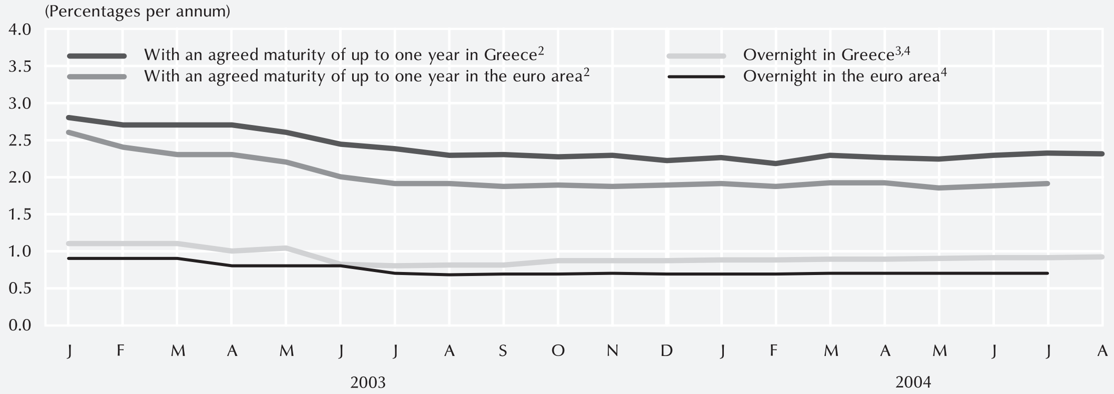
The annual growth rate of consumer loans accelerated to 38.4% in August 2004, from 24.8% in the fourth quarter of 2003.[9] It should be noted that 2004 saw a continuation of the slowdown in loans through credit cards (August 2004: 22.9%, fourth quarter of 2003: 27.8%), which carry the highest interest rates among all consumer loan categories. In contrast, personal loans and loans against supporting documents —the interest rates of which are 2.5 to 4.5 percentage points lower than those on loans through credit cards— increased at a very high and accelerating rate (August 2004: 55.4%, fourth quarter of 2003: 21.8%). Finally, a considerable deceleration was recorded in "other" loans to households, which mainly involve overdraft facilities on current accounts (August 2004: 50.4%, fourth quarter of 2003: 135.7%).[10]

3. Bank interest rates

Interest rates on bank deposits[11] showed marginal changes in the first eight months of 2004, since ECB rates also remained unchanged in the same period. In contrast, interest rates on bank loans recorded greater changes, showing mixed trends.

8 Securitisation of loans by a bank entails an equal reduction in its loan portfolio and thus a lower growth rate of outstanding amounts of its housing loans, as securitised loans are transferred to a special purpose vehicle. A securitisation of housing loans took place for the first time in Greece in November 2003 and involved a relatively small amount (€250 million). However, June 2004 saw a second securitisation, of a much larger amount (€750 million). At the end of August 2004 the outstanding amount of securitised loans stood at €960 million.
9 It should be recalled that, as from June 2003, all remaining restrictions on consumer credit and personal loans have been abolished (see Bank of Greece Governor's Act 2523/12 June 2003).
10 The outstanding amount of such loans is relatively small and its high rates of change reflect exactly this low starting level.
11 From the beginning of 2003 onwards, bank interest rates on loans and deposits are recorded in Greece, as well as in the other euro area countries, using a common methodology (see Bank of Greece, *Monetary Policy 2003-2004*, Box 2).

Chart V.2
Bank interest rates on new deposits from households in Greece and in the euro area[1]
(January 2003 - August 2004)
(Percentages per annum)



1 See footnote 12 in the text.
2 Monthly average rate.
3 The interest rate on savings deposits is used, as these deposits represent the bulk of overnight deposits and their interest rate is almost the same as the overnight rate.
4 Interest rate at the end of the month.

Sources: Bank of Greece and ECB.

In more detail, the average rate on household overnight deposits remained virtually unchanged in the first eight months of the current year (August 2004: 0.92%, December 2003: 0.87%, see Chart V.2), reflecting the likewise stable rates on both savings deposits —which make up 92% of overnight deposits— and current account deposits. As was pointed out in previous Reports, the rates on the above two types of deposits, aside from the low level of key ECB rates, also reflect their high degree of liquidity, as well as their high operating cost due to the facilities offered by banks through such deposit accounts (e.g. standing payment orders and bill payments through cards). It should be noted that the interest rates applied by banks to these deposit categories also depend on the balance of the deposit and are very low or zero for lower brackets of deposit balances.

A small increase (of 9 basis points) was recorded during the first eight months of 2004 in the interest rate of household new deposits with an agreed maturity of up to one year, which stood at 2.31% in August, while the rate on repos remained practically unchanged in the period under review (August 2004: 1.96%, December 2003: 1.98%).

In the euro area, interest rates on the above categories of deposits remained broadly unchanged in the first seven months of 2004[12] and continue to stand at a lower level than the corresponding Greek rates. Specifically, in July the average euro area rate on overnight deposits from households stood at 0.70%, i.e. 21 basis points lower than the corresponding Greek rate (see Table V.4). The rate on new deposits from households with an agreed maturity of up to one year showed no significant change in the same period and stood at 1.91% in July (i.e. 41 basis points lower than the corresponding Greek rate). The rate on new repos in the euro area remained unchanged at 1.99% in July 2004. This rate is essentially at the same level as the corresponding Greek one (1.97%), given that the homogeneity of products and the typically large amounts involved in the transactions in

12 Data on the euro area bank interest rates for August 2004 were not available at the time when this Report was finalised.

Table V.4
Bank interest rates on new deposits and loans in the euro area and Greece
(Percentages per annum)

A. Deposits

	December 2003	July 2004	Change July 2004/ Dec. 2003
A.1. Overnight from households[1]			
Weighted average interest rate in the euro area	0.69	0.70	0.01
Maximum interest rate	1.20	1.16	-0.04
Minimum interest rate	0.07	0.12	0.05
Interest rate in Greece	0.87	0.91	0.04
A.2. With an agreed maturity of up to one year, from households[2]			
Weighted average interest rate in the euro area	1.89	1.91	0.02
Maximum interest rate	2.38	2.32	-0.06
Minimum interest rate	1.47	1.48	0.01
Interest rate in Greece	2.22	2.32	0.10

B. Loans with a floating rate or an initial rate fixation of up to one year[2]

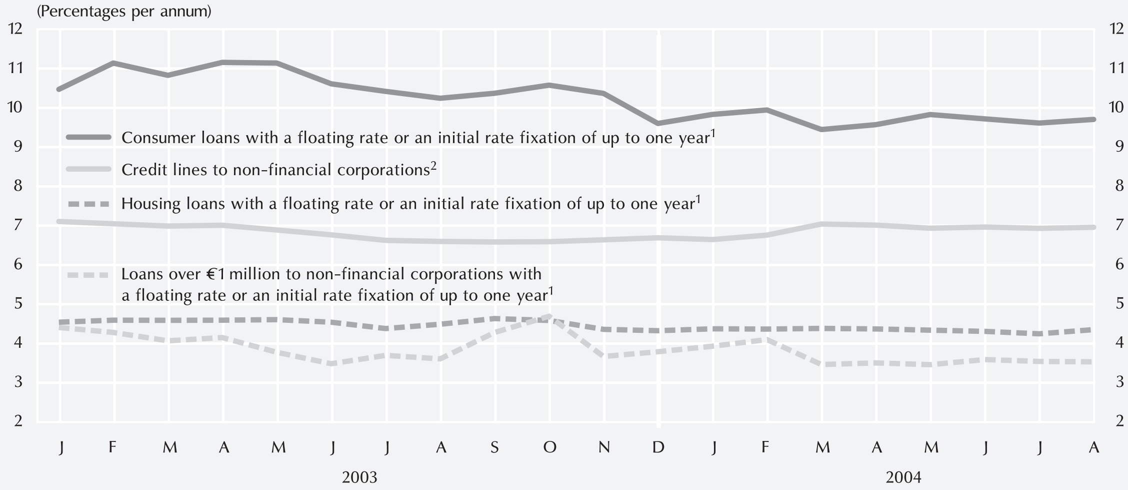
	December 2003	July 2004	Change July 2004/ Dec. 2003
B.1. Loans up to €1 million to non-financial corporations			
Weighted average interest rate in the euro area	4.04	4.03	–0.01
Maximum interest rate	5.63	5.69	0.06
Minimum interest rate	2.78	3.47	0.69
Interest rate in Greece	5.13	4.84	–0.29
B.2. Loans over €1 million to non-financial corporations			
Weighted average interest rate in the euro area	3.12	3.03	–0.09
Maximum interest rate	4.33	4.31	–0.02
Minimum interest rate	2.88	2.73	–0.15
Interest rate in Greece	3.78	3.53	–0.25
Housing loans			
Weighted average interest rate in the euro area	3.63	3.46	–0.17
Maximum interest rate	4.63	4.26	–0.37
Minimum interest rate	3.29	3.18	–0.11
Interest rate in Greece	4.31	4.24	–0.07
Consumer loans			
Weighted average interest rate in the euro area	7.66	7.23	–0.43
Maximum interest rate	10.87	10.85	–0.02
Minimum interest rate	5.02	5.12	0.10
Interest rate in Greece	9.60	9.60	0.00

1 Interest rate at the end of the month.
2 Monthly average rate.
Sources: ECB and euro area NCBs.

Chart V.3

Interest rates on new bank lending in Greece (January 2003 - August 2004)

(Percentages per annum)



1 Monthly average rate.
2 Interest rate at the end of the month.

Source: Bank of Greece.

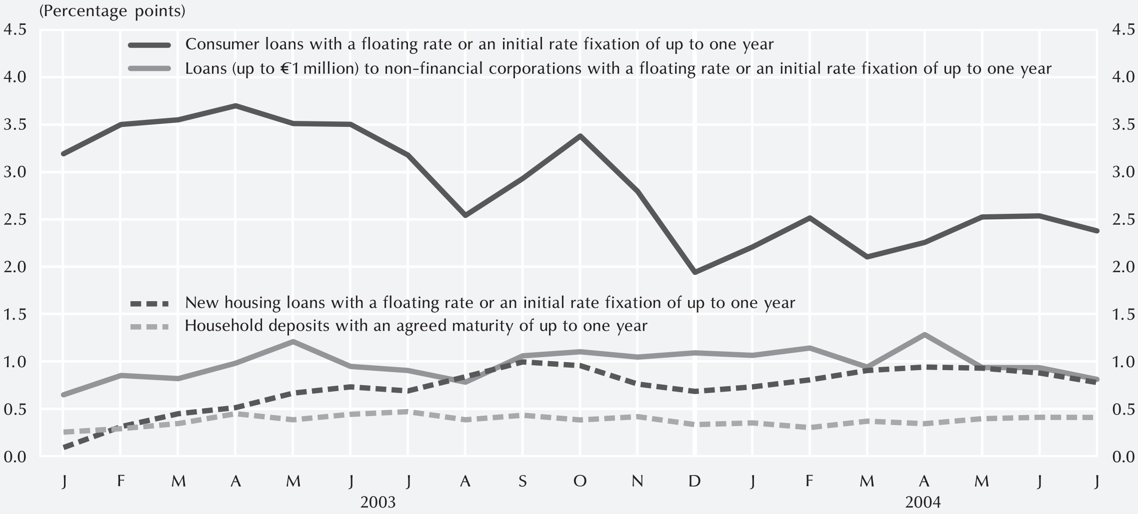
the repo market do not allow for large yield differentials across euro area countries.

As regards bank lending rates in Greece, rates on consumer loans increased, rates on housing loans remained unchanged, while rates on loans to enterprises presented a mixed picture (see Chart V.3). The average rate on all new consumer loans with a defined maturity was 10.05% in August 2004, i.e. 19 basis points higher than in December 2003. Specifically, the rate on new consumer loans with a floating rate or an initial rate fixation of up to one year fluctuated during the period under review and rose to 9.70% in August 2004, i.e. 10 basis points higher than in December 2003. As the corresponding euro area rate fell in the first seven months of 2004, the differential between the two rates widened to 2.37 percentage points in July, up from 1.94 percentage points in December 2003 (see Chart V.4). In contrast, in the first eight months of 2004, a drop of 31 basis points was recorded in the average rate on consumer loans without a defined maturity[13] —the most important type of consumer loans— which stood at 13.77% in August. As the corresponding euro area rate decreased less in the same period (July 2004: 9.57%, December 2003: 9.69%), the differential between the two rates narrowed slightly in July, to 4.27 percentage points (from 4.39 percentage points in December 2003). This relatively wide differential between Greek and euro area rates on loans without a defined maturity mainly reflects the high share of loans through credit cards in Greece and the high rates on such loans, which in turn reflect their higher credit risk and operating costs for banks. In particular, the rate on loans through credit cards fluctuated during the first eight months of 2004, but at the end of this period was at approximately the same level as at the end of 2003 (August 2004: 14.77%, December 2003: 14.80%).

13 Loans without a defined maturity to households comprise credit extended through credit cards, open loans and overdraft facilities on current accounts. A characteristic of such loans is that in the case of interest rate changes, the new rate is applicable to the total outstanding amount and not just to the amounts disbursed following the interest rate change. Thus, for statistical purposes, "new" loans in this case coincide with the total outstanding amounts of such loans at the end of the reference month (see website of the Bank of Greece/Statistics/Bank Interest Rates/Methodological Note).

Chart V.4

Interest rates on new bank deposits and loans: differentials between Greece and the euro area
(January 2003 - July 2004)
(Percentage points)



Sources: Bank of Greece and ECB.

The weighted average interest rate on all new housing loans, despite an upward movement in the first quarter of 2004, edged down afterwards to stand in August at the same level as at the end of the previous year (4.53%). In more detail, the interest rate on new housing loans with a floating rate or an initial rate fixation of up to one year —which account for about 80% of total housing loans— showed relatively small fluctuations and stood at 4.34% in August 2004, i.e. roughly the same as at the end of 2003 (4.31%). As the euro area rate applied to the same category of housing loans decreased in the first seven months of 2004 by 17 basis points (i.e. more than the Greek one), the differential between the two rates broadened in July to 78 basis points from 68 basis points in December 2003 (see Table V.4). The considerable differentials between Greek and euro area rates on housing loans are associated with the relatively larger arrears observed in Greece, as well as with the fact that, compared with the euro area, housing loans in Greece generally cover a higher percentage of the property's value.

As was mentioned earlier, interest rates on loans to non-financial corporations showed mixed trends. The rate on loans without a defined maturity[14,15] rose by 28 basis points in the first eight months of the current year and stood at 7.06% in August. As the corresponding euro area rate decreased in the first seven months of 2004, the differential between the two rates widened to 1.69 percentage points in July 2004, up from 1.20 percentage points in December of the previous year. In contrast, a drop was recorded in the first eight months of 2004 in the average rate on new loans to enterprises with a defined maturity, particularly loans with a floating rate or with an initial rate fixation of up to one year, which are the most important type of such loans. In more detail, the rates on loans of up to €1 million and those on loans over €1 million fell by 18 and 26 basis

14 Loans without a defined maturity to enterprises comprise credit lines and debit balances on sight deposit accounts. As in the case of loans without a defined maturity to households, "new" loans coincide with the outstanding amounts of such loans at the end of the reference month (see footnote 11).

15 Such loans are a major category, as they account for one third of the outstanding amount of loans to non-financial corporations.

points, respectively, to stand at 4.95% and 3.52% in August 2004. As the rates in these two categories of loans decreased less in the euro area in the first seven months of 2004, their differential vis-à-vis the corresponding Greek ones narrowed in July to 81 basis points for loans of up to €1 million and to 50 basis points for loans over €1 million, whereas these differentials in December 2003 stood at 1.09 and 0.66 percentage points.[16]

The spread between the average rate on total new bank loans and the corresponding rate on deposits remained roughly unchanged in the period under review (August 2004: 4.83 percentage points, December 2003: 4.89 percentage points), as both lending and deposit rates remained broadly stable. Specifically, the average rate on deposits stood at 1.17% in August 2004, approximately the same as in December 2003 (1.15%), while the average rate on loans stood at 6.00% in August 2004, compared with 6.04% in December 2003. In particular, the average rate on loans to enterprises fell by 16 basis points (August 2004: 4.99%, December 2003: 5.15%), while the average rate on loans to households remained almost unchanged (August 2004: 7.25%, December 2003: 7.23%). It should be noted that developments in the average rate on loans are affected not only by changes in individual rates, but also by each loan category's share in total loans. The high growth rates of consumer loans lead to an increase in their share and, as rates on consumer loans are among the highest, the average rate on total loans is affected upwards.

Additional information on developments in bank interest rates can be derived from the average rates applied to the outstanding amounts of loans. These rates are indicative of the interest income of MFIs as well as of the financial costs incurred by enterprises and households. As regards households, the average interest rates applied to the outstanding amounts of consumer and housing loans fell slightly in the first eight months of 2004, reflecting the reduced interest rates applied to new loans. In more detail, the rate on housing loans with a maturity of more than five years —which very nearly represent total housing loans— fell by 13 basis points in August 2004 compared with December 2003, and stood at 5.03%. Moreover, as regards the two major categories of consumer loans, a drop of 21 basis points was recorded in the rate on consumer loans with a maturity of up to one year, while the rate on consumer loans with a maturity of one to five years remained practically unchanged. A relatively small drop was also recorded in the rates applied to the outstanding amounts of both short-term and long-term loans to enterprises. In particular, in August 2004 the interest rate on short-term loans stood at 5.74% and on long-term loans at 5.06%, down by 8 and 16 basis points respectively compared with December 2003. The rate on medium-term loans (with a maturity of one to five years) —the share of which is relatively small— stood at 5.36% in August 2004, i.e. it remained practically unchanged from December 2003.

