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The Greek Economy & its Stability Programme

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- A restructuring of the Greek debt, a possibility currently discounted by markets, does not seem either likely or necessary
- The EU/IMF Programme has a high chance to succeed as Pros outweigh the Cons by a significant margin
- Our baseline scenario predicts a debt-to-GDP ratio of 90% in 2020 relative to EU/IMF's 119%; If growth gradually reaches historical norms by 2015, the ratio can decline below 72%
- The Greek economy has strong growth potential resulting from: strong productivity growth, public sector crowding in, structural reforms and institutions' building, potential for exports growth
- There is potential for positive surprises in fiscal consolidation: significant fiscal cushion embedded in the Programme, gradual capturing of the underground economy, scope for further decline of the public debt burden from privatizations and exploitation of public property

1. The EU/IMF adjustment programme for the Greek economy

1.1 Overview of the EU/IMF Adjustment Programme

On May 2, the Greek Government sealed an agreement with the EU, ECB and the IMF on a € 110 bn rescue package. The mechanism aims to address the immense funding problems the country is presently facing and contain the spillover effects of the debt crisis to other EU countries featuring deteriorated public finances. The new macroeconomic projections of the EU/IMF package update the projections of the Greek Stability and Growth Programme (SGP), which was submitted to the European Commission (EC) on January 15, 2010. The new projections reflect the IMF's and EC's views about the potential impact the agreed fiscal consolidation programme on the future course of the Greek economy.

The EU/IMF package aims at cutting the budget deficit by €26.1bn over a four-year period. In order for this target to be achieved, a range of new measures are introduced on top of those envisioned in the SGP and the auxiliary budget for 2010, announced by the government in early March. Note that the SGP and the March auxiliary budget were targeting a €12.5bn cut in the 2010 budget deficit. As a result, the total measures up to year 2014, envisioned under the SGP, the March 2010 auxiliary budget and the EU/IMF program amount to ca €42.5bn or 17.8% of 2009 GDP.

Reflecting a more realistic view of the present situation and incorporating the recent upward revisions to the 2009 fiscal data, the new programme targets a reduction in the general government budget deficit to sub-3.0%-of-GDP levels by the end of 2014 *i.e., two years later than projected in the SGP.* To that end, the targeted fiscal adjustment for 2010 is strengthened with additional *cost-saving and revenue-generating m*easures, expected to reduce the fiscal deficit by a further €5.8bn *i.e.,* in addition to the adjustment that was foreseen earlier. For the next 3-years, the total fiscal adjustment is expected to be ca €10bn in 2011, €5bn in 2012 and €4.8bn in 2013. Evidently, the EU/IMF programme is frontloaded with the bulk of the fiscal adjustment taking place during 2010.

Measures and policies included in the new austerity package cover the following three general areas:

1. Measures to facilitate fiscal adjustment
2. Measures to initiate structural changes and boost competitiveness of the Greek economy
3. Measures to strengthen liquidity and capitalization of domestic banks

A detailed description of measures can be found in Appendix 1.

In our view, the EU/IMF programme is well-balanced and draws on IMF's experience. Its key characteristics can be summarized as follows:

- *Real growth resuming in 2012* but staying well below the 1996-2007 historical norm
- *Inflation subdued*, even turning negative in 2011
- *Front-loaded* reforms and drastic first-year fiscal tightening with a large subsequent fiscal cushion, with only €1 bn revenues from privatizations and with no zeal to ever zero the deficit
- EU/IMF detailed *conditionalities* with quarterly targets as a strong disciplinary device
- Effort to minimize the burden on the poor
- *Real pension solution* sought which controls for hidden future liabilities

The timely implementation of the agreed measures is imposed by the inclusion of explicit timetables in the EU/IMF programme. Greece's progress with respect to the execution of the programme will be monitored by the EU and the IMF on a quarterly basis. Loans' installments will be dispersed upon successful completion of each quarterly review and additional measures will be requested in case of deviations from the programmme's targets.[1]

[1] The detailed conditionalities for June, September and December 2010, as well as the progress made so far – with respect to the EU/IMF programme, the SGP and the March auxiliary budget – can be found in Appendix 2.

1.2 Assumptions of the EU/IMF Adjustment Programme and Projected Debt Dynamics

Tables 1 and 2 present the baseline assumptions of the EU/IMF package as well as respective projections for the 2010-2015 (plus 2020) period.

Based on the assumptions defined in Table 1, a baseline scenario for the evolution of public debt as a percentage of GDP is constructed (Table 3). Under this scenario the debt-to-GDP ratio will culminate in 2012 (and 2013) at 149% of GDP and then move downwards, reaching 139% of GDP in 2015 and 119% of GDP in 2020.

