Athens, November 15, 2010

Focus Greece:

Fiscal data revisions: *Assessment & implications*

Eurostat releases 2nd notification on provisional EU27 deficit and debt figures for the period 2006-2009; revisions to Greece's past fiscal data broadly in line with market expectations

Eurostat released earlier today a second notification on provisional EU27 deficit and debt figures for the period 2006-2009. The report showed a rise in the euro area government deficit to 6.3%-of-GDP last year, from 2.0%-of-GDP in 2008, with the corresponding debt to GDP ratio reaching 79.2% in 2009 compared to 69.8%-of-GDP in the prior year. At a EU27-wide level, the fiscal deficit rose to 6.8%-of-GDP in 2009, from 2.3%-of-GDP in 2008, while the corresponding government debt-to-GDP ratios stood at 74% and 61.8% at the end of 2009 and 2008, respectively.

For Greece, the announced revisions were broadly in line with market expectations, following a number of recent press reports on their likely direction and expected size. Specifically, the 2009 general government budget deficit was re-estimated at 15.4%-of-GDP, compared to a deficit of 13.8%-of-GDP presented in the 2011 draft budget (released in mid-October). Moreover, the 2009 government debt to GDP ratio was revised to 126.8%, from a 115.4% figure recorded in the draft budget (see table below).

Revisions in Greek government deficit and government debt ratios

	2006	2007	2008	2009
Revision in government budget deficit (% of GDP)	**-2.2**	**-1.3**	**-1.8**	**-1.8**
	to -5.7 from -3.6	*to -6.4 from -5.1*	*to -9.4 from -7.7*	*to -15.4 from -13.6*
due to revision of defict	-2.2	-1.3	-1.7	-1.6
due to revision of GDP	0.0	0.0	-0.1	-0.1

	2006	2007	2008	2009
Revision in government debt (% of GDP)	**8.3**	**9.3**	**11.1**	**11.7**
	to 106.1 from 97.8	*to 105.0 from 95.7*	*to 110.3 from 99.2*	*to 126.8 from 115.1*
due to revision of debt	8.7	9.6	10.2	10.5
due to revision of GDP	-0.4	-0.3	0.9	1.2

Source: Eurostat

The upward data revisions were broadly shrugged off by the Greek government bond market (GGBs), with yields declining marginally following the news on a buy-the-rumor-sell-the-fact type of reaction and, importantly, **the lifting of Eurostat's reservations on Greece's past fiscal data expressed in the April 2010 notification**. The latter effectively means that any further revisions to the country's past fiscal data would *not* be due to *methodological* factors and thus, not nearly as significant in magnitude as the revisions instrumented in the recent past.

At the time of writing (14.40GMT, Monday Nov. 15) the yield spread of the on-the-run Greek 10-year bond vs. the corresponding German benchmark stood at ca 887bps, broadly unchanged for the day. The post-revisions spread compression was more pronounced in the intermediate segment of the GGBs curve with the 5-year yield differential over the similar-maturity German bond standing around at 1,051bps, ca 36bps down relative to levels prevailing shortly before the Eurostat announcement.

Greek government revised 2010 deficit forecast to 9.4%-of-GDP, from 7.8%-of-GDP expected earlier; debt ratio now seen reaching 144.2% at the end of this year compared to 132.7% expected earlier

Following the release of Eurosta's revisions to Greece's 2006-2009 fiscal data earlier today, the Greek Finance Ministry announced new forecasts for the general government deficit and debt figures for 2010. Specifically, the government now forecasts the overall budget deficit to amount to ca €22bn (9.4%-of-GDP) this year, which compares with an earlier deficit target of €18.5bn (7.8%-of-GDP) envisioned in the revised memorandum of understanding (MoU) agreed with the EC/ECB/IMF 'troika". Taking into account the latest upward revision to the 2009 deficit figure, the overall fiscal adjustment *(i.e., deficit reduction)* in 2010 is expected to amount to 6ppts-of-GDP vs. 5.5ppts-of-GDP expected earlier.