4. Capital markets

4.1 The bond market

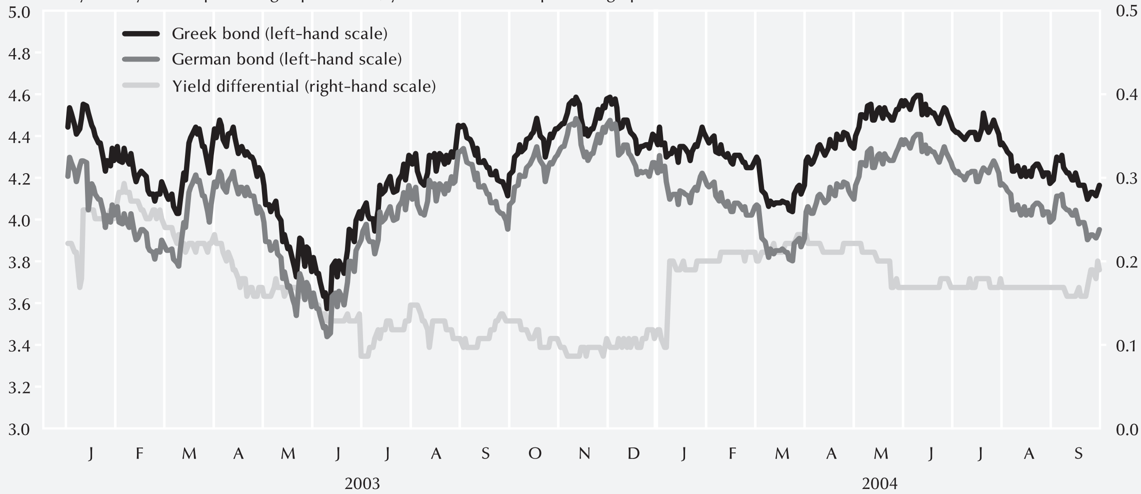
In the period from January to September 2004, the yields of Greek government bonds declined, while the volume of transactions in these securities on the secondary market rose substantially.

In more detail, Greek government bond yields followed a downward path between early

16 To some extent, the positive differential between Greek and euro area rates on loans to enterprises reflects the higher share of SMEs in the total of enterprises in Greece than in the euro area.

Chart V.5

Yields on the 10-year Greek and German government bonds
(January 2003 - September 2004)
(Daily data; yields in percentages per annum, yield differential in percentage points)



Sources: Bank of Greece and Bloomberg.

December 2003 and the end of March 2004 (see Chart V.5), reflecting similar developments in the yields of comparable securities in the euro area.[17] Underlying the latter developments were factors such as macroeconomic data[18] releases falling short of market expectations, the appreciation of the euro and its implications for euro area exports and growth, as well as the market assessment that short-term interest rates in the euro area would remain at the same low levels for longer than had been expected earlier.[19] Thereafter, however, and until the end of June, bond yields rebounded appreciably, owing to upward revisions of market perceptions about the strength of economic recovery, as well as to expectations of an increase in US interest rates.[20] In the next three months, euro area bond yields fell gradually, amid heightened concerns about the potential impact of higher oil prices on global economic recovery.

The yield on the ten-year Greek government bond stood at 4.19% at the end of September 2004, i.e. 23 basis points lower than at the end of December 2003 (4.42%). During the period from January to September 2004, it fluctuated between a trough of 4.07% on 26 March and a peak of 4.61% on 14 and 15 June. The range between these two extreme values (54 basis points) was narrower than the respective range for the entire 2003 (98 basis points).[21] The yield differential between the Greek ten-year bond and the comparable German bond increased to 20 basis points at end-September 2004,[22] from 12 basis points at end-December 2003 (see Chart V.5).

---

17 For bond market developments in the euro area and the United States, see Chapter II.3.3.

18 These data for the euro area referred, on the one hand, to household expenditure, which did not provide any clear indication about a recovery in private consumption, and, on the other hand, to the fact that conditions in the labour market remained weak.

19 The terrorist attack of 11 March 2004 in Madrid is estimated to have had only a small and temporary effect on international bond markets.

20 On 30 June 2004, the Federal Reserve System increased, for the first time in recent years, its key rate by 25 basis points.

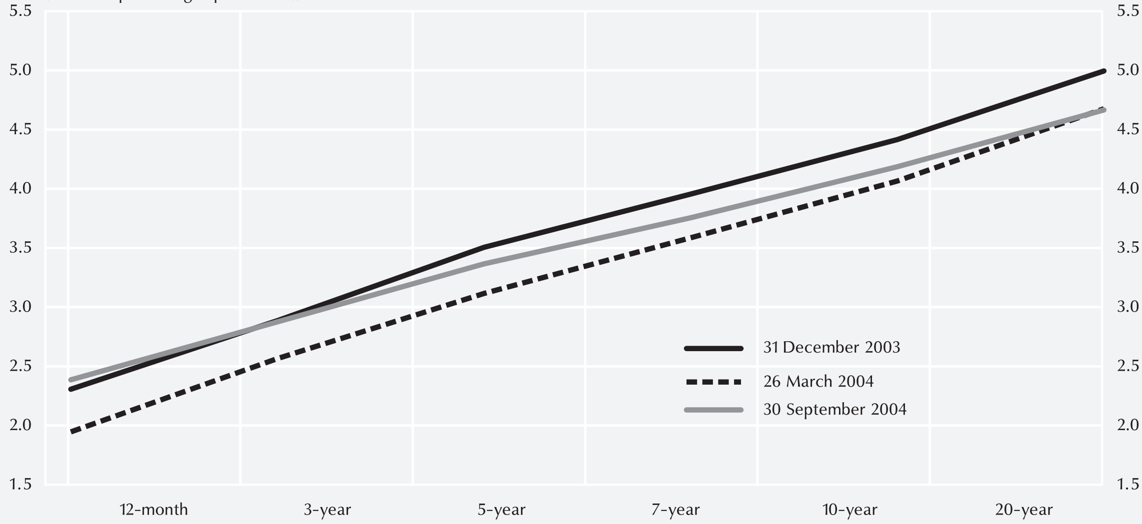
21 In the period under review, reduced volatility was also seen in euro area bond yields.

22 This differential could be somewhat higher, given that the residual maturity of the Greek bond (maturing on 20 May 2014) is 1.5 month shorter than that of the corresponding German bond (maturing on 4 July 2014).

Chart V.6

Greek government paper yield curves

(Yields in percentages per annum))

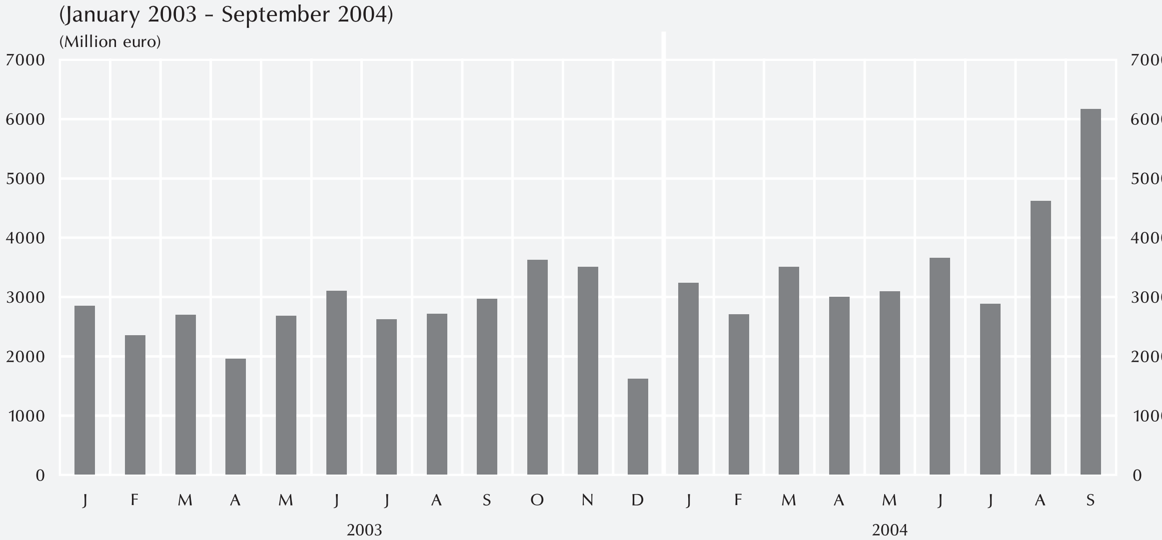


Source: Bank of Greece.

Chart V.7

Average daily value of transactions in the Electronic Secondary Securities Market (HDAT) (January 2003 - September 2004)

(Million euro)



Source: Bank of Greece.

During the first nine months of 2004, Greek government bond yields declined across the maturity spectrum, with the exception of the twelve-month maturity which showed a small rise. The most marked reductions were seen in long-term (10-year and 20-year) bonds. The bond yield curve flattened in the section corresponding to maturities of 12 months to 10 years (see Chart V.6), as evidenced by the yield spread between the ten-year bond and the 12-month Treasury bill, which narrowed by 31 basis points between end-December 2003 and end-September 2004.

Table V.5
Greek government paper issuance

Type of security	January - September 2003: Million euro	2003: Percentage of total		2004: Million euro	2004: Percentage of total	
Treasury bills	*1,737*	*5.5*		*1,674*	*4.2*	
Bonds[1]	*29,980*	*94.5*	*100.0*	*38,017*	*95.8*	*100.0*
1-year	2,053		6.8	7,183		18.8
3-year	6,430		21.4	6,432		16.9
5-year	9,002		30.0	12,352		32.5
7-year	191		0.6	96		0.4
10-year	8,195		27.3	9,456		24.9
15-year	649		2.4	–		–
20-year	2,214		7.4	242		0.6
23-year	1,246		4.1	2,256		5.9
Total	**31,717**	**100.0**		**39,691**	**100.0**	

1 By initial maturity.
Source: Ministry of Economy and Finance.

The average daily value of transactions in the Electronic Secondary Market for Government Securities (HDAT) grew by 37% in the January-September 2004 period, to € 3.7 billion from €2.7 billion in the corresponding period of 2003 (see Chart V.7). This rise in turnover enhanced the liquidity of the secondary market. The bid-ask spread stood at 8.1 basis points in September 2004, compared with 8.2 basis points in December 2003 and 9.4 basis points in December 2002.

In the primary market for Greek government securities, the total amount of funds raised in the January-September 2004 period rose by 25% to €39.7 billion, from €31.7 billion in the corresponding period of 2003 (see Table V.5). A significant part of total bond issues concerned syndicated loans (new issues and reopenings of past issues)[23] and, to a lesser extent, issues by auction procedures (new and reopenings). The high bid coverage ratio of the auctioned issues[24] reflects the continued attractiveness of Greek government bonds for domestic and foreign investors.

It should be noted that, out of bonds with a maturity of up to one year (representing 19% of the total value of bond issues), an amount of €1.1 billion concerned Special Savings Bonds issued in February 2004, while €6.1 billion were issues of euro commercial paper.[25] Moreover, the maturity breakdown of longer-term bonds shows that 3- and 5-year bond issues totalled €18.8 billion and had a share of 49%, while the remaining 32% was allocated among 7-, 10-, 20- and 23-year bond issues. Finally, Treasury bill issues accounted for about 4% of the total value of issues in the January-September 2004 period, compared with 5% in the corresponding period of 2003.

4.2 Stock market developments

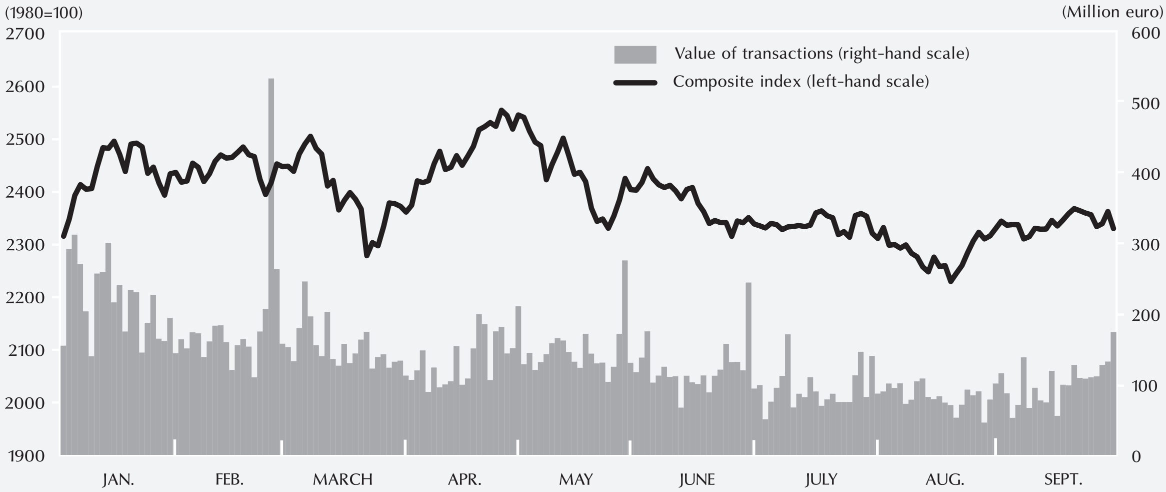
The composite share price index of the Athens Exchange (Athex) picked up slightly during the first nine months of 2004 (see Chart V.8).

23 Out of syndicated issues, an amount €2.3 million concerned the reopening of the 23-year bond issue linked to the Harmonised Index of Consumer Prices (excluding tobacco) of the euro area.
24 Specifically, in the first half of 2004, demand for Greek government securities quadrupled supply.
25 These are instruments of short-term financing and are sold to Primary Dealers. Apart from asset management purposes, they serve to ensure higher liquidity and lower borrowing costs for the government.

Chart V.8

Athens Exchange: composite share price index and value of transactions (January - September 2004)

(Daily data)



Source: Athens Exchange.

Specifically, share prices in the Greek stock market, in line with similar developments mainly in the stock markets of the euro area, rose between the beginning of 2004 and early March. This increase was due to a visible recovery in corporate profitability last year (35%) and a decline in market uncertainty. However, in the aftermath of the terrorist attack in Madrid on 11 March, stock prices began to fall again, thus reversing much of the increases witnessed in the first two months of 2004. After a temporary rise in April, Athex stock prices followed a broadly downward path until late August 2004, only recovering slightly in September, despite an increase of 15% in the profitability of Athex-listed firms in the first half of 2004. This decline in stock prices was mainly due to investors' concern about the potential impact of rising oil prices on economic activity and corporate profitability.

In more detail, between end-December 2003 and end-September 2004, the composite share price of the Athex rose by 2.9%, having ranged between a peak of 2,553.8 points on 28 April and a trough of 2,227.3 points on 20 August, and outpaced both the Dow Jones EURO STOXX index in the euro area[26] (+1.5%) and the Standard and Poor's 500 index in the United States (+0.2%).

In the period under review, the average daily value of transactions on the Athex came to €133 million, from 131 million in the corresponding period of 2003. This rise stemmed mainly from foreign institutional investors.[27] The total amount of funds raised from the stock market[28] rose to €451 million in the first nine months of 2004[29] from €293 million in the corresponding period of 2003 (see Table V.6). These funds were raised by 39 companies (January-September 2003: 42 companies), of which 10 were newly listed and raised

26 For a detailed discussion of stock market developments in the euro area, see Chapter II.3.4.

27 At the end of September 2004, foreign investors accounted for 35% of the Athex market capitalisation in shares. Out of this percentage, 22% were institutional investors.

28 Through capital increases.

29 In addition, €15 million were raised through secondary public offerings, compared with €738 million in the respective period of 2003.

Table V.6
Funds raised through the Athens Exchange

Branches	January - September			
	Number of firms		Funds raised (million euro)[1]	
	2003	2004*	2003	2004*
Listed companies	31	29	244.4	371.6
Newly listed companies	11	10	48.1	79.5
Total	**42**	**39**	**292.5**	**451.1**
– Banks	4	4	105.8	185.2
– Investment	2	1	3.0	13.2
– Insurance	1	1	60.2	3.0
– Holding	1	1	0.3	0.2
– Industrial	15	12	49.7	96.8
– Construction	1	2	7.5	41.0
– Commercial	3	5	21.3	29.0
– Telecommunications	3	2	3.0	10.0
– Information technology	11	9	33.5	24.8
– Other	1	2	8.2	47.9

1 Share capital increase through public subscription and private investment. Subscriptions to new capital are entered on the last day of the subscription period.
* Provisional data.
Sources: Athens Exchange and Bank of Greece.

€80 million (January-September 2003: 11 companies, €48 million).

The stock market figures of the banking sector improved faster than those of the market as a whole. In particular, the share prices, the stock market transactions and the market capitalisation of banks with shares listed on the Athex all performed better than the corresponding figures of the stock market as a whole in the January-September 2004 period. This development was largely due to the fact that in the first half of 2004 the profitability of Greek banks continued the recovery under way since 2003, following the decline seen in 2000-2002. Specifically, in the first half of 2004 pre-tax profits of Greek banks with Athex-listed shares[30] rose by 8.1%[31] relative to the corresponding period of 2003,[32] compared with a 34% increase in 2003 and a 45% drop in 2002. The improved profitability of Greek banks in the first half of the current year stemmed mainly from the increase in net interest income as well as income from commission fees, financial operations and securities, all of which rose faster than operating costs.[33]

30 Excluding the Bank of Greece.
31 The relatively low rate of growth reflects the increased provisions of Geniki Bank, following its takeover by Société Générale in 2003. Excluding Geniki Bank, the profits of banks with Athex-listed shares grew by 23.6%, while for the five largest Greek commercial banks the increase was 28.7%.
32 The total net pre-tax profits of the financial sector rose by about 16% in the first half of 2004 in comparison with the first half of 2003.
33 For a detailed discussion of the performance of Greek commercial banks in the first half of 2004, see Appendix to Chapter V.