Two alternative scenaria are examined.[2] The first – the optimistic one – is based on the assumption that growth will be higher by 1% per year than that assumed in the baseline scenario. In this case, the debt-to-GDP ratio will peak again in 2012 but at a lower rate (142% of GDP), and then move downwards, reaching 122% of GDP in 2015 and 80% of GDP in 2020.

Table 1: Basic Assumptions & Projections of the EU/IMF package

	2009	2010	2011	2012	2013	2014	2015	2020
GDP Growth (%)	-2.0	-4.0	-2.6	1.1	2.1	2.1	2.7	2.7
GDP deflator (%)	0.7	1.2	-0.5	1.0	0.7	1.0	1.1	1.5
Nom. GDP (€ bn)	237	231	224	228	235	242	251	308
Int. Rate (%)	5.0	4.8	4.8	5.3	5.6	5.8	5.8	5.9
Bund Rate		175	275	350	350	350	350	350

Source: IMF

Table 2: The EU/IMF programme: Detailed forecasts

	2009	2010	2011	2012	2013	2014	2015	2020
Current Account (%GDP)	-11.2	-8.4	-7.1	-5.6	-4.0	-2.8	-1.9	---
Gen Gov Deficit (%GDP)	-13.6	-8.1	-7.6	-6.5	-4.8	-2.6	-2.0	-1.0
(€ bn)	-32.3	-18.6	-17.0	-14.7	-11.5	-6.2	-5.0	-3.1
Gen Gov Debt * (%GDP)	115.1	133.3	145.1	148.6	149.1	144.3	138.8	119.2
(€ bn)	273.4	307.5	324.7	339.7	350.4	353.8	348.4	367.5
Interest Expense (%GDP)	5.1	5.6	6.5	7.5	8.1	8.4	8.1	7.0
(€ bn)	11.9	13.0	14.9	17.1	18.9	20.4	20.3	21.5
Primary Surplus (%GDP)	-8.6	-2.4	-0.9	1.0	3.1	5.9	6.0	6.0
(€ bn)	-20.4	-5.5	-2.0	2.3	7.3	14.3	15.1	18.5

Source: IMF

* Debt numbers do not include the reducing effect of privatizations, neither the €26 bn or 11% of GDP of government guarantees (according to Eurostat rules)

[2] The IMF analysis in the Request for Stand-By Agreements includes other alternative scenaria too. We consider the scenaria concerning growth as the most important ones and thus include them to our analysis.

Table 3: Sensitivity analysis of debt-to-GDP ratio

Debt-to-GDP	2009	2010	2011	2012	2013	2014	2015	2020
Baseline	115	133	145	149	149	144	139	119
Higher growth +1% per year	115	131	141	142	139	131	122	80
Lower growth -1% per year	115	135	150	156	160	159	158	166

Source: IMF

The second scenario – the pessimistic one – is based on the assumption that growth will be lower by 1% per year than the respective rate assumed in the baseline scenario. In that case, the debt-to-GDP ratio will peak in 2013 (160% of GDP) and it will remain at 158% of GDP in 2015 and 166% of GDP in 2020.

The two alternative scenarios define a wide range for the forecasted path of debt. Our view is that a rate of GDP growth 1% higher per year than in the baseline scenario is not too optimistic and it is certainly closer to the Greek economy's historical norm. In what follows we will explore, *inter alia*, the sources of such a growth potential.

2. Risks Exist but Restructuring is Unlikely

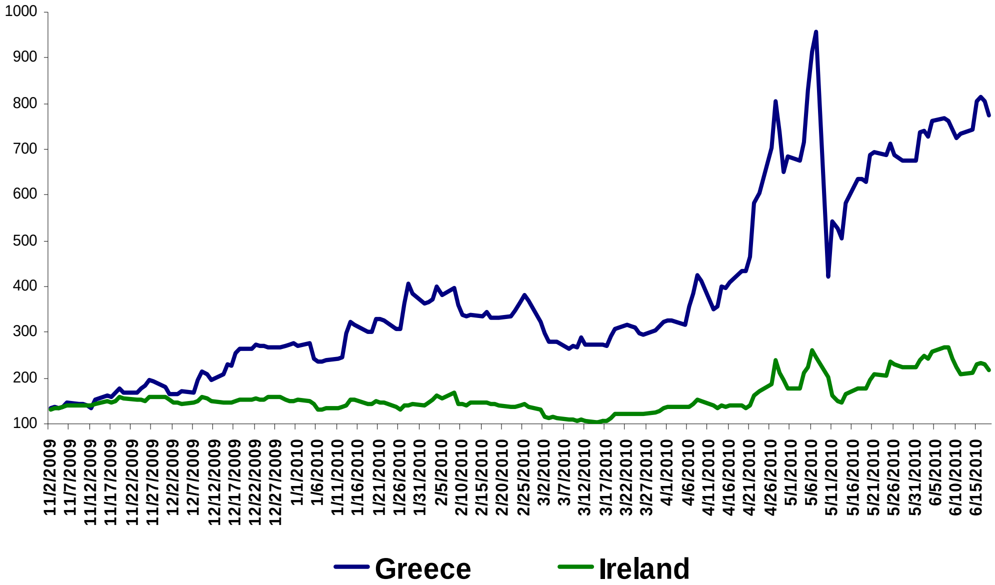
2.1 The market remains negative on GGBs despite the rescue package