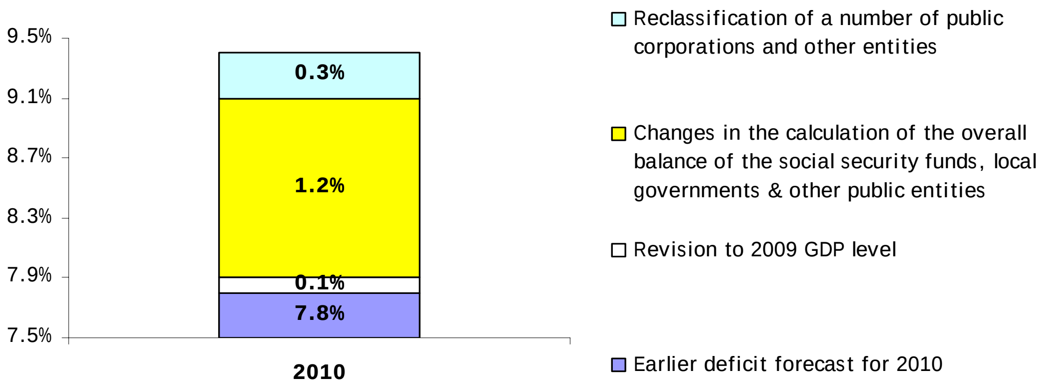
In more detail, the ca €3.5bn (~1.5ppts-of-GDP) upward revision in the 2010 general government deficit forecast is due to:

a) Methodological changes in the calculation of the overall balance of the social security funds, local governments & other public entities (expected to increase the 2010 deficit by around 1.2ppts-of-GDP relative to the earlier estimates).

b) The reclassification of 10 public corporations (DEKOs) and 3 other organizations in the calculation of the general government deficit (ESA 95 definition). This is expected to boost the 2010 deficit ratio by a further 0.3ppts-of-GDP.

c) Downward revision to 2009 GDP level, expected to increase the 2010 deficit ratio by a further 0.1ppts-of-GDP. *(Please see graph below).*

Revisions to the 2010 deficit forecast (% of GDP)



Source: FinMin

In line with the aforementioned changes to the deficit forecast for 2010 and the latest revisions to Greece's past fiscal data by Eurostat, the government now expects the debt-to-GDP ratio to rise to 144.2%-of-GDP by the end of this year. This compares with an earlier debt ratio forecast of 132.7%-of-GDP *(see 2011 draft budget).* In more detail, the significant revision to the government forecast for 2010 debt ratio is estimated to result from:

i) The incorporation of past off-market swaps in the calculation of the overall public debt stock (expected to add ca 2ppts-of-GDP to the 2010 debt ratio).

ii) The inclusion of outstanding debts of a number of public corporations and other entities (expected to add a further 7ppts-of-GDP to the 2010 ratio).

iii) Recent downward revisions in the GDP level and other adjustments (expected to increase the 2010 ratio by a further 2.5ppts-of-GDP).

Our take of the aforementioned developments and their potential implications is as follows:

First of all, Eurostat's latest revisions to Greece's 2006-09 fiscal data and the government's updated deficit forecast for 2010 were broadly in line with analyst expectations *(probably, with the exception of this year's debt ratio).* This helps to explain the market's *benign* reaction to today's announcements.

The announced revisions to the 2006-2009 deficit figures and the government's deficit forecast for this year are, to a large extent, the result of methodological changes in the calculation of the general government accounts. Furthermore, even accounting for today's revisions, the total fiscal adjustment in 2010 is expected to be as sizeable as 6ppts of GDP, compared to a deficit reduction of ca 5.5ppts-of-GDP envisioned in the updated MoU.

The silver lining in the announced revisions to Greece's past fiscal data is the lifting of Eurostat's reservations on the country's past fiscal data as expressed in the April 2010 notification.

On a less encouraging note, today's revisions suggest that if all relevant macroeconomic and market variables were to evolve in line with the projections incorporated in the EC/ECB/IMF baseline scenario, the debt to GDP ratio would pick at levels higher than these projected in the EU/IMF-agreed stabilization programme (~144% of GDP in 2012-2013). Yet, there are some potential developments that could help alleviate the aforementioned risk; specifically:

a) According to reports, the government is planning to take additional measures worth at least €4bn (~1.7ppst of GDP) in 2011 to partially compensate for the underperformance of this year's deficit target. Presumably, these measures will mainly aim to cut expenditure in the broader public sector *(i.e., loss-making public enterprises, hospitals and local governments)* and will be included in the final budget draft for next year *(to be unveiled on November 18).*

b) The extra measures noted above will reportedly be in addition to those already envisioned in the revised MoU and the 2011 budget draft *(the latter are worth 3.9ppts-of-GDP, according to IMF estimates).*

c) According to reports, the government will now be pushed to take drastic action on structural reforms and also accelerate its privatization program, with a local newspaper suggesting today that a number of crucial EU/IMF-agreed reforms will be enacted before the end of this year.

d) In a public address y-day, Prime Minister, George Papandreou, emphasized his government's commitment to exhaust its full four-year term in power and reiterated his strong commitment to the EU/IMF-backed reforms. This effectively puts the risk of early elections off the table, at least in the foreseeable future. The latter constitutes a very important development in our view, given that a credible commitment by the government on fiscal reforms is key for influencing market perceptions about medium-term fiscal sustainability.

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