Appendix to Chapter V

The performance of Greek commercial banks[1] in the first half of 2004

1. Introduction

In the first half of 2004, the pre-tax profits of Greek commercial banks increased by 8.1% compared with the same period of 2003. On a consolidated basis, the increase was 17.6%[2] (see Chart A1 and Table A1). The profitability of the five largest commercial banks grew at a considerably higher rate, as their pre-tax profits rose by 28.7% (37.1% on a consolidated basis). As shown in Chart A1, bank profits, after following a declining path throughout 2000-2002, reversed in 2003, and this rise continued in the first half of 2004. However, the level of profits, both for banks and for bank groups, is still below the average of the 1998-2001 period. It is worth mentioning that increased profitability enabled banks to set aside higher provisions.

In the European Union (EU), during the first half of 2004 the profits of a sample of bank groups mostly consisting of large commercial banks[3] grew at a lower rate (15.9%) than the profits of the largest Greek bank groups, while in the euro area the profitability of bank groups increased at a rate (23.7%) higher than the EU total.

The improved profitability of Greek banks is attributed to the fact that the growth rate of operating income (11%) nearly doubled that of operating expenses (6.4%). Among individual income categories, interest income had the greatest contribution (over 50%) to the increase in profits, while income from securities also had a significant contribution of about 25% (see Table A1 and Chart A4).

2. The performance of banks

2.1 All banks

The increase in bank profits contributed to an improvement in Return on Assets (ROA)[4] for banks as a total as well as for the total excluding Geniki Bank (first half of 2004, total: 0.94%, excluding Geniki Bank: 1.10%; first half of 2003: 0.90%). Return on Equity (ROE)[5] showed a similar improvement (first half of 2004, total: 13.80%, excluding Geniki Bank: 15.90%; first half of 2003: 13.28% — see Charts A2 and A3).

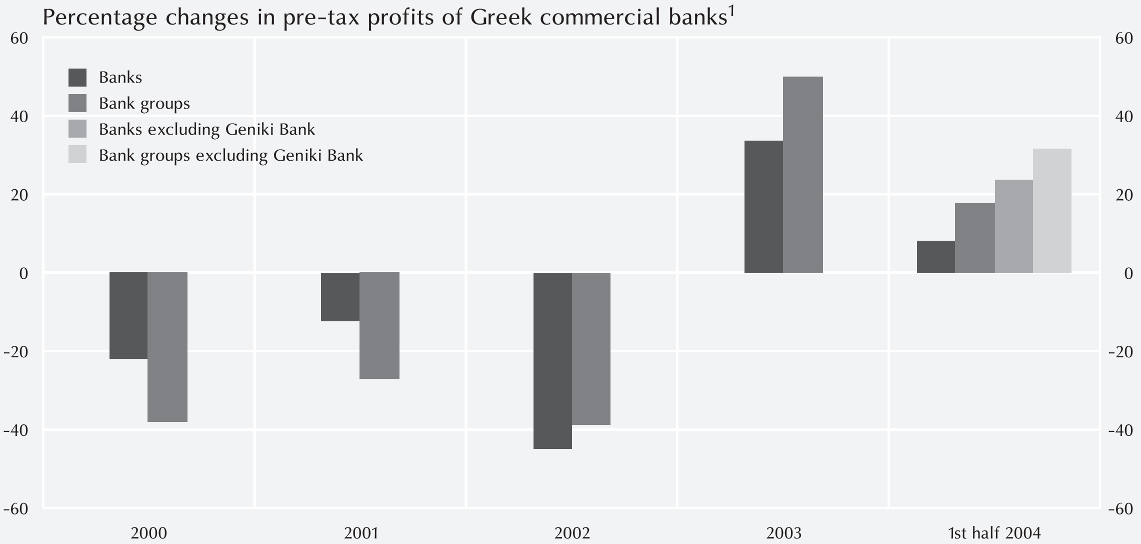
The increase in the total operating income of Greek banks was, as already mentioned, 11% and was broadly based across all income categories (with the exception of "other income", which declined) (see Table A1). Income from securities[6] rose by an impressive 61%, while income from financial transactions increased by 17.8%. Net commission income and net interest income improved by 13.7% and 8.4%, respectively.

Regarding the breakdown of income, Chart A4 shows that in the period under review, as had been the case in 2003, interest income was the main source of bank

1 The discussion refers to Greek commercial banks with shares listed on the Athens Exchange (10 banks). These banks have a domestic market share of 96%, based on total assets. The performance of the five largest banks (79% of total assets) is also discussed. Pre-tax profits include extraordinary profits which, however, represent a small proportion of total profits.
2 Excluding Geniki Bank, the profitability of banks increased by 23.6%, and by 31.6% on a consolidated basis. The profitability of Geniki Bank was affected by the restatement of some of its balance sheet items following its acquisition by Société Générale in 2003.
3 See Table A2, note 6.
4 This ratio is on an annual basis and has been calculated using the average value of total assets.
5 This ratio has been calculated using the average value of shareholders equity. Shareholders equity also includes profits carried forward. In the case of bank groups, minority interests are not included in profits or in shareholders equity.
6 Income from securities includes income from shares and other non-fixed-income securities, income from participation in other companies, as well as the surpluses from participation in related companies.

Chart A1

Percentage changes in pre-tax profits of Greek commercial banks[1]



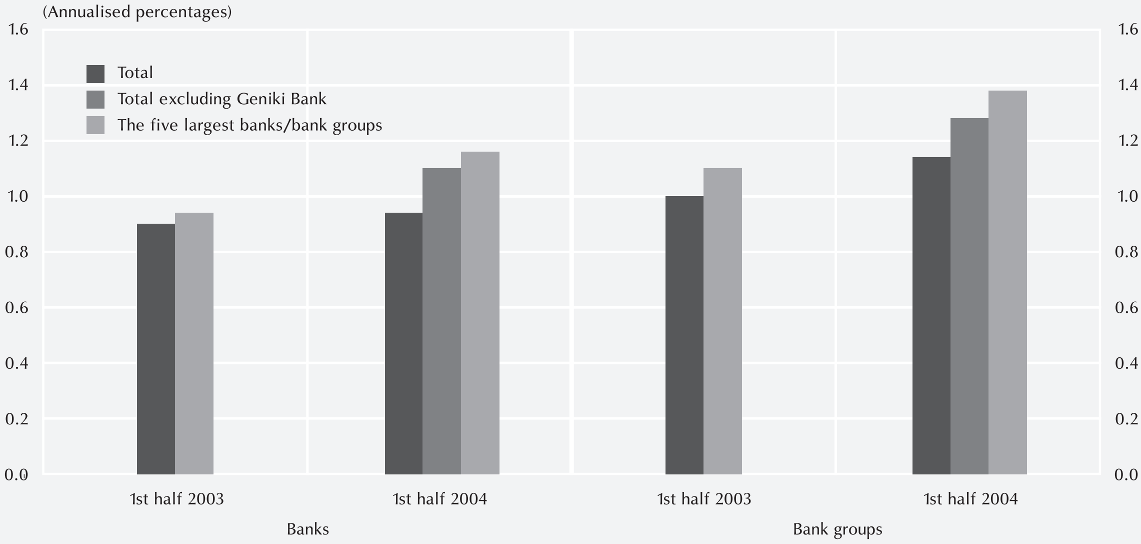
1 Compared with the previous financial year or the corresponding period of the previous financial year.

Source: Income statements for the financial year (period).

Chart A2

Return on assets (ROA)

(Annualised percentages)

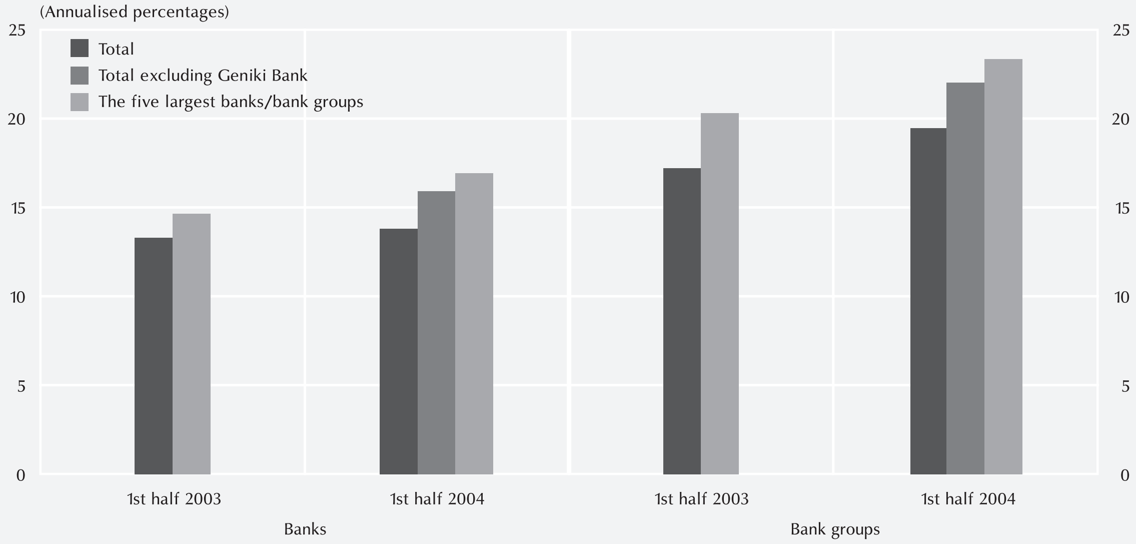


Source: Balance sheets and income statements for the period.

profitability, although its share in total income (73%) fell slightly compared with the respective period of 2003 (75%). By contrast, the shares of all the other income categories increased.

At the same time, banks' efforts to control their costs are reflected in the relatively low rate of increase in operating expenses (6.4%)(see Table A1). Staff costs, which constitute the largest part of total expenses (61%), increased at a rate (6.7%) slightly higher than total operating expenses, while "other expenses" (28% of total) increased even faster, by 8.3%. Depreciation expenses played a role in the containment of overall costs, as they remained

Chart A3
Return on equity (ROE)
(Annualised percentages)



Source: Balance sheets and income statements for the period.

unchanged[7] from the first half of 2003. Effective cost control, in conjunction with a stronger increase in income, led to a rise in the efficiency ratio (operating expenses over operating income) to 59% from 62% in 2003.

The increase in net interest income is to a large extent attributable to strong credit expansion both to enterprises and, most importantly, to households.[8] The drop in interest rates to historically low levels during the period under review[9] boosted demand for loans, which more than offset the negative effect of lower interest rates on net interest income. In this respect, a very large positive contribution came from loans to households, which not only include loan categories with higher interest rates but also were in strong demand.[10]

The significant increases in income from securities as well as in income from financial transactions mainly reflect the recovery of share prices,[11] the greater involvement of banks in investment and private banking and their participation in the capital of other companies.

Reflecting the aforementioned developments, the net interest margin[12] for banks as a whole remained at 2.8% (on an annual basis) in the first half of 2004.

High profitability in the first six months of the current year enabled banks to create higher provisions for losses and bad debts.[13] In more detail, provisions increased by 45.3% for the total of commercial banks or by 18.4% excluding Geniki Bank (see Table A1). Underlying this development were factors such as stricter provisioning requirements,[14] an increase in risk

7 A factor contributing to this development was the maturing of past investments.
8 See Section 2 of this chapter.
9 See Section 3 of this chapter.
10 Specifically, consumer loans grew at a higher rate, especially following their complete deregulation in June 2003 (under Bank of Greece Governor's Act 2523/12 June 2003).
11 The composite share price index of the Athens Exchange increased by 24.2% between the end of June 2003 and the end of June 2004, compared with a fall of 15.5% in the preceding twelve-month period.
12 Measured as the ratio of net interest income to average earning assets.
13 This figure refers to provisions for contingent liabilities and asset valuation differences and appears in the income statement for the financial year.
14 See Bank of Greece Governor's Act 2513/2003.

T a b l e   A1

Key balance sheet aggregates of Greek commercial banks and bank groups in the first half of 2004

(Percentage changes over the first half of 2003)

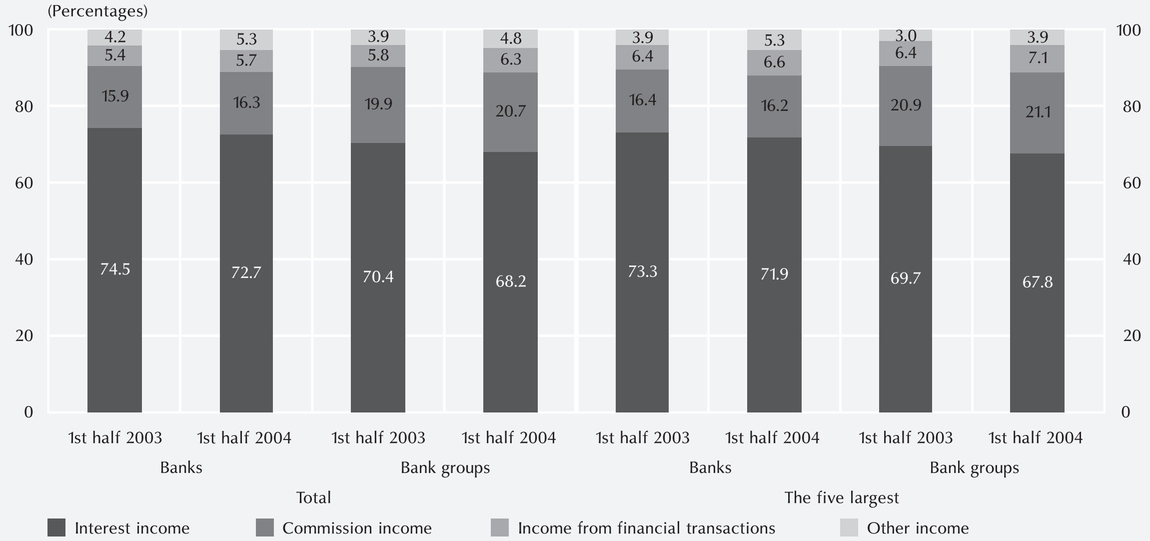
	Banks		Bank groups	
	Total[1]	Five largest	Total[1]	Five largest
Total assets	10.8	11.9	10.7	11.7
Operating income	11.0	14.5	14.6	18.1
– Interest income	8.4	12.4	11.1	14.9
– Commission income	13.7	13.5	18.8	19.6
– Income from financial transactions	17.8	18.3	23.4	31.1
– Income from securities	61.0	81.6	67.4	85.6
– Other income	–2.4	–7.9	19.2	4.3
Operating expenses	6.4	6.2	8.6	8.0
Provisions	45.3 (18.4)	26.6	47.1 (22.8)	31.8
– Provisions for loan losses	19.1 (15.9)	17.3	18.5 (15.6)	16.8
Pre-tax profits	8.1 (23.6)	28.7	17.6[2] (31.6)	37.1[3]

1 The percentages in parentheses refer to the total excluding Geniki Bank, whose profitability was affected by the restatement of some of its balance sheet items following its acquisition by Société Générale in 2003. Revisions for 2003 have been taken into account.
2 Net of minority interests, the profits increased by 16%.
3 Net of minority interests, the profits increased by 35.8%.
Source: Balance sheets and income statements for the period.

Chart A4

Income structure of Greek commercial banks and Greek bank groups

(Percentages)



Source: Income statements for the period.

related to strong credit expansion in recent years, the policy of provisioning against risks associated with a potential slowdown in the economy, as well as the restructuring of activities pursued by banks, especially at group level, in the last few years. It should be noted that, if banks —in the face of increased competition— relax their credit standards,[15] this would imply an increase in expected losses and would therefore, from

15 See ECB, *The euro area bank lending survey*, 12 August 2004.

the viewpoint of effective risk management, require higher provisions.

2.2 The five largest banks

In the period under review, the five largest banks[16] performed better than the total number of banks.

Specifically, the five largest banks recorded a greater improvement in profitability, performance and efficiency. This was due to the fact that their total revenue increased at a higher rate than that of the total number of banks, while their expenses rose at roughly the same rate. On the other hand, their net interest margin stood at a relatively lower level.

In more detail, the significant increase in the profitability (28.7%) of the five largest banks led to a notable improvement in both their ROA (first half of 2004: 1.16%, first half of 2003: 0.94%) and their ROE (first half of 2004: 16.92%, first half of 2003: 14.6%) (see Charts A2 and A3), while the net interest margin remained at 2.7%.

Total operating income of the five largest banks rose by 14.5%, as a result of increases in all income categories (with the exception of “other income”, which declined) (see Table A1). Income from securities showed the highest rate of growth (81.6%), followed by income from financial transactions (18.3%), from commissions (13.5%) and from interest (12.4%). The income structure of these banks was similar to that of the total (see Chart A4).

Operating expenses increased by 6.2% and staff costs by 7.2%. Other expenses rose by 6.9% and depreciation expenses fell by 1%.[17] Therefore, the efficiency ratio of these banks improved appreciably, to 56% from 61% in 2003.

Finally, total provisions showed a high rate of increase (26.6%) (see Table A1).

3. The performance of Greek bank groups and comparison with the European Union

In the first half of 2004, the total assets of Greek bank *groups* increased at roughly the same rate as the total assets of banks, while their profitability showed a larger improvement (see Table A1). This resulted in an increase, relative to 2003, in the return on assets (ROA) (first half of 2004, total: 1.14%, excluding Geniki Bank: 1.38%, first half of 2003: 1.0%) and in the return on equity (ROE) (first half of 2004, total: 19.46%, excluding Geniki Bank: 22.0%, first half of 2003: 17.2%). Compared with the total bank groups, the five largest bank groups showed higher profitability indices, with their ROA and ROE rising to 1.38% and 23.34% respectively in the first half of 2004, from 1.1% and 20.28% in the first half of 2003) (see Charts A2 and A3).