The developments in the Greek Government Bonds (GGB) market turned unfavorable from October 2009 onwards. Firstly, in mid October 2009, the newly elected government announced that the budget deficit for 2009 was estimated to be 12.7% of GDP, more than double than the 6.5% of GDP figure that was expected by the previous government in September 2009. The perceived forging of statistical data repeated previous practices and led to a loss of credibility. When the news of a possible default by Dubai World in early November 2009 were aired, the negative feeling against GGBs intensified. These two facts, along with the chronic problem of low competitiveness of the Greek economy, the high levels of accumulated debt and the ill-defined measures of the Greek government in the SGP and the March 2010 auxiliary budget, led to a deteriorating situation with regard to the Greek sovereigns. The crisis peaked at the end of April 2010 when markets effectively closed down for Greece and an official request for subordination to the EU/IMF adjustment programme had to be filed.

Nevertheless, this was not the end of the crisis. Fears persisted about a possible spread of the crisis to other southern EU countries, namely Portugal and Spain, as well as doubts about the ability of the Greek government to implement the EU/IMF adjustment programme in a timely and orderly manner. All these negative developments continued to put pressure on GGBs, as evident in the evolution of the 5-YR CDS contracts.[3] Figure 1 bellow presents the 5-yr CDS spread for Greece and Ireland, the latter being the first EU economy to have entered the economic crisis twilight zone in 2008 because of its faulty banking sector.

[3] A Credit Default Swap (CDS) is a contract in which the buyer agrees to pay the seller a regular premium in return for a commitment that the seller will pay out in the event of a default in the underlying security, Greek Government bonds in our case.

Figure 1: 5YR CDS GREECE – IRELAND



Source: Bloomberg

It can be seen that the upward trend in the CDS market started in early November 2009, accelerated during April 2010, and reached its peak in early May 2010, after the talks with EU and the IMF concluded and led to the EU/IMF adjustment programme. The downward move that followed was related to the ECB's interventions in the secondary bond market but proved only temporary. From mid May, CDS spreads continued their previous upward trend. This indicates that markets continue to discount the possibility of a Greek default, as illustrated in Table 4. In fact, on June 18th, 5-yr CDS was 7.75%, implying a cumulative risk-neutral probability of 30.7% for a total capital loss any time during the 5-year period, or a 99.7% probability for a capital loss of 10%. At the same time, the 2-year GGB yield was 8.75%, a spread of 8.17% over Bunds, signaling that the market does not even trust the rescue package will be used. Markets may have overreacted. Yet, they do have legitimate concerns.

Table 4: Greek 5-YR CDS-based probabilities of default

Greek 5-YR CDS-based probabilities of default (5 yr CDS premium775.2 on June 18th, 2010)		
Haircut	**Marginal 1-yr Risk-neutral Probability**	**Cumulative 5-yr Risk-Neutral Probability**
100%	7.8%	30.7%
90%	8.6%	33.6%
80%	9.7%	36.9%
70%	11.1%	41.1%
60%	12.9%	46.2%
50%	15.5%	52.7%
40%	19.4%	61.2%
30%	25.8%	72.5%
20%	38.8%	87.1%
10%	77.5%	99.7%

Source: Eurobank EFG Research, Bloomberg

2.2 Market Worries Are Overblown

The argument goes that if the EU/ECB/IMF Program succeeds and in 2012 Greece begins generating the first primary surpluses, then it will be tempted to default or restructure its huge debt. This, in our view, is very unlikely to happen because:

1. The stakeholders of GGBs are primarily Greeks and other EMU members, who have a strong incentive against the default solution
    i. Greek banks own approximately €45 bn, pension and other funds another €25bn, individuals around €15bn. Thus, a haircut would force the government to bail out its banking sector and its pension system. Then, any financial benefit from debt relief would be counterbalanced by the cost of the bailout.
    ii. EMU banks hold a major chunk of GGBs. EMU members would object to a default. It may create FI bankruptcies in the Euro Area. Thus, a Greek default would be an EMU decision, not a Greek decision.
    iii. The ECB holds significant amounts of GGBs and Greek Government guaranteed bonds as collateral. Greece cannot go against its own lender of last resort.
    iv. EMU countries have given €80 bn in loans and IMF €30bn, on which Greece cannot default. Even if this was possible, these loans have priority over loans from private lenders and they also have real collateral which the country would lose.
2. Haircuts provide only a short run solution. Debt-to-GDP ratio will soon shoot up if the underlying causes are not cured.
3. Huge adjustment costs during the default/restructuring process and inability to tap the markets for a long time. Huge strategic costs from permanent distancing from Europe's core.
4. Contagion risks cannot be ignored in the European financial sector with a possible spread of fear for EMU sustainability