Operating income rose by 14.6% (five largest groups: 18.1%). This development stemmed from all income categories, most notably interest income that rose by 11.1% (14.9%) and accounted for two thirds of total income in the period under review. Income from securities increased by a substantial 67.4% (85.6%). A significant rise of 23.4% (31.1%) was recorded in income from financial transactions, although this category has a small share in total operating income (see Table A1 and Chart A4).

Operating expenses increased by 8.6% (8% for the five largest groups) and thus the efficiency ratio reached 60% (57%) compared with 63% (62%) in the respective period of 2003.

The net interest margin stood at 3% in the first half of 2004 (on an annual basis) both for the total number of bank groups and for the five largest groups.

Data on a small sample of bank groups, comprising mostly large banks (see Table A2), show that in the

16 Not including the Agricultural Bank of Greece.
17 See footnote 7.

T a b l e A2

Performance and efficiency ratios of Greek and EU bank groups[1]

(In percentages)

	Net interest margin	ROA	ROE	Efficiency
2003				
EU[2]	**3.0**	**1.0**	**12.0**	**69.6**
(euro area)	**(2.4)**	**(0.5)**	**(9.9)**	**(73.2)**
– Group 1:				
assets up to	3.9	1.4	13.2	65.7
€10 billion[3]	(3.2)	(0.8)	(10.9)	(64.2)
– Group 2:				
assets over	2.3	0.5	10.9	71.0
€10 billion and up to €50 billion[4]	(2.2)	(0.4)	(9.0)	(72.5)
– Group 3:				
assets over	1.8	0.5	10.8	76.7
€50 billion[5]	(1.9)	(0.4)	(9.1)	(82.1)
1st half 2003[6]				
EU	2.1	0.5	10.6	65.2
(euro area)	(2.1)	(0.5)	(10.4)	(71.6)
1st half 2004[6]				
EU	2.0	0.7	13.9	63.6
(euro area)	(1.9)	(0.5)	(12.0)	(69.3)
2003				
Greece[7]	3.1	1.1	18.9	62.8
– 1st half 2003[7]	3.0	1.0	17.2	63.3
– 1st half 2004[7]	3.0	1.1	19.5	60.0
– 1st half 2004 (excluding Geniki Bank)	3.0	1.4	22.0	59.1

1 The figures in parentheses refer to the consolidated results of euro area commercial bank groups.
2 Consolidated results of 146 (82) banks in the EU (euro area).
3 Consolidated results of 61 (23) banks in the EU (euro area).
4 Consolidated results of 45 (34) banks in the EU (euro area).
5 Consolidated results of 40 (25) banks in the EU (euro area).
6 Only 48 (31) large commercial bank groups in the EU (euro area). Therefore. the results for these two year halves are not comparable with the results for the entire 2003 and are shown indicatively. The figures are annualised.
7 Consolidated results of 10 banks.
Sources: Bloomberg and income statements for the period.

euro area the net interest margin stood at a lower level (1.9%) in the period under review compared with the same period of 2003 (2.1%), despite a stagnation in the return on assets (0.5%) and improvements in the return on equity (12.0% from 10.4%) and in the efficiency ratio (69.3% from 71.6%).

The observed difference in bank groups' net interest margins between Greece (3.1%) and the euro area (2.4%) for 2003 may be attributed to the different average sizes.[18] In particular, as shown in Table A2, the Greek figure (3.1%) is close to that reported for Group 1 of the euro area and between the figures for Group 1 and Group 2 of the EU.

Greek bank groups compare favourably with their EU or euro area counterparts in terms of efficiency ratio and return on equity; in terms of return on assets they outperform all euro area bank groups and rank between Groups 1 and 2 of the EU.

To sum up, the performance of Greek banks with shares listed on the Athens Exchange and Greek bank

18 Empirical studies for the US and EU banking markets have found that small banks exhibit different patterns in terms of performance, cost and risk compared with larger banks. See, for instance, Altunbas *et al.* (2001), "Efficiency in European Banking", *European Economic Review*, 45, pp. 1931-95, and Bossone B., and J. Lee (2002), "In finance size matters", IMF Working Paper No. 113, June.

groups for the first half of 2004 is positive, benefiting from a favourable environment of strong demand and low interest rates, as well as from a significant increase in income from securities and financial transactions. However, particular attention should be given to risk management issues, through further development and implementation of credit risk control and rating systems, as well through adequate provisions, as bank profitability could be negatively affected in the event of an economic slowdown and/or a rise in interest rates, which would imply problems in the servicing of floating-rate housing and consumer loans.

VI. The state of the economy and challenges for economic policy and for the social partners

1. The current state of the economy and the major challenges for economic policy

As noted in the preceding chapters, the Greek economy, supported by domestic demand, has continued to grow strongly in 2004 for the eighth consecutive year, helping to raise employment further. Unemployment, however, remains particularly high. The current account deficit appears to have been contained, albeit at a high level, against the backdrop of a generally improving external environment. However, large fiscal imbalances and an acceleration of wage growth are adversely affecting inflation and external competitiveness and, if not addressed in time, could threaten medium-term growth prospects.

Specifically, real GDP is expected to grow by around 4% in 2004, which is only slightly lower than in 2003 and significantly exceeds the average euro area growth rate (around 2%). Growth continues to be driven primarily by private consumption, reflecting rising real disposable household income, continued consumer credit expansion and increased household wealth in recent years. Public consumption is also rising at a fast pace. Total investment continues to grow in 2004, albeit at a lower rate than in 2003, due to the completion of the 2004 Olympic Games-connected projects and the halt in private residential investment. Given the strength of domestic demand, the real external balance will again have a negative contribution to GDP growth in 2004, approximately of the same size as in 2003. Nevertheless, the current account deficit (as compiled by the Bank of Greece) is expected to decline in relation to GDP —but to remain relatively high at 5% of GDP in 2004— as a widening of the trade deficit would be more than offset by higher surpluses in the services and transfers

Table VI.1
Main macroeconomic aggregates in Greece: 2003-2004

	2003	2004 (estimate)
	Annual percentage changes	
GDP	4.5	4.0
Inflation (HICP)	3.4	3.0
Core inflation (HICP-based)	3.1	3.6
Total employment	1.9	2.0
Employment (employees)	2.1	2.0
Average earnings in the whole economy	5.5	6.4
	Percentage of GDP	
Current account deficit	5.7	5.0
General government deficit	4.6	5.3
General government primary surplus	1.2	0.0
General government debt	109.9	112.1

Source: See Chapters III and IV.
Note: For 2004: Ministry of Economy and Finance estimates *(Draft Budget for 2005)* for the deficit, the primary surplus and the debt of general government. For all the other aggregates: Bank of Greece estimates.

accounts.[1] It is estimated that employment continues to grow, possibly faster than in 2003 (see Chapter III.2). Nevertheless, the unemployment rate remains particularly high, as already mentioned.

Meanwhile, inflationary pressures are on the rise. CPI and HICP inflation is lower than last year, but this stems from temporary exogenous factors (mainly the fall in prices of fresh fruit and vegetables). Core inflation (i.e. the HICP excluding prices of energy and unprocessed food) has trended upwards since the middle of 2003: from 2.8% in the second quarter of 2003, it has risen to an estimated 3.7% in the third quarter of 2004. On an average annual basis, it is expected to rise to 3.6% in 2004 from 3.1% in 2003, implying some increase in the core inflation differential vis-à-vis the euro area (by 0.3 percentage point to 1.4 percentage points). The Bank of Greece's assessment of increasing inflationary pressures is supported, *inter alia*, by the accelerated growth of wholesale prices for domestically manufactured goods, an early indicator of consumer price inflation.

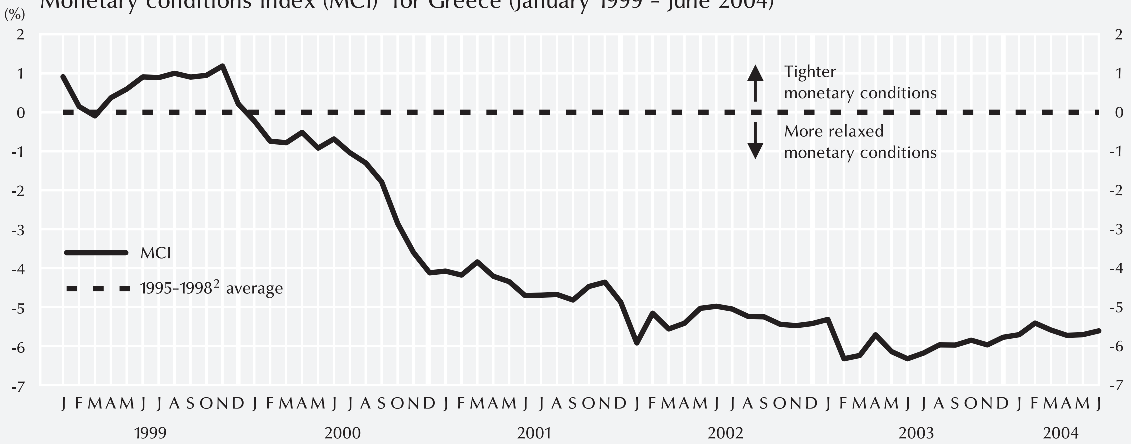
The size of the fiscal imbalances and the acceleration of unit labour cost growth in 2004 are especially worrisome developments. As noted in past reports, with Greece's loss of monetary policy independence after its entry into the euro area and the inevitable relaxation of monetary conditions for Greece (see Chart VI.1), the burden of macroeconomic stabilisation shifts to fiscal policy and the social partners, as well as to structural policies. The current year 2004, however, has been characterised by:

First, a further relaxation of fiscal policy, which — in combination with the revision of fiscal statistics— has led the fiscal deficit- and the public debt-to-GDP ratios to very high levels.

Second, an acceleration of wage growth in the economy, led by developments in the public sector. The acceleration in unit labour cost growth,

1 As noted in Chapter III.3, there are often significant differences between Bank of Greece trade statistics and NSSG trade statistics, as the former relate to receipts and payments mainly through the domestic banking system, while the latter are based on tax data (for intra-EU transactions) and customs data (for transactions with non-EU countries).

Chart VI.1
Monetary conditions index (MCI)[1] for Greece (January 1999 - June 2004)



1 The monetary conditions index (MCI) is defined as:
MCI=0.25 (E(t)/E* - 1) + 0.75 (R(t) - R*), where E(t): real effective exchange rate based on the CPI, E*: average real effective exchange rate for 1995-1998, R(t): real interest rate (3-month Athibor minus CPI inflation until December 2000; thereafter 3-month Euribor minus CPI inflation), R*: average real interest rate for 1995-1998 (see note 2).
2 Excluding the period of serious market turmoil from October 1997 to February 1998.

Sources: Bank of Greece and IMF.

both in the whole economy and in the business sector, has contributed to the rise in core inflation and has added to the considerable cumulative loss of price competitiveness in recent years, which adversely affects employment developments.

The Greek economy therefore still faces major challenges. The macroeconomic stabilisation gradually achieved since the early 1990s, as well as structural reforms, have certainly helped to release productive forces and contributed to the attainment of high growth rates in recent years. However, the sustainability of relative high growth rates over the medium term —a necessary condition for further reducing unemployment and improving the living standards— critically depends on increasing the economy's potential output through improved competitiveness, fiscal consolidation and structural reforms. In this regard, it should be noted that the growth rates of around 4% recorded in recent years have exceeded significantly the potential output growth rate, resulting in an increasing positive output gap,[2] which, along with large increases in nominal wages, has contributed to Greece's relatively high inflation. If Greece is to sustain growth at satisfactory levels —thereby taking advantage of the stable macroeconomic environment made possible by the country's full membership in EMU— the fiscal imbalances and structural rigidities will need to be addressed decisively.

2. Fiscal policy

Fiscal consolidation has become an issue of great urgency. The recent revision of fiscal statistics and further fiscal slippages in 2004 — reflecting the "political cycle" and the 2004 Olympic Games — have raised the general government deficit to a clearly unsustainable level. The Ministry of Economy and Finance estimates that the deficit will reach 5.3% of GDP in 2004, from 4.6% of GDP in 2003, and that the general government debt-to-GDP ratio will reach 112.1% of GDP by

2 See Chapter III.1.

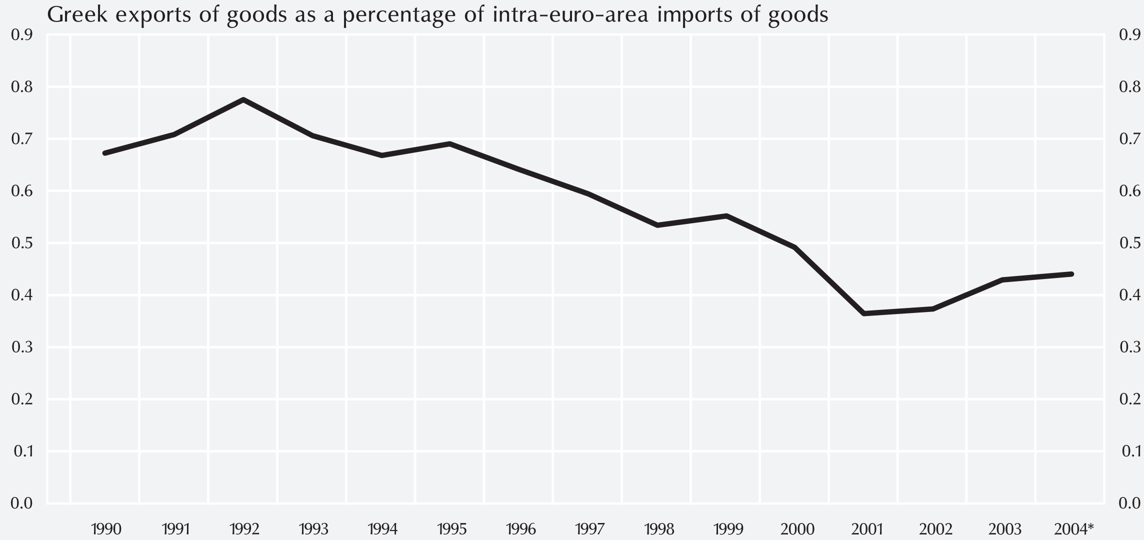
end-2004. The widening of the deficit has occurred against the backdrop of strong economic growth. Thus, the cyclically adjusted deficit would rise by 1.0% of GDP in 2004, following another 0.7% increase in 2003; this compares with the original aim to reduce it this year (by 0.2% of GDP). The cyclically adjusted primary balance, a better indicator of the fiscal effort, is expected to worsen even more, declining by 1.5 percentage points of GDP in 2004, after a 1.2 percentage point decline in 2003 (see Chart IV.1 on page 81).

Rapid fiscal consolidation is absolutely necessary in order to address existing macroeconomic imbalances and ensure longer-term fiscal sustainability; moreover, it is dictated by Greece's obligations under the Growth and Stability Pact (see above, Chapter IV.3, and Appendix to Chapter IV). The large fiscal imbalances fuel inflation, erode external competitiveness, increase (instead of substantially lowering as needed) the excessively high public debt-to-GDP ratio and undermine macroeconomic stability. In addition, given an ageing population, it is necessary to achieve fiscal surpluses in the medium term and to gradually reduce debt to a low level, in order to allow for the pension and health costs that are expected to rise rapidly after 2010. The current high levels of the deficit- and debt-to-GDP ratios are clearly in conflict with Greece's obligation under the Pact to keep the general government deficit to no more than 3% of GDP and to reduce its debt ratio towards 60% at a "satisfactory" pace. As a result, the Excessive Deficit Procedure (EDP) has been initiated by the European Commission (see Chapter IV.3).

Against this background, the government has announced its intention to lower the general government deficit by 2.5 percentage points to 2.8% of GDP in 2005. This adjustment is expected to result largely from the reduction (non-repetition) of expenditure related to the Olympic Games. In addition, it is expected to result from the containment of growth in primary spending. This presupposes that the growth of compensation per employee in central government will be limited and that new personnel will be hired only when absolutely necessary, so that —in conjunction with retirements and resignations— the increase in central government employment may come to a halt. Also, improved conditions in the region would permit cuts in spending on defence. On the revenue side, a rise in the revenue-to-GDP ratio is sought through a curtailment of tax evasion, better use of state-owned property and accelerated receipts from the EU under CSF III. Further, revenue from privatisation would be used to repay debt.

The government's aim to reduce the general government deficit to 2.8% of GDP in 2005 is satisfactory and implies a substantial immediate correction of fiscal imbalances; for this to be achieved, the fiscal policy measures that have been announced must be concretised and implemented decisively and coherently. International experience suggests that durable progress in correcting the fiscal imbalances will require current spending restraint, curtailment of tax evasion and a widening of the tax base, with a view to allowing adequate spending on infrastructure and a reduction in the tax burden through lower tax rates, as well as small fiscal deficits as an end-result. In particular, containment of wage increases in central government would have a signalling effect for the rest of the economy and help improve competitiveness by setting an example for the private sector. A gradual reduction in public-sector employment, through attrition (by applying the principle that recruitments would be fewer than retirements and resignations), together with more efficient management of available

Chart VI.2
Greek exports of goods as a percentage of intra-euro-area imports of goods



* January-June 2004 data.

Sources: NSSG for Greek exports of goods, Eurostat for intra-euro-area imports.

human resources and their redistribution to sectors with more pressing needs,[3] would help raise productivity. Finally, a reduction of subsidies, capital transfers and loan guarantees would help strengthen financial discipline in the economy as well as the public finances.

3. Wage developments, pricing policies and external competitiveness

Unit labour cost developments in 2004 continued to be in conflict with the disinflation, competitiveness and employment needs of the economy. As noted in previous reports, the acceleration of wage growth since 1999 —when it had been limited to 4.5% as a result of a more responsible attitude by the social partners— has played an important role in the persistence of relatively high inflation and the cumulative loss of competitiveness. In the event, growth in gross average earnings in the whole economy is expected to accelerate significantly in 2004 (by 0.9 percentage point to 6.4%), while unit labour cost growth is expected to accelerate even more (by 1.8 percentage points to 4.8%). Wage increases have been led by the public sector, with gross average compensation in central government and public enterprises expected to rise by 8.4% and 7.8%, respectively, compared with 5.8% in the private sector. Looking forward, it is important for the state and for the social partners to agree on wage moderation. As suggested in the last Monetary Policy Report (March 2004), if the nominal rate of increase in wages gradually converges on the sum of productivity growth and euro area (rather than Greece's) inflation until the inflation differential vis-à-vis the euro area is virtually wiped out, this would contribute to the much needed improvement in external competitiveness vis-à-vis our euro area trading partners (see Chart VI.2).[4]

3 The final aim should be the creation of a smaller, but much more efficient public administration. See also Bank of Greece, *Annual Report 2002*, April 2003, p. 63.
4 It is of course assumed that all other factors remain unchanged. See Bank of Greece, *Monetary Policy 2003-2004*, March 2004, p. 100.

However, such a policy by itself would do little to maintain the competitiveness of economic sectors that face increased competition from producers from outside the euro area, who compete with Greece both within and outside the euro area market. This particularly applies to tourism, where Greece is facing increased competition from lower-cost neighbouring countries, including in attracting visitors from euro area countries. Besides greater wage and price flexibility, sustained growth in tourism will require intensified efforts by all concerned in order to improve productivity and the quality of services and thus withstand the pressure of competition.

4. Structural reforms

Structural reforms, as pointed out repeatedly by the Bank of Greece in the past, need to be accelerated over a wide spectrum of economic sectors. Sustaining relatively high growth rates will require intensified structural reforms to enhance the productive potential of the economy, notably by improving further the business climate and the functioning of the labour and product markets. The reduction of administrative burdens and of red tape is of great importance – especially for small and medium-sized enterprises that generate most jobs. These administrative barriers are overly burdensome and must be replaced by more efficient arrangements; the budgetary cost of such arrangements is small, but they have considerable potential in terms of encouraging private investment, including from abroad. In the area of product markets, considerable efficiency gains can be obtained by strengthening effective competition in the electricity market, by fully implementing Greek and EU legislation for the liberalisation of internal sea transport, by liberalising the natural gas market and —more generally— by a further reduction in the role of the government through continued privatisations. Finally, to address the high unemployment rate as well as particularly low employment rates among women and youth, the education and training systems as well as aspects of labour legislation that discourage hiring need to be reappraised.

* * *

Along with strong growth for the eighth consecutive year, 2004 has ushered in serious challenges for the policy makers and the social partners that, if left unaddressed, could undermine medium-term growth prospects. Fiscal imbalances are very large and risk undermining macroeconomic stability by fuelling inflation, eroding external competitiveness, and adding to the excessively high public debt. In addition, unit labour cost developments are not consistent with the disinflation, competitiveness, and employment needs of the economy. Meanwhile, structural rigidities are constraining output growth, as indicated by the growing “output gap” and inflationary pressures in conjunction with the high rate of unemployment. This is why it is important that the authorities address fiscal imbalances and structural rigidities decisively and that the social partners show more moderation in settlements on wage increases. If these conditions are met, Greece’s medium-term growth prospects would be assured and convergence towards EU income levels would continue at a satisfactory pace.

Monetary policy measures of the Eurosystem

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.

5 February, 4 March, 1 April, 6 May, 3 June, 1 July, 5 August, 2 September, 7 October 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.

Glossary

Community Support Framework (CSF): compiled by the Commission of the European Communities in co-operation with the Member State and approved by the Commission. It includes the country's growth strategy, activity priorities and financing resources (participation of the Community, national public expenditure, participation of the private sector).

Deposit facility: a *standing facility* of the *Eurosystem* which counterparties may use to make overnight deposits, remunerated at a pre-specified interest rate, at a national central bank.

Deposits redeemable at notice: this instrument comprises savings deposits which the depositor may withdraw once he has given notification thereof within a predetermined time period. At some instances, it is possible to withdraw part of the amount deposited at notice or before, subject to penalty. Deposits redeemable at notice of up to three months pertain to M2 (hence to M3). Longer-term deposits redeemable at notice pertain to (non-monetary) longer-term financial liabilities of the monetary financial institutions (MFIs).

Deposits with an agreed maturity: deposits with a fixed maturity, which, according to the national practice, are either not convertible into cash before their maturity or are convertible into cash subject to penalty. They include some non-negotiable instruments, such as non-negotiable certificates of (private) deposit. Deposits with an agreed maturity of up to two years pertain to M2 (hence to M3). Longer-term deposits with an agreed maturity pertain to (non-monetary) longer-term financial liabilities of the monetary financial institutions (MFIs).

Effective (nominal/real) exchange rates: nominal effective exchange rates are weighted averages of bilateral exchange rates. Real effective exchange rates are nominal effective exchange rates deflated by a weighted average of foreign, relative to domestic, prices or costs. They are, thus, measures of price and cost competitiveness.

EONIA (euro overnight index average): a measure of the interest rate prevailing in the euro interbank overnight market, based on transactions.

EURIBOR (euro interbank offered rate): the rate at which a prime bank is willing to lend funds in euro to another prime bank, computed daily for interbank deposits with different maturities of up to 12 months.

Euro area: the area encompassing those Member States in which the euro has been adopted as the single currency in accordance with the Treaty and in which a single monetary policy is conducted under the responsibility of the *Governing Council* of the ECB. The euro area currently comprises 12 countries: Austria, Belgium, Germany, Greece, Finland, France, Ireland, Italy, Luxembourg, the Netherlands, Portugal and Spain.

European Central Bank (ECB): the ECB lies at the centre of the *European System of Central Banks* (ESCB) and the *Eurosystem* and has legal personality under Community law. It ensures that the tasks conferred upon the Eurosystem and the ESCB are implemented either through its own activities or through those of the national central banks, pursuant to the Statute of the ESCB and of the ECB. The ECB is governed by the *Governing Council* and the *Executive Board*, and, as a third decision-making body, by the *General Council*.

European System of Central Banks (ESCB): composed of the ECB and the national central banks of all 25 EU Member States, i.e. it includes, in addition to the members of the *Eurosystem*, the national central banks of those Member States that have not yet adopted the euro. The ESCB is governed by the *Governing Council* and the *Executive Board*, and, as a third decision-making body, by the *General Council*.

Eurosystem: comprises the ECB and the national central banks of those Member States that have adopted the euro. There are currently 12 national central banks in the Eurosystem. The Eurosystem is governed by the *Governing Council* and the *Executive Board* of the ECB.

Executive Board: one of the decision-making bodies of the ECB. It comprises the President and the Vice-President of the ECB and four other members appointed by common accord by the Heads of State or Government of the countries that have adopted the euro.

General Council: one of the decision-making bodies of the ECB. It comprises the President and the Vice-President of the ECB and the governors of the 25 EU national central banks.

General government: as defined in the European System of Accounts 1995 (ESA 95), comprises central, state and local government and social security funds.

Governing Council: one of the decision-making bodies of the ECB. It comprises all the members of the *Executive Board* and the governors of the national central banks of the countries that have adopted the euro.

Harmonised Index of Consumer Prices (HICP): a measure of consumer prices which is compiled by Eurostat and harmonised for all EU countries.

Key ECB interest rates: the interest rates, set by the *ECB*, which reflect the monetary policy stance of the ECB. Currently, key ECB interest rates are the minimum bid rate on the *main refinancing operations*, the interest rate on the *marginal lending facility* and the interest rate on the *deposit facility*.

Main refinancing operation: a weekly open market operation conducted by the *Eurosystem*. The operations are conducted as variable rate tenders with a pre-announced minimum bid rate and have a maturity of 1 week.

Marginal lending facility: a *standing facility* of the *Eurosystem* which counterparties may use to receive overnight credit from a national central bank at a pre-specified interest rate against eligible assets.

Monetary aggregates: a monetary aggregate is the sum total of currency in circulation plus the overdue amounts of certain liabilities of the MFIs and the central governments which have a high degree of "moneyness" (or liquidity in a broad sense). The narrow monetary aggregate M1, as defined by the *Eurosystem*, comprises currency in circulation plus *overnight deposits* which non-MFI *euro area* residents (other than general government) keep with *euro area* institutions that issue money. The monetary aggregate M2 comprises M1 plus *deposits with an agreed maturity* of up to two years plus *deposits redeemable at* a period of *notice* of up to three months. The broad monetary aggregate M3 comprises M2 and repurchase agreements (repos), money market fund shares/units, money market paper and debt securities with a maturity of up to two years.

Overnight deposits: deposits due on the next working day. This instrument comprises both fully transferable (through cheques etc.) and non-transferable deposits convertible into cash upon request or until the end of the next working day. Particularly for Greece, this instrument includes sight deposits, deposits in current accounts and savings deposits.

Standing facility: a central bank facility available to counterparties on their own initiative. The *Eurosystem* offers two overnight standing facilities: the *marginal lending facility* and the *deposit facility*.

Statistical appendix

Tables

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

Period	General index		Goods		Services		CPI excluding fresh fruit/ vegetables and fuel		CPI excluding food and fuel	
	(1999=100)	Percentage change over previous year	(1999=100)	Percentage change over previous year	(1999=100)	Percentage change over previous year	(1999=100)	Percentage change over previous year	(1999=100)	Percentage change over previous year
2000	102.9	3.2	103.4	3.4	102.1	2.8	101.4	2.0	101.3	2.0
2001	106.4	3.4	106.7	3.2	105.9	3.7	105.3	3.8	105.0	3.7
2002	110.2	3.6	110.1	3.2	110.4	4.3	109.0	3.6	108.7	3.6
2003	114.1	3.5	113.5	3.1	115.1	4.2	112.6	3.2	112.2	3.1
2003 I	112.8	3.8	112.4	3.4	113.4	4.5	110.7	3.6	110.1	3.4
II	114.9	3.7	114.9	3.4	114.7	4.1	112.8	3.1	112.5	3.0
III	113.3	3.4	112.0	2.9	115.4	4.1	112.1	3.0	111.6	2.9
IV	115.5	3.2	114.6	2.5	116.9	4.3	114.6	3.2	114.5	3.3
2004 I	115.8	2.7	114.4	1.8	118.0	4.0	114.3	3.3	113.7	3.2
II	118.2	2.9	117.5	2.3	119.1	3.9	116.6	3.3	116.1	3.2
2002 Jan.	108.4	4.4	108.5	5.2	108.4	3.3	106.5	3.3	106.0	3.2
Feb.	107.3	3.4	106.7	3.1	108.3	3.9	105.7	3.1	105.2	3.2
March . .	110.0	4.0	110.7	3.8	109.0	4.4	108.4	3.6	108.3	3.7
Apr.	110.9	3.8	111.7	4.0	109.6	3.6	109.0	3.4	108.8	3.5
May	110.8	3.4	111.1	2.4	110.5	4.9	109.7	4.2	109.5	4.3
June	110.6	3.3	110.9	2.5	110.3	4.5	109.7	3.9	109.5	3.8
July	108.7	3.3	107.6	2.7	110.5	4.4	108.1	3.7	107.4	3.5
Aug.	109.0	3.5	107.9	2.9	110.7	4.5	108.2	3.6	107.6	3.6
Sept. . . .	111.0	3.5	110.8	2.7	111.5	4.8	110.3	3.7	110.1	3.8
Oct.	111.6	3.7	111.6	3.2	111.7	4.6	110.7	3.5	110.6	3.6
Nov. . . .	111.6	3.6	111.5	3.1	111.9	4.5	110.9	3.5	110.8	3.5
Dec. . . .	112.4	3.4	112.3	2.8	112.7	4.3	111.4	3.5	111.2	3.5
2003 Jan.	111.8	3.1	110.8	2.1	113.4	4.7	110.4	3.7	109.9	3.6
Feb.	112.0	4.3	111.1	4.1	113.3	4.7	109.7	3.8	108.9	3.5
March . .	114.5	4.1	115.2	4.1	113.4	4.1	112.0	3.4	111.6	3.1
Apr.	114.6	3.4	114.6	2.6	114.6	4.5	112.6	3.4	112.3	3.1
May	115.1	3.8	115.4	3.9	114.7	3.7	112.8	2.9	112.6	2.8
June	114.9	3.8	114.9	3.6	114.9	4.2	113.0	3.0	112.7	3.0
July	112.7	3.6	111.1	3.2	115.0	4.1	111.2	2.9	110.5	2.9
Aug.	112.6	3.3	110.9	2.8	115.2	4.0	111.4	3.0	110.7	2.9
Sept. . . .	114.8	3.3	113.9	2.8	116.1	4.2	113.8	3.2	113.5	3.1
Oct.	115.2	3.2	114.4	2.5	116.4	4.2	114.3	3.2	114.1	3.2
Nov. . . .	115.4	3.3	114.7	2.9	116.5	4.1	114.4	3.1	114.3	3.2
Dec. . . .	115.9	3.1	114.7	2.2	117.7	4.5	115.2	3.3	115.0	3.4
2004 Jan.	115.1	2.9	113.3	2.3	117.9	3.9	114.0	3.2	113.4	3.2
Feb.	114.8	2.5	112.7	1.5	117.9	4.0	113.2	3.1	112.2	3.1
March . .	117.6	2.7	117.2	1.8	118.2	4.2	115.9	3.4	115.3	3.3
Apr.	117.9	2.9	117.2	2.3	119.0	3.9	116.3	3.2	115.9	3.2
May	118.5	2.9	118.1	2.4	119.0	3.8	116.6	3.3	116.1	3.2
June	118.1	2.8	117.3	2.1	119.4	3.9	116.9	3.5	116.5	3.3
July	116.0	2.9	113.6	2.2	119.6	4.0	115.5	3.8	114.8	3.8
Aug.	115.7	2.7	113.0	1.9	119.8	4.0	115.0	3.2	114.1	3.1

Source: Calculations based on NSSG data.

Table 2

Harmonised index of consumer prices: general index and basic sub-indices

Period	HICP (general)		Unprocessed food		Processed food		Non-energy industrial goods	
	(1996=100)	Percentage change over previous year	(1996=100)	Percentage change over previous year	(1996=100)	Percentage change over previous year	(1996=100)	Percentage change over previous year
2000	115.8	2.9	116.9	1.7	114.6	2.7	111.8	0.6
2001	120.1	3.7	124.8	6.7	120.4	5.1	115.1	2.9
2002	124.8	3.9	133.5	6.9	127.0	5.5	118.0	2.5
2003	129.0	3.4	142.0	6.4	131.7	3.6	119.8	1.6
2003 I	127.3	3.8	141.0	0.8	129.6	4.7	116.8	1.7
II	129.9	3.5	150.4	12.3	130.6	2.4	122.0	1.8
III	128.2	3.4	138.9	9.0	132.4	3.2	117.4	1.3
IV	130.8	3.2	137.5	3.8	134.2	4.4	123.1	1.5
2004 I	130.9	2.9	146.2	3.7	135.9	4.9	118.9	1.7
II	133.9	3.1	142.8	–5.1	138.2	5.9	124.5	2.1
2002 Jan.	122.4	4.8	143.4	20.9	123.3	4.8	113.9	3.3
Feb.	121.0	3.8	137.5	13.9	123.5	4.3	111.4	2.6
March ..	124.5	4.4	138.8	12.8	124.6	5.1	119.3	2.6
Apr.	125.5	4.1	138.3	10.1	126.9	7.0	119.4	2.6
May	125.8	3.8	132.4	2.2	127.6	7.4	120.0	2.9
June ...	125.5	3.6	131.2	3.9	128.0	6.1	120.2	2.6
July	123.0	3.6	126.6	3.8	128.2	5.7	113.7	2.4
Aug. ...	123.2	3.8	127.3	4.5	128.4	5.6	113.7	2.4
Sept. ...	125.8	3.8	128.4	4.2	128.4	5.3	120.1	2.2
Oct.	126.4	3.9	130.8	5.1	128.5	5.0	121.1	2.1
Nov. ...	126.5	3.9	132.4	4.8	128.6	5.0	121.4	2.1
Dec. ...	127.4	3.5	134.5	–1.1	128.6	4.7	121.4	2.1
2003 Jan.	126.4	3.3	136.6	–4.7	128.9	4.5	116.1	1.9
Feb.	126.1	4.2	141.6	3.0	129.7	5.0	113.1	1.5
March ..	129.3	3.9	144.8	4.4	130.2	4.5	121.3	1.7
Apr.	129.6	3.3	147.7	6.8	130.5	2.8	121.5	1.7
May	130.2	3.5	153.8	16.1	130.6	2.3	122.2	1.8
June ...	130.0	3.6	149.8	14.2	130.7	2.1	122.2	1.7
July	127.3	3.5	141.2	11.6	130.8	2.1	115.5	1.6
Aug. ...	127.3	3.3	137.8	8.3	132.0	2.9	115.2	1.3
Sept. ...	129.9	3.3	137.6	7.2	134.3	4.6	121.4	1.1
Oct.	130.4	3.2	136.3	4.2	134.2	4.5	122.8	1.4
Nov. ...	130.6	3.2	137.4	3.8	134.1	4.3	123.2	1.5
Dec. ...	131.4	3.1	138.9	3.3	134.2	4.4	123.4	1.7
2004 Jan.	130.3	3.1	142.3	4.1	134.7	4.5	118.4	1.9
Feb.	129.4	2.6	148.1	4.5	135.8	4.7	114.6	1.3
March ..	133.1	2.9	148.3	2.4	137.2	5.4	123.6	1.9
Apr.	133.6	3.1	144.6	–2.1	137.5	5.4	123.8	2.0
May	134.2	3.1	144.8	–5.8	138.5	6.1	124.7	2.0
June ...	133.9	3.0	138.9	–7.3	138.7	6.2	125.0	2.3
July	131.3	3.1	127.9	–9.5	138.8	6.1	119.7	3.6
Aug. ...	130.9	2.8	129.4	–6.1	138.9	5.2	117.5	2.0

Source: Calculations based on NSSG data.

T a b l e 2 *(continued)*

Harmonised index of consumer prices: general index and basic sub-indices

Period		Energy		Services		HICP excluding unprocessed food and energy	
		(1996=100)	Percentage change over previous year	(1996=100)	Percentage change over previous year	(1996=100)	Percentage change over previous year
2000		108.3	17.3	123.3	2.6	116.7	1.8
2001		106.4	–1.7	128.1	3.9	121.1	3.8
2002		106.1	–0.3	133.8	4.5	125.8	3.9
2003		110.0	3.7	139.4	4.1	129.7	3.1
2003	I	114.1	12.6	137.4	4.5	127.3	3.5
	II	106.8	–1.0	139.0	3.9	130.2	2.8
	III	109.5	1.5	139.8	4.1	129.0	2.9
	IV	109.7	2.1	141.4	4.1	132.3	3.2
2004	I	110.4	-3.3	142.8	4.0	131.5	3.3
	II	117.2	9.7	144.3	3.8	134.8	3.5
2002	Jan.	99.9	–3.7	131.4	3.6	122.5	3.6
	Feb.	100.6	–6.6	130.9	4.1	121.3	3.5
	March	103.7	–3.0	132.0	4.7	125.1	4.0
	Apr.	108.6	–1.4	133.0	3.7	126.0	3.8
	May	108.1	–4.9	134.5	5.4	127.0	4.8
	June	106.8	–3.0	133.8	4.7	126.8	4.1
	July	107.0	–0.2	134.0	4.6	124.3	3.9
	Aug.	108.2	1.5	134.1	4.6	124.4	3.9
	Sept.	108.6	0.5	135.0	4.9	127.4	3.9
	Oct.	108.9	4.9	135.2	4.6	127.9	3.7
	Nov.	105.1	4.5	135.4	4.5	128.1	3.6
	Dec.	108.1	9.9	136.8	4.4	128.7	3.6
2003	Jan.	111.0	11.2	137.7	4.8	127.0	3.7
	Feb.	115.2	14.5	137.2	4.7	125.7	3.6
	March	116.1	12.0	137.3	4.0	129.1	3.2
	Apr.	107.9	–0.6	139.0	4.5	130.0	3.2
	May	105.9	–2.0	138.8	3.2	130.2	2.5
	June	106.5	–0.3	139.1	4.0	130.4	2.8
	July	108.4	1.3	139.3	4.0	127.8	2.8
	Aug.	110.1	1.7	139.6	4.1	128.0	2.9
	Sept.	110.1	1.3	140.4	4.0	131.2	3.0
	Oct.	110.5	1.4	140.8	4.1	131.9	3.1
	Nov.	110.6	5.2	140.8	4.0	132.1	3.1
	Dec.	107.9	-0.2	142.7	4.3	133.0	3.3
2004	Jan.	109.5	-1.4	143.0	3.9	131.2	3.3
	Feb.	108.9	-5.5	142.5	3.9	129.6	3.1
	March	112.8	-2.9	143.0	4.1	133.7	3.5
	Apr.	115.6	7.0	144.3	3.8	134.4	3.4
	May	119.0	12.4	143.9	3.7	134.7	3.5
	June	116.9	9.8	144.6	4.0	135.2	3.7
	July	117.5	8.4	144.9	4.0	133.2	4.2
	Aug.	118.6	7.8	145.2	4.0	132.4	3.5

Source: Calculations based on NSSG data.

Table 3

Wholesale price index: general index and basic sub-indices

Period	General index		Domestic primary products[1]		Domestic industrial products[1]		Exported products		Imported products	
	(1995=100)	Percentage change over previous year	(1995=100)	Percentage change over previous year	(1995=100)	Percentage change over previous year	(1995=100)	Percentage change over previous year	(1995=100)	Percentage change over previous year
2000	124.0	6.6	126.5	1.5	125.2	5.2	128.1	12.3	118.5	6.4
2001	126.8	2.3	139.2	10.0	128.7	2.7	128.9	0.7	120.7	1.9
2002	129.8	2.4	154.7	11.2	132.0	2.6	131.4	1.9	121.2	0.4
2003	132.5	2.1	168.1	8.6	135.6	2.7	131.5	0.1	122.5	1.1
2003 I	132.6	1.7	169.8	-2.5	134.9	3.6	131.9	1.1	122.6	1.5
II	132.7	2.2	183.1	19.6	134.4	1.9	129.6	-2.0	122.3	0.9
III	132.0	2.2	159.9	12.2	135.7	2.4	131.4	0.2	122.6	1.0
IV	132.8	2.2	159.5	7.1	137.2	3.1	132.8	1.0	122.6	0.8
2004 I	134.9	1.8	177.6	4.6	138.7	2.8	134.0	1.6	122.5	0.0
II	136.2	2.6	168.3	-8.1	141.7	5.4	137.0	5.6	123.1	0.6
2002 Jan.	130.4	5.1	181.4	44.4	129.7	2.7	129.4	2.4	120.7	0.8
Feb.	129.6	3.6	168.5	29.5	129.8	2.0	129.9	1.9	120.7	0.5
March ..	131.1	4.2	172.6	30.5	131.4	3.0	132.3	2.8	121.0	0.5
Apr.	131.7	3.7	172.2	23.3	132.1	2.7	133.5	2.8	121.2	0.4
May	129.5	1.2	147.0	1.4	132.0	2.1	132.2	1.2	121.2	0.2
June ...	128.5	0.3	140.2	-3.4	131.5	1.8	131.0	-0.3	121.1	0.0
July	128.2	0.8	136.0	-0.7	132.1	2.3	130.4	0.5	121.0	-0.1
Aug. ...	129.2	2.1	144.3	9.2	132.5	2.5	130.8	1.6	121.5	0.4
Sept. ...	130.0	1.9	147.5	6.0	133.1	2.5	132.3	1.7	121.6	0.4
Oct.	130.0	2.4	145.7	5.6	133.3	3.1	132.3	3.2	121.6	0.3
Nov. ...	129.5	2.1	147.2	4.5	132.7	2.9	130.6	2.2	121.5	0.5
Dec. ...	130.5	1.4	154.0	-6.8	133.3	3.2	131.5	2.7	121.8	0.9
2003 Jan.	131.0	0.5	155.6	-14.2	134.3	3.5	131.2	1.4	122.4	1.4
Feb.	133.0	2.6	172.7	2.5	135.2	4.1	132.3	1.9	122.7	1.6
March ..	133.7	2.0	181.0	4.9	135.4	3.0	132.4	0.0	122.7	1.4
Apr.	133.0	1.0	183.4	6.5	134.5	1.8	130.6	-2.2	122.4	1.0
May	132.6	2.4	188.3	28.1	134.3	1.7	127.8	-3.3	122.3	0.9
June ...	132.5	3.1	177.5	26.6	134.4	2.2	130.5	-0.3	122.3	1.0
July	131.9	2.9	164.3	20.9	134.9	2.1	131.3	0.7	122.4	1.2
Aug. ...	132.1	2.2	159.7	10.6	135.8	2.5	131.7	0.7	122.6	1.0
Sept. ...	131.9	1.5	155.8	5.6	136.4	2.5	131.3	-0.7	122.7	0.9
Oct.	132.4	1.9	156.6	7.5	136.8	2.7	132.6	0.2	122.6	0.9
Nov. ...	132.9	2.6	158.9	7.9	137.4	3.5	133.0	1.8	122.6	0.9
Dec. ...	133.1	2.0	163.0	5.9	137.3	3.0	132.9	1.1	122.5	0.6
2004 Jan.	134.1	2.3	172.1	10.6	137.9	2.7	133.7	1.9	122.4	0.0
Feb.	134.8	1.4	180.9	4.7	138.6	2.5	132.9	0.5	122.5	-0.1
March ..	135.8	1.6	179.7	-0.7	139.6	3.1	135.5	2.3	122.7	0.0
Apr.	136.7	2.8	179.2	-2.3	141.2	5.0	136.6	4.6	123.2	0.7
May	136.7	3.1	172.2	-8.5	142.2	5.9	137.4	7.5	123.1	0.7
June ...	135.0	1.9	153.6	-13.5	141.7	5.4	136.8	4.8	123.0	0.6
July	134.9	2.3	150.9	-8.2	142.0	5.3	136.7	4.1	123.1	0.5
Aug. ...	134.9	2.2	148.4	–7.1	142.4	4.9	136.9	4.0	123.1	0.3

1 For home consumption.

Source: Calculations based on NSSG data.

Table 4

Gross value added at basic prices and gross domestic product at market prices

	Million euro	Annual percentage changes (at constant prices of year 1995)					
	1995	1999	2000	2001	2002	2003	2004
Primary sector (agriculture)	7,277	3.5	–3.7	–3.8	–1.1	–4.0	. . .
Secondary sector	16,550	2.4	5.4	6.9	1.9	5.8	. . .
Mining and quarrying	476	–17.9	23.1	2.2	8.5	–4.8	. . .
Manufacturing	9,572	1.3	4.6	3.3	2.4	2.5	. . .
Electricity - natural gas - water supply	1,751	13.4	4.8	1.4	1.8	6.3	. . .
Construction	4,751	2.3	5.7	14.4	0.8	11.2	. . .
Tertiary sector	50,031	2.0	5.0	5.0	3.7	4.8	. . .
Trade	10,018	–0.8	3.1	11.4	1.4	6.7	. . .
Hotels - restaurants	4,821	–5.7	5.4	6.2	5.2	5.3	. . .
Transport - communications	4,978	33.4	16.2	1.3	5.9	6.0	. . .
Financial intermediaries	3,112	11.0	10.0	5.9	–5.2	8.9	. . .
Real estate management and other activities	12,577	–5.9	3.5	3.6	1.6	2.8	. . .
Public administration - security	5,308	0.9	–2.8	1.1	8.0	2.4	. . .
Education	3,298	–2.2	1.6	–1.2	12.2	1.4	. . .
Health	3,855	–2.0	3.0	2.6	4.9	4.9	. . .
Miscellaneous services	2,064	9.6	7.6	14.9	7.3	6.0	. . .
Gross value added	73,858	2.1	4.4	4.8	3.0	4.4	. . .
Imputed bank services	–2,175	2.8	13.8	12.1	–9.3	12.8	. . .
Gross value added at basic prices	71,683	2.1	4.1	4.5	3.5	4.1	. . .
Final consumption	70,655	2.4	4.2	1.8	3.4	3.1	3.9
Private consumption	58,405	2.5	2.0	3.0	3.0	4.4	3.6
Public consumption	12,250	2.1	14.8	–3.1	5.3	–2.5	5.5
Gross fixed capital formation	14,867	11.0	8.0	6.5	5.7	13.7	5.8
Housing	4,031	3.7	–4.3	4.8	8.8	7.3	–6.5
Other construction	5,391	6.6	8.9	8.2	0.7	13.2	12.6
Equipment	4,680	21.4	14.1	4.9	6.9	18.3	6.5
Other	765	–2.4	7.6	20.1	21.0	3.4	2.0
Change in stocks and statistical discrepancy (as a percentage of GDP)	251	0.0	0.7	0.1	0.4	0.1	0.0
Domestic final demand	85,774	3.8	5.6	2.4	4.2	5.3	4.3
Exports of goods and services	14,087	18.1	14.1	–1.1	–7.7	1.0	7.3
Exports of goods	8,344	6.3	8.7	–1.6	–7.1	4.2	–10.0
Exports of services	5,743	29.0	18.2	–0.7	–8.1	–1.3	20.0
Final demand	99,861	6.1	7.2	1.7	2.0	4.6	4.8
Imports of goods and services	19,934	15.0	15.1	–5.2	–2.9	4.8	8.3
Imports of goods	18,084	8.5	15.2	–6.3	3.2	6.6	7.5
Imports of services	1,849	52.9	14.4	–0.4	–26.5	–5.3	13.0
GDP at market prices	79,927	3.4	4.5	4.3	3.6	4.5	3.7

Source: NSSG/National Accounts, September 2004: final data for 1999 and revised data for 2000-2003. For 2004, Ministry of Economy and Finance (Draft Budget for 2005).

Table 5
Balance of payments
(Million euro)

	January - July			July		
	2002	2003	2004	2002	2003	2004
I CURRENT ACCOUNT BALANCE (I.A+I.B+I.C+I.D)	**–4,910.4**	**–5,775.3**	**–4,480.2**	**18.2**	**15.5**	**263.9**
***I.A TRADE BALANCE** (I.A.1-I.A.2)*	***–13,079.8***	***–13,267.7***	***–14,391.9***	***–1,941.7***	***–1,961.2***	***–2,223.1***
Non-oil trade balance	–11,202.8	–10,818.5	–11,995.9	–1,653.9	–1,690.6	–1,886.6
Oil trade balance	–1,877.0	–2,449.2	–2,396.0	–287.8	–270.6	–336.5
I.A.1 *Exports of goods*	*6,000.3*	*6,397.1*	*7,154.5*	*989.3*	*968.8*	*1,097.2*
Fuel	665.4	783.7	802.6	89.4	83.1	128.1
Other goods	5,334.9	5,613.4	6,351.9	899.9	885.7	969.1
I.A.2 *Imports of goods*	*19,080.1*	*19,664.8*	*21,546.4*	*2,931.0*	*2,930.0*	*3,320.3*
Fuel	2,542.4	3,232.9	3,198.6	377.2	353.7	464.6
Other goods	16,537.7	16,431.9	18,347.8	2,553.8	2,576.3	2,855.7
***I.B SERVICES BALANCE** (I.B.1-I.B.2)*	***5,539.2***	***5,929.9***	***7,789.2***	***1,918.4***	***1,951.5***	***2,128.8***
I.B.1 *Receipts*	*11,504.2*	*11,385.2*	*14,175.1*	*2,890.2*	*2,828.3*	*3,129.6*
Travel	5,064.7	4,640.4	4,815.0	1,913.9	1,780.0	1,710.0
Transport	5,034.3	5,444.5	7,659.6	764.5	838.0	1,146.4
Other goods	1,405.1	1,300.3	1,700.4	211.8	210.3	273.2
I.B.2 *Payments*	5,965.0	5,455.3	6,385.8	971.7	876.8	1,000.9
Travel	1,301.7	1,033.3	1,210.5	266.9	156.9	180.0
Transport	2,977.0	2,763.1	3,297.3	436.4	410.1	501.5
Other services	1,686.3	1,658.9	1,878.1	268.5	309.8	319.4
***I.C INCOME BALANCE** (I.C.1-I.C.2)*	***–1,242.2***	***–1,802.7***	***–1,758.8***	***–144.3***	***–320.3***	***–291.7***
I.C.1 *Receipts*	*991.4*	*989.5*	*917.7*	*156.5*	*157.3*	*152.9*
Wages. salaries	329.8	203.6	168.7	47.4	36.6	26.7
Interest. dividends. profits	661.6	785.9	749.1	109.1	120.7	126.1
I.C.2 *Payments*	2,233.6	2,792.2	2,676.5	300.8	477.5	444.5
Wages. salaries	155.9	90.5	104.1	22.3	15.6	16.1
Interest. dividends. profits	2,077.7	2,701.6	2,572.5	278.6	462.0	428.5
***I.D TRANSFERS BALANCE** (I.D.1-I.D.2)*	***3,872.3***	***3,365.2***	***3,881.3***	***185.8***	***345.4***	***649.9***
I.D.1 *Receipts*	*5,356.7*	*4,797.7*	*5,561.5*	*364.2*	*582.8*	*902.2*
General government (mainly transfers from the EU)	4,087.2	3,387.4	4,066.0	160.3	333.6	656.7
Other sectors (emigrants' remittances etc.)	1,269.6	1,410.4	1,495.5	203.9	249.2	245.5
I.D.2 *Payments*	1,484.4	1,432.6	1,680.3	178.4	237.3	252.3
General government (mainly payments to the EU)	1,106.5	1,119.4	1,311.8	121.3	187.3	199.9
Other sectors	377.9	313.2	368.5	57.1	50.1	52.4
II FINANCIAL ACCOUNT BALANCE (II.A+II.B+II.C+II.D)	**5,493.5**	**5,876.6**	**5,344.4**	**464.3**	**78.1**	**–1.7**
***II.A DIRECT INVESTMENT**[1]*	***–333.0***	***–579.7***	***435.4***	***–159.4***	***–36.5***	***89.0***
By residents abroad	–368.1	–416.4	–312.3	–149.6	–50.5	–89.5
By non-residents in Greece	35.1	–163.3	747.6	–9.9	14.1	178.5
***II.B PORTFOLIO INVESTMENT**[1]*	***6,055.7***	***10,520.4***	***6,845.7***	***–460.1***	***–907.8***	***1.274.8***
Assets	–1,710.2	–5,238.5	–6,820.8	–271.5	–241.7	–559.9
Liabilities	7,765.9	15,758.9	13,666.5	–188.6	–666.0	1.834.8
***II.C OTHER INVESTMENT**[1]*	***1,293.8***	***–8,022.1***	***–3,067.6***	***1.486.8***	***1,132.3***	***–1,229.6***
Assets	–7,119.8	–3,636.3	–7,561.2	–3,052.8	691.9	–897.6
Liabilities	8,413.6	–4,385.7	4,493.6	4,539.6	440.4	–332.0
(General government loans)	–2,123.7	–1,882.6	–372.1	–168.8	–24.6	–58.5
***II.D CHANGE IN RESERVE ASSETS**[2]*	***–1,523.0***	***3,958.0***	***1,131.0***	***–403.0***	***–110.0***	***–136.0***
III ERRORS AND OMISSIONS	**–583.1**	**–101.3**	**–864.3**	**–482.5**	**–93.6**	**–262.1**
RESERVE ASSETS[3]				8,554.0	5,056.0	3,474.0

1 (+) net inflow, (–) net outflow.
2 (+) decrease, (–) increase.
3 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" at 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.
Source: Bank of Greece.

Table 6

Monetary aggregates in the euro area[1,2]

(Outstanding balances in billion euro, not seasonally adjusted)

End of period	Currency in circulation (1)	Overnight deposits (2)	**M1** (3)=(1)+(2)	Deposits with agreed maturity up to two years (4)	Deposits redeemable at notice up to three months (5)	**M2** (6)=(3)+(4)+(5)	Repurchase agreements (7)	Money market fund shares/units (8)	Money market paper and debt securities up to two years (9)	**M3**[3] (10)=(6)+(7)+(8)+(9)
2000	348.4	1,784.4	2,132.8	991.8	1,165.5	4,290.0	174.9	300.0	135.7	4,900.7
2001	239.7	2,040.6	2,280.3	1,088.8	1,316.3	4,685.4	218.5	398.0	145.9	5,447.8
2002	341.2	2,158.3	2,499.4	1,075.7	1,406.3	4,981.4	226.9	470.5	127.6	5,806.4
2003	397.9	2,331.5	2,729.4	1,039.0	1,529.6	5,298.0	208.7	581.8	87.7	6,176.1
2002 Jan.	246.7	1,993.4	2,240.0	1,081.0	1,335.0	4,856.1	216.2	416.6	141.8	5,430.7
Feb.	240.6	1,997.9	2,228.3	1,076.8	1,339.1	4,644.2	221.1	427.0	138.8	5,431.0
March ..	254.3	1,984.4	2,238.7	1,088.5	1,343.1	4,670.2	229.6	431.2	137.2	5,468.4
Apr.	261.7	2,016.5	2,278.1	1,092.1	1,336.1	4,706.3	228.1	437.5	134.7	6,508.6
May	273.8	2,016.7	2,290.5	1,099.6	1,338.1	4,728.2	234.8	442.6	144.0	5,549.6
June	285.7	2,064.1	2,349.8	1,074.9	1,343.5	4,768.2	229.6	439.1	132.8	5,569.6
July	296.6	2,031.5	2,328.1	1,083.7	1,346.5	4,758.3	228.8	450.1	125.5	5,562.7
Aug.	301.1	2,000.3	2,301.5	1,096.9	1,351.9	4,750.3	236.5	463.4	126.5	5,576.7
Sept.	306.7	2,057.8	2,364.4	1,073.6	1,354.1	4,792.1	238.3	460.9	131.3	5,622.7
Oct.	313.9	2,041.2	2,355.1	1,093.7	1,362.2	4,811.0	235.6	463.1	133.7	5,643.4
Nov.	321.4	2,093.2	2,414.6	1,086.3	1,374.6	4,875.5	229.6	477.6	131.1	5,713.6
Dec.	341.2	2,158.3	2,499.4	1,075.7	1,406.3	4,981.4	226.9	470.5	127.6	5,806.4
2003 Jan.	312.1	2,128.7	2,440.8	1,077.2	1,405.5	4,923.5	232.8	534.9	109.1	5,800.4
Feb.	319.3	2,131.9	2,451.2	1,079.6	1,420.7	4,951.5	233.3	547.2	109.0	5,841.0
March ..	327.2	2,170.2	2,497.2	1,072.9	1,435.8	5,006.2	224.0	555.3	101.3	5,886.8
Apr.	336.3	2,190.9	2,527.2	1,082.1	1,443.1	5,052.4	230.5	563.0	123.8	5,969.7
May	343.8	2,217.7	2,081.5	1,097.4	1,450.5	5,109.4	231.7	571.1	104.9	6,017.2
June	351.0	2,254.4	2,605.4	1,060.6	1,464.0	5,130.1	215.0	570.8	96.6	6,012.5
July	361.5	2,223.3	2,564.8	1,064.1	1,475.3	5,124.3	219.9	585.6	90.8	6,020.6
Aug.	362.7	2,210.5	2,573.2	1,070.1	1,482.7	5,126.0	217.1	587.8	89.6	6,020.4
Sept.	364.6	2,250.7	2,615.6	1,038.6	1,482.8	5,136.9	211.5	576.9	91.2	6,016.6
Oct.	311.3	2,249.1	2,620.4	1,049.6	1,487.9	5,157.9	224.7	582.3	100.8	6,065.8
Nov.	379.2	2,289.6	2,667.8	1,043.6	1,494.8	5,206.1	224.7	584.7	100.9	6,116.4
Dec.	397.9	2,331.5	2,729.4	1,039.0	1,529.6	5,298.0	208.7	581.8	87.7	6,176.1
2004 Jan.	389.1	2,313.9	2,703.1	1,021.5	1,547.2	5,271.7	214.6	591.6	91.0	6,168.9
Feb.	393.5	2,310.1	2,703.5	1,016.2	1,553.8	5,273.5	228.6	599.2	92.0	6,193.3
March ..	399.6	2,346.1	2,745.7	1,005.3	1,559.2	5,310.2	217.9	602.1	89.8	6,220.0
Apr.	409.4	2,371.2	2,770.9	1,005.0	1,567.5	5,344.4	225.5	611.4	94.7	6,276.1
May	416.6	2,371.2	2,787.8	1,015.1	1,573.4	5,376.3	221.9	609.5	89.3	6,297.0
June	423.0	2,411.7	2,834.7	989.5	1,585.6	5,409.8	217.9	608.6	94.0	6,330.3
July	436.2	2,398.1	2,834.3	1,000.4	1,593.3	5,428.0	222.9	613.0	90.3	6,354.2
Aug.* ...	433.4	2,363.0	2,796.4	1,003.2	1,598.9	5,398.5	225.9	624.5	91.3	6,340.3

1 Monetary aggregates comprise monetary liabilities of MFIs and central government (Post Office, Treasury) vis-à-vis non-MFI euro area residents excluding central government.
2 Data for the euro area until the end of 2000 concern the Euro-11. As from 1 January 2001. they concern the Euro-12.
3 M3 and its components exclude holdings by non-residents of the euro area of money market fund shares/units, money market paper and debt securities up to 2 years.
* Provisional data.
Source: ECB.

Table 7

The Greek contribution to the monetary aggregates of the euro area[1]

(Outstanding balances in billion euro. not seasonally adjusted)

End of period	Overnight deposits (1)=(1.1)+(1.2)	Sight deposits and current accounts (1.1)	Savings deposits (1.2)	Deposits with an agreed maturity up to two years (2)	Deposits redeemable at notice up to three months[2] (3)	Repurchase agreements (repos) (4)	Money market fund shares/units (5)	Debt securities up to two years (6)	Total[3] (M3 excluding currency in circulation) (7)=(1)+(2)+ +(3)+(4)+ +(5)+(6)
2000	61.2	13.3	47.9	28.9	2.0	18.5	15.4	0.2	126.2
2001	70.8	16.1	54.7	29.4	2.4	24.2	9.7	0.1	136.7
2002	71.7	15.2	56.5	28.9	2.3	20.0	10.7	0.2	133.8
2003	79.5	17.6	61.9	32.3	2.0	10.8	15.7	0.5	140.8
2002 Jan.	69.2	14.3	54.9	26.5	2.4	23.9	9.8	0.1	131.9
Feb.	68.9	13.8	55.1	27.3	2.4	23.0	9.4	0.1	131.1
March ..	67.4	12.5	54.9	27.2	2.4	24.2	9.3	0.1	130.7
Apr.	69.3	13.7	55.6	26.9	2.4	22.9	8.9	0.0	130.4
May	69.0	13.3	55.7	26.6	2.4	22.8	8.9	0.0	129.8
June	70.6	14.2	56.4	26.0	2.3	22.6	8.7	0.0	130.2
July	70.8	14.3	56.5	26.0	2.3	22.5	8.9	0.0	130.6
Aug.	71.3	14.1	57.2	26.3	2.3	22.8	8.9	0.1	131.7
Sept.	72.3	14.7	57.6	25.4	2.3	22.9	9.1	0.1	132.2
Oct.	70.0	13.5	56.5	26.6	2.3	23.2	9.0	0.1	131.2
Nov.	69.1	13.3	55.8	27.3	2.3	22.0	9.1	0.2	130.0
Dec.	71.7	15.2	56.5	28.9	2.3	20.0	10.7	0.2	133.8
2003 Jan.	70.3	14.2	56.1	28.9	2.2	20.2	12.0	0.2	133.7
Feb.	71.8	14.4	57.4	27.1	2.2	19.2	12.9	0.2	133.5
March ..	72.5	14.9	57.6	27.3	2.2	16.8	14.1	0.2	133.2
Apr.	72.7	14.6	58.1	28.7	2.2	16.3	14.4	0.3	134.7
May	71.9	14.5	57.4	28.8	2.0	15.7	14.7	0.3	133.4
June	74.9	16.7	58.2	29.7	2.1	13.5	15.7	0.4	136.3
July	72.9	15.8	57.1	32.0	2.1	13.0	15.8	0.4	136.3
Aug.	74.0	16.1	57.9	33.0	2.2	12.2	15.7	0.4	137.5
Sept.	74.9	17.1	57.8	32.7	2.1	12.0	15.6	0.4	137.7
Oct.	74.0	16.2	57.8	33.3	2.1	11.8	15.6	0.5	137.3
Nov.	74.1	15.4	58.7	32.9	2.1	11.6	15.5	0.5	136.7
Dec.	79.5	17.6	61.9	32.3	2.0	10.8	15.7	0.5	140.8
2004 Jan.	79.5	17.2	61.6	32.5	2.1	10.6	15.2	0.5	139.7
Feb.	79.6	17.3	62.3	32.1	2.1	10.5	15.2	0.5	139.9
March ..	82.1	17.8	64.3	31.8	2.1	9.5	15.8	0.4	141.6
Apr.	81.4	17.8	63.6	33.5	2.2	9.1	15.9	0.4	142.5
May	82.5	17.0	65.5	32.2	2.1	8.9	15.6	0.4	141.8
June	84.9	18.3	66.6	32.4	2.1	9.4	15.8	0.4	145.0
July	85.5	18.3	67.2	33.0	2.1	9.3	15.9	0.4	146.2
Aug.	84.9	17.7	67.2	33.2	2.1	9.6	15.8	0.4	146.1

1 The Greek contribution begins upon Greece's entry into the euro area (1 January 2001). For statistical reasons, however, the data on monetary aggregates were extended to cover previous years as well.
2 Including savings deposits in currencies other than the euro.
3 As in all other euro area countries, Greece's M3 can no longer be calculated accurately, since part of the quantity of euro banknotes and coins in circulation in each country is held by residents of other euro area countries (as well as non-euro area residents). Owing to these technical problems, the compilation of the Greek M0, M1, M2 and M3 was discontinued in January 2003.
Source: Bank of Greece.

Table 8

Greece: deposits of domestic firms and households with Other MFIs,[1] by currency and type

(Outstanding balances in million euro, not seasonally adjusted)

End of period	Total deposits	Breakdown by currency		Breakdown by type		
		Deposits in euro[2]	Deposits in other currencies	Sight deposits	Savings deposits	Time deposits[3]
2000	90,737.8	73,720.2	17,017.6	11,007.0	50,917.8	28,813.0
2001	101,809.5	79,566.0	22,243.5	13,385.2	58,323.1	30,101.1
2002	104,761.1	87,732.3	17,028.8	13,367.3	60,406.1	30,987.7
2003	115,750.1	98,119.3	17,630.8	15,395.8	65,141.1	35,213.2
2002 Jan.	97,542.0	78,693.6	18,848.4	11,839.1	58,355.2	27,347.7
Feb.	98,302.4	79,029.9	19,272.4	11,356.7	58,674.4	28,271.3
March	96,741.8	77,970.2	18,771.6	10,267.5	58,309.6	28,164.7
Apr.	98,685.7	80,274.3	18,411.5	11,584.4	58,979.2	28,122.2
May	97,779.9	79,934.6	17,845.3	10,795.2	59,174.0	27,810.7
June	98,751.5	81,549.4	17,202.1	11,758.3	59,654.1	27,339.2
July	99,132.9	81,816.4	17,316.4	11,888.0	59,768.1	27,476.8
Aug.	99,924.1	82,255.7	17,668.4	11,656.2	60,475.4	27,792.5
Sept.	101,076.4	84,497.2	16,579.2	12,328.6	61,820.2	26,927.6
Oct.	100,492.7	83,175.9	17,316.8	11,399.8	60,572.9	28,519.9
Nov.	100,771.6	83,612.4	17,159.2	11,686.3	59,933.8	29,151.4
Dec.	104,761.1	87,732.3	17,028.8	13,367.3	60,406.1	30,987.7
2003 Jan.	102,687.7	85,423.3	17,264.4	11,703.0	59,707.7	31,277.0
Feb.	102,455.9	85,527.5	16,928.4	12,419.8	60,981.4	29,054.7
March	103,684.4	86,637.5	17,046.9	12,996.7	61,203.6	29,484.0
Apr.	105,407.4	87,642.8	17,764.6	12,664.5	61,690.6	31,052.2
May	104,593.8	86,997.3	17,596.5	12,586.4	60,809.6	31,197.8
June	108,637.5	90,199.0	18,438.5	14,702.7	61,700.5	32,234.3
July	108,694.9	89,934.1	18,760.8	13,670.6	60,471.2	34,553.1
Aug.	110,793.2	91,498.3	19,294.9	14,035.9	61,242.3	35,515.0
Sept.	111,384.5	92,881.7	18,502.8	14,958.4	61,151.5	35,274.5
Oct.	111,068.9	92,207.8	18,861.1	14,024.4	61,020.5	36.024.0
Nov.	110,668.9	92,383.7	18,285.2	13,157.4	61,846.9	35,664.6
Dec.	115,750.1	98,119.3	18,630.8	15,395.8	65,141.1	35,213.2
2004 Jan.	114,996.0	96,977.6	18,018.4	14,874.7	64,645.4	35,476.0
Feb.	115,491.9	97,036.0	18,455.9	15,089.7	66,332.2	34,070.0
March	117,571.4	98,647.3	18,924.1	15,479.0	67,322.0	34,770.4
Apr.	118,835.4	99,526.4	19,309.0	15,687.6	66,697.8	36,450.0
May	118,645.4	99,905.7	18,739.7	14,995.6	68,548.9	35,100.9
June	120,997.2	102,774.4	18,222.8	16,078.1	69,641.4	35,277.7
July	122,396.3	103,778.5	18,617.8	16,368.9	70,186.6	35,840.9
Aug.	122,065.6	103,347.9	18,717.7	15,579.5	70,397.0	36,089.1

1 Other Monetary Financial Institutions (Other MFIs) comprise credit institutions other than the Bank of Greece and money market funds.
2 Including (until 31 December 2001) deposits in drachmas and the other euro legacy currencies.
3 Including blocked deposits.
Source: Bank of Greece.

Table 9

ECB and Bank of Greece interest rates

(Percentages per annum)

1. ECB interest rates

With effect from:[1]		Deposit facility	Main refinancing operations[3]	Marginal lending facility
1999	1 Jan.	2.00	3.00	4.50
	4 Jan.[2]	2.75	3.00	3.25
	22 Jan.	2.00	3.00	4.50
	9 Apr.	1.50	2.50	3.50
	5 Nov.	2.00	3.00	4.00
2000	4 Feb.	2.25	3.25	4.25
	17 March	2.50	3.50	4.50
	28 Apr.	2.75	3.75	4.75
	9 June	3.25	4.25	5.25
	28 June[3]	3.25	4.25	5.25
	1 Sept.	3.50	4.50	5.50
	6 Oct.	3.75	4.75	5.75
2001	11 May	3.50	4.50	5.50
	31 Aug.	3.25	4.25	5.25
	18 Sept.	2.75	3.75	4.75
	9 Nov.	2.25	3.25	4.25
2002	6 Dec.	1.75	2.75	3.75
2003	7 March	1.50	2.50	3.50
	6 June	1.00	2.00	3.00

2. Bank of Greece interest rates

With effect from:		Overnight deposit facility – first tier[4]	Overnight deposit facility – second tier[4]	14-day intervention rate	Lombard rate
1999	14 Jan.	11.50	9.75	12.00	13.50
	21 Oct.	11.00	9.75	11.50	13.00
	16 Dec.	10.25	9.25	10.75	12.25
	27 Dec.	10.25	9.00	10.75	11.50
2000	27 Jan.	9.50	8.50	9.75	11.00
	9 March	8.75	8.00	9.25	10.25
	20 Apr.	8.00	7.50	8.75	9.50
	29 June	7.25	–	8.25	9.00
	6 Sept.	6.50	–	7.50	8.25
	15 Nov.	6.00	–	7.00	7.75
	29 Nov.	5.50	–	6.50	7.25
	13 Dec.	4.75	–	5.75	6.50
	27 Dec.	3.75	–	4.75	5.75

1 The date refers to the deposit and marginal lending facilities. For main refinancing operations, unless otherwise indicated, changes in the rate are effective from the first operation following the date indicated. The change on 18 September 2001 was effective on that same day.

2 On 22 December 1998 the ECB announced that, as an exception measure between 4 and 21 January 1999, a narrow corridor of 50 basis points would be applied between the interest rates for the marginal lending facility and the deposit facility, aimed at facilitating the transition to the new regime by market participants.

3 Until 21 June 2000: fixed rate tenders, from 28 June 2000: minimum bid rate in variable rate tenders.

4 On 29 June 2000 the second tier of the deposit facility was abolished; the interest rate thereafter applies to the unified deposit acceptance account.

Sources: ECB and Bank of Greece.

Table 10
Money market interest rates
(Percentages per annum, period averages)

Period	Overnight deposits[1]	1-month deposits[2]	3-month deposits[2]	6-month deposits[2]	9-month deposits[2]	12-month deposits[2]
2000	8.24	8.28	7.89	7.32	6.90	6.55
2001	4.39	4.33	4.26	4.15	4.10	4.08
2002	3.29	3.30	3.32	3.35	3.41	3.49
2003	2.32	2.35	2.33	2.31	2.31	2.34
2002 Jan.	3.29	3.35	3.34	3.34	3.39	3.48
Feb.	3.28	3.34	3.36	3.40	3.48	3.59
March	3.26	3.35	3.39	3.50	3.65	3.82
Apr.	3.32	3.34	3.41	3.54	3.70	3.86
May	3.31	3.37	3.46	3.62	3.80	3.95
June	3.35	3.38	3.46	3.59	3.73	3.87
July	3.30	3.36	3.41	3.48	3.54	3.64
Aug.	3.29	3.33	3.35	3.38	3.40	3.44
Sept.	3.32	3.32	3.31	3.27	3.23	3.24
Oct.	3.30	3.31	3.26	3.17	3.12	3.13
Nov.	3.30	3.23	3.12	3.04	3.01	3.02
Dec.	3.09	2.98	2.94	2.89	2.87	2.87
2003 Jan.	2.79	2.86	2.83	2.76	2.72	2.71
Feb.	2.76	2.77	2.69	2.58	2.53	2.50
March	2.75	2.60	2.53	2.45	2.42	2.41
Apr.	2.56	2.58	2.53	2.47	2.45	2.45
May	2.56	2.52	2.40	2.32	2.27	2.26
June	2.21	2.18	2.15	2.08	2.04	2.01
July	2.08	2.13	2.13	2.09	2.07	2.08
Aug.	2.10	2.12	2.14	2.17	2.21	2.28
Sept.	2.02	2.13	2.15	2.18	2.21	2.26
Oct.	2.01	2.10	2.14	2.17	2.23	2.30
Nov.	1.97	2.09	2.16	2.22	2.31	2.41
Dec.	2.06	2.13	2.15	2.20	2.28	2.38
2004 Jan.	2.02	2.08	2.09	2.12	2.15	2.22
Feb.	2.03	2.06	2.07	2.09	2.11	2.16
March	2.01	2.04	2.03	2.02	2.02	2.06
Apr.	2.08	2.05	2.05	2.06	2.11	2.16
May	2.02	2.06	2.09	2.14	2.21	2.30
June	2.03	2.08	2.11	2.19	2.29	2.40
July	2.07	2.08	2.12	2.19	2.26	2.36
Aug.	2.04	2.08	2.11	2.17	2.22	2.30
Sept.	2.05	2.08	2.12	2.20	2.28	2.38

1 Until end-December 2000: interbank overnight rate in Greece. As from January 2001: euro overnight index average (EONIA).
2 Until end-December 2000: interbank rates (ATHIBOR). As from January 2001: euro interbank offered rates (EURIBOR).
Sources: Bank of Greece and Bloomberg.

T a b l e 11

Greek government paper yields

(Percentages per annum, period averages)

Period	Yield on one-year Treasury bills	Bond yields					
		3-year	5-year	7-year	10-year	15-year	20-year
2000	6.22	5.99	5.98	6.05	6.10	6.26	6.35
2001	4.08	4.28	4.58	4.82	5.30	5.51	5.76
2002	3.50	4.06	4.45	4.78	5.12	5.24	5.52
2003	2.34	2.82	3.37	3.83	4.27	4.32	4.91
2002 Jan.	3.48	4.27	4.51	4.95	5.24	5.36	5.55
Feb.	3.59	4.37	4.73	5.07	5.31	5.41	5.60
March	3.81	4.58	5.00	5.27	5.51	5.58	5.78
Apr.	3.86	4.59	4.99	5.27	5.51	5.60	5.84
May	3.98	4.63	5.00	5.27	5.52	5.60	5.86
June	3.87	4.46	4.81	5.09	5.36	5.47	5.71
July	3.65	4.23	4.59	4.90	5.21	5.33	5.57
Aug.	3.44	3.90	4.29	4.60	4.95	5.07	5.34
Sept.	3.24	3.59	3.98	4.33	4.73	4.86	5.18
Oct.	3.13	3.52	3.95	4.34	4.79	4.94	5.32
Nov.	3.02	3.40	3.87	4.26	4.76	4.90	5.33
Dec.	2.87	3.19	3.63	4.05	4.58	4.71	5.13
2003 Jan.	2.70	2.91	3.36	3.81	4.43	4.51	4.97
Feb.	2.50	2.65	3.31	3.89	4.24	4.27	4.83
March	2.41	2.82	3.38	3.83	4.26	4.33	4.90
Apr.	2.46	2.99	3.50	3.96	4.38	4.45	5.02
May	2.25	2.64	3.12	3.57	4.02	4.09	4.73
June	2.02	2.38	2.88	3.33	3.81	3.86	4.57
July	2.08	2.62	3.18	3.65	4.12	4.16	4.83
Aug.	2.28	2.98	3.51	3.91	4.29	4.34	4.90
Sept.	2.26	2.91	3.47	3.91	4.32	4.37	4.96
Oct.	2.30	2.94	3.52	3.95	4.38	4.43	5.02
Nov.	2.41	3.06	3.67	4.09	4.51	4.55	5.10
Dec.	2.38	2.97	3.58	4.02	4.45	4.49	5.04
2004 Jan.	2.21	2.71	3.34	3.81	4.37	4.33	4.94
Feb.	2.17	2.91	3.28	3.90	4.35	4.28	4.91
March	2.06	2.71	3.26	3.71	4.17	4.43	4.75
Apr.	2.16	2.90	3.45	3.90	4.35	4.72	4.88
May	2.30	3.08	3.63	4.07	4.49	4.86	5.01
June	2.41	3.19	3.73	4.15	4.55	4.89	5.03
July	2.36	3.07	3.61	4.03	4.44	4.79	4.93
Aug..	2.30	2.91	3.43	3.85	4.28	4.63	4.78
Sept.	2.37	2.91	3.40	3.79	4.22	4.56	4.70

Source: Bank of Greece.

Table 12

Greece: domestic MFI loans to domestic firms and households, by branch of economic activity

(Balances in million euro)

End of period		Total	In euro	In foreign currency	Branch of economic activity: Agriculture	Industry[1]	Trade	Housing	Tourism	Consumer credit	Other
2000	. . . .	59,330.0	50,065.6	9,264.4	3,884.9	11,823.7	12,374.2	11,271.9	1,814.3	5,511.3	12,649.7
2001	. . . .	74,027.4	66,722.6	7,304.8	3,724.2	12,614.9	15,524.3	15,652.2	2,171.3	7,852.0	16,488.5
2002	. . . .	86,510.5	80,099.7	6,410.8	3,224.7	14,364.0	15,670.8	21,224.7	2,903.2	9,755.4	19,367.7
2003	. . . .	10,178.1	95,649.4	5,528.7	3,082.7	15,865.1	16,514.4	26,534.2	3,488.2	1,.409.6	23,283.9
2002	Jan.	73,982.0	66,648.1	7,333.9	3,230.0	12,435.1	15,174.6	16,024.7	2,236.0	7,783.7	17,097.9
	Feb.. . . .	75,202.2	67,723.9	7,478.3	3,030.3	12,724.5	15,846.7	16,417.5	2,267.5	7,944.7	16,971.0
	March . .	76,235.3	69,080.0	7,155.3	3,139.4	13,168.1	15,788.0	16,891.9	2,316.4	8,129.8	16,801.7
	Apr.. . . .	76,958.0	69,886.9	7,071.1	3,196.1	12,801.1	15,939.4	17,362.1	2,341.0	8,301.2	17,017.1
	May . . .	78,009.6	71,192.8	6,816.8	3,193.0	12,912.6	16,064.7	17,721.8	2,372.2	8,508.3	17,237.0
	June . . .	79,960.9	73,475.3	6,485.6	3,167.7	13,360.0	16,516.2	18,194.3	2,414.5	8,678.1	17,630.1
	July	81,233.9	74,622.8	6,611.1	3,167.7	13,720.8	16,570.9	18,759.9	2,411.6	8,868.0	17,735.0
	Aug. . . .	82,041.4	75,311.8	6,729.6	3,191.4	13,625.4	16,580.6	19,304.9	2,399.3	8,997.7	17,942.1
	Sept. . . .	82,662.6	75,930.7	6,731.9	3,212.8	13,785.6	16,059.8	19,503.8	2,560.0	9,228.1	18,312.5
	Oct. . . .	83,996.1	77,164.1	6,832.0	3,221.6	13,961.2	16,161.2	19,914.7	2,635.0	9,420.9	18,681.5
	Nov. . . .	85,614.8	78,732.9	6,881.9	3,167.1	14,528.2	15,663.2	20,416.6	2,761.1	9,612.9	19,465.7
	Dec. . . .	86,510.5	80,099.7	6,410.8	3,224.7	14,364.0	15,670.8	21,224.7	2,903.2	9,755.4	19,367.7
2003	Jan.	88,241.8	81,751.6	6,490.2	2,964.2	14,529.2	16,321.5	21,599.4	2,978.4	9,884.9	19,964.2
	Feb.. . . .	88,787.7	82,332.2	6,455.5	2,980.5	14,485.6	16,310.3	22,062.6	3,049.0	1,023.3	19,876.4
	March . .	89,363.0	83,075.2	6,287.8	2,994.0	14,422.3	16,053.5	22,366.8	3,095.5	1,247.3	20,183.6
	Apr.. . . .	90,770.3	84,710.6	6,059.7	3,043.0	14,565.0	16,113.4	22,747.1	3,149.2	1,344.7	20,807.9
	May . . .	92,497.1	86,811.4	5,685.7	3,027.6	14,866.7	16,488.6	23,183.1	3,085.8	1,432.6	21,412.7
	June . . .	94,344.1	88,447.4	5,896.7	3,062.3	15,165.2	16,139.3	23,705.7	3,201.0	1,600.9	22,469.7
	July	96,253.7	90,203.0	6,050.7	3,062.9	15,674.1	16,307.5	24,267.2	3,207.5	1,871.8	22,862.7
	Aug. . . .	97,350.8	91,177.5	6,173.3	3,102.1	15,681.4	16,700.8	24,573.2	3,255.1	11,075.2	22,963.0
	Sept. . . .	97,747.2	91,865.5	5,881.7	3,103.0	15,544.4	16,612.9	25,043.9	3,278.1	11,301.1	22,863.8
	Oct. . . .	98,403.4	92,480.6	5,922.8	3,117.3	15,481.2	16,393.0	25,559.5	3,321.0	11,670.4	22,861.0
	Nov. . . .	99,829.3	94,044.9	5,784.4	3,093.6	15,780.9	16,633.3	25,808.6	3,392.4	12,063.2	23,057.3
	Dec. . . .	101,178.1	95,649.4	5,528.7	3,082.7	15,865.1	16,514.4	26,534.2	3,488.2	12,409.6	23,283.9
2004	Jan.	102,748.9	96,982.9	5,766.0	3,055.4	16,005.1	16,822.7	26,902.8	3,536.8	12,690.8	23,735.3
	Feb.. . . .	103,899.7	98,214.0	5,685.7	3,042.0	15,948.2	17,060.8	27,334.5	3,587.7	13,041.9	23,884.6
	March . .	105,263.2	99,372.4	5,890.8	3,095.5	15,831.8	17,012.4	27,894.2	3,661.6	13,442.3	24,325.4
	Apr.. . . .	106,447.1	100,530.0	5,917.1	3,150.5	15,734.1	17,134.7	28,465.8	3,703.2	13,798.6	24,460.2
	May . . .	108,835.0	103,158.1	5,676.9	3,242.6	15,950.4	17,773.5	29,080.6	3,766.9	14,169.3	24,851.7
	June . . .	109,806.8	104,096.1	5,710.7	3,324.8	15,831.1	17,952.6	29,035.7	3,801.5	14,585.6	25,275.5
	July	111,624.2	105,976.3	5,647.9	3,348.0	15,997.2	18,214.6	29,822.1	3,862.7	14,985.2	25,394.4
	Aug. . . .	111,905.0	106,222.2	5,682.8	3,376.4	15,740.2	18,062.7	30,244.2	3,841.8	15,327.8	25,311.9

1 Comprising manufacturing and mining.
Source: Bank of Greece.

Table 13

Greece: bank rates on new euro-denominated deposits of, and loans to, euro area residents

(Percentages per annum)

Period		Deposits by households			Deposits by non-financial corporations		Repurchase agreements (repos)[3]
		Overnight deposits[1,2]	Savings deposits[2]	Deposits with agreed maturity up to one year[3]	Overnight deposits[2]	Deposits with agreed maturity up to one year[3]	
2002	Sept.	1.57	1.57	3.13	0.84	3.36	3.22
	Oct.	1.56	1.57	3.17	0.90	3.39	3.01
	Nov.	1.55	1.55	3.15	0.84	3.46	3.17
	Dec.	1.10	1.09	2.93	0.74	3.10	2.97
2003	Jan.	1.10	1.09	2.83	0.74	2.88	2.75
	Feb.	1.10	1.10	2.73	0.75	2.79	2.71
	March	1.06	1.05	2.68	0.69	2.40	2.54
	Apr.	1.05	1.04	2.70	0.73	2.67	2.46
	May	1.04	1.03	2.61	0.70	2.66	2.45
	June	0.82	0.81	2.44	0.55	2.41	2.10
	July	0.80	0.79	2.38	0.60	2.36	2.04
	Aug.	0.81	0.79	2.29	0.52	2.31	2.00
	Sept.	0.81	0.80	2.30	0.55	2.30	1.98
	Oct.	0.87	0.85	2.27	0.62	2.37	1.98
	Nov.	0.87	0.85	2.29	0.54	2.33	1.94
	Dec.	0.87	0.86	2.22	0.59	2.35	1.98
2004	Jan.	0.88	0.86	2.26	0.55	2.18	1.99
	Feb.	0.88	0.87	2.18	0.57	2.17	1.98
	March	0.89	0.87	2.29	0.54	2.13	1.95
	Apr.	0.89	0.88	2.26	0.56	2.13	1.97
	May	0.90	0.89	2.24	0.56	2.23	1.95
	June	0.91	0.90	2.29	0.54	2.16	1.97
	July	0.91	0.91	2.32	0.56	2.18	1.97
	Aug.	0.92	0.91	2.31	0.60	2.19	1.96

1 The rate on overnight deposits by households is the weighted average of the current account rate and the savings deposit rate.
2 End-of-month interest rate.
3 Average monthly rate.
Source: Bank of Greece.

Table 13 *(continued)*

Greece: bank rates on new euro-denominated deposits of, and loans to, euro area residents

(Percentages per annum)

Period	Loans to households[1]					Loans to non-financial corporations[1]		
		Consumer loans[4]		Housing loans[4]			With a floating rate or an initial rate fixation of up to one year[4]	
	Loans without defined maturity[2,3]	With a floating rate or an initial rate fixation of up to one year	Total consumer loans average rate	With a floating rate or an initial rate fixation of up to one year	Total housing loans average rate	Loans without defined maturity[3,5]	Up to €1 million	Over €1 million
2002 Sept.	14.40	10.86	10.43	4.62	4.74	7.31	6.64	5.33
Oct.	14.51	10.69	10.45	4.65	4.81	7.28	6.37	4.98
Nov.	14.48	10.87	10.61	4.56	4.75	7.23	5.78	4.54
Dec.	14.54	10.58	10.45	4.42	4.61	7.23	5.76	4.50
2003 Jan.	14.71	10.46	10.17	4.53	4.77	7.15	5.53	4.39
Feb.	14.68	11.13	10.60	4.58	4.81	7.09	5.59	4.27
March	14.66	10.82	10.76	4.58	4.87	7.04	5.37	4.06
Apr.	14.76	11.15	10.82	4.58	4.93	7.07	5.55	4.14
May	14.58	11.13	10.70	4.59	4.93	6.95	5.68	3.76
June	14.54	10.61	10.44	4.53	4.86	6.84	5.15	3.47
July	14.24	10.41	10.33	4.37	4.66	6.70	5.06	3.68
Aug.	14.05	10.24	10.37	4.48	4.76	6.67	4.95	3.60
Sept.	14.14	10.37	10.60	4.62	4.81	6.67	5.14	4.27
Oct.	14.22	10.57	10.58	4.57	4.81	6.68	5.24	4.68
Nov.	14.27	10.36	10.46	4.35	4.63	6.72	5.14	3.66
Dec.	14.08	9.60	9.86	4.31	4.53	6.78	5.13	3.78
2004 Jan.	13.92	9.82	9.94	4.36	4.68	6.74	5.12	3.92
Feb.	13.97	9.94	9.99	4.35	4.63	6.85	5.16	4.09
March	14.00	9.44	9.87	4.37	4.63	7.13	4.88	3.45
Apr.	14.06	9.56	9.85	4.36	4.55	7.11	5.15	3.49
May	13.79	9.82	10.07	4.33	4.54	7.02	4.91	3.45
June	13.89	9.71	10.05	4.30	4.54	7.06	4.89	3.58
July	13.84	9.60	9.67	4.24	4.43	7.03	4.84	3.53
Aug.	13.77	9.70	10.05	4.34	4.53	7.06	4.95	3.52

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