The question as to whether Greece would be forced or voluntarily led to apply a haircut in GGBs can be restated. The various eventualities are as follows:

1) *The Main scenario – Eurobank's view*: Euro Area remains intact and the Program succeeds. Then, Greece has a choice to voluntarily take or not take a haircut.
    i). Greece would choose not to take a haircut, since a cost-benefit analysis would show that the cost – especially the political and strategic one - is way too high, which could eliminate all benefits form restructuring debt. Also, success implies conformity with the established EU rules.
    ii) A rescheduling of the EU/IMF €110 bn loan is possible to provide time for adjustment.
2) *The Remote scenario*: Euro Area remains intact, Program fails as Greeks prove incapable of handling belt-tightening. This would have severe repercussions:
    i) Either a new austerity program with stricter conditionalities, which would lead to a worse recession and significant lowering of living standards but no haircut because of the repercussions.
    ii) Or a forced exit from EU. In this case, all hell breaks loose with no reversal in sight, additional loss of political power in Europe, default.
3) *The Extreme scenario:* Euro Area collapses. In this case turmoil would erupt in Greece and a severe lowering of living standards. Default is then likely as foreigners own most of the debt. A vicious cycle of deep economic recession and societal upheaval is possible but there is a reversal of fortunes in sight, as every other EMU country suffers as well.

Current credit default swap rates over-penalize lenders to the Greek government. Given all the considerations articulated above, we do not think a haircut is probable because case #1 above would prevail. In addition, our research below suggests that by 2014, if the EU/IMF stabilization programme is successfully implemented, net revenues will improve far more than the increase in the interest cost of government debt, allowing the Greek government to service its debt from primary surpluses, while the debt-to-GDP ratio will be declining due to a growing economy.

2.3 Quantitative estimates of distance to default suggest no restructuring

Probabilities of default extracted from CDS spreads are in our view biased due to lack of liquidity in the CDS market. An alternative indicator of the probability of default can be based on an economic measure of the distance to default (obviously, the probability of default is lower; the higher is the distance to default). In order to obtain an economic measure of distance to default (DTD), we define default as a situation where the government cannot service its outstanding debt (i.e. pay interest) out of its current revenues, after subtracting all "inelastic" expenditures which are necessary in order for the government sector and the social state to function, though at a lower speed. Inelastic expenditures are admittedly difficult to define without some degree of arbitrariness. For our purpose, however, we can consider as inelastic 90% of expenditures in wages of public employees, pensions and other social transfers and operating expenses. Thus, net revenues are defined as (Total revenues – 90% of public wages, social transfers, pensions and operating expenses). The above definition of net revenues essentially means that in a crisis situation, the government can cut down to zero defense expenditures and public investment. All other expenditures would be reduced by 10% allowing the public sector and the social state to continue functioning. In order to account for the effect of economic growth over time, we measure both net revenues and interest expenditure as shares of GDP. Hence, distance to default (DTD) can be defined as the distance in percentage points of GDP between net revenues and interest payments to bond holders of GGBs, (Net revenues – interest on debt)/GDP. Table 5 and Figure 2 show the expected development of the DTD measure in the case IMF projections materialize.

It can be seen that by 2015 DTD will be as good as in 2000, away from 2009 levels. The two danger years were 1993 and 2009. In 1993, interest expense was 12.5% of GDP. Now, the worst case expected is for interest payments to increase to 8.4% GDP in 2014. With the EU/IMF programme, DTD increases above its historical lower two standard deviation bound in 2010 and continues to improve despite the higher debt service cost, due to permanent wage cuts and improved tax revenues. The improvement will be much higher when the pension reform kicks in after 2015.

Sensitivity analysis was also performed. In case GDP growth (and inflation) turns out to be higher, DTD improves. If GDP growth is 1% higher, DTD increases to 9.2% of GDP in 2014, its highest level ever (from 8.1% of the baseline). If debt service increases by 1ppt of GDP in 2014 (to 9.4%), DTD still increases to 6.2% of GDP, still well above the long-term average. If both A and B occur, DTD increases to 8.2% in 2014, i.e. effects cancel out each other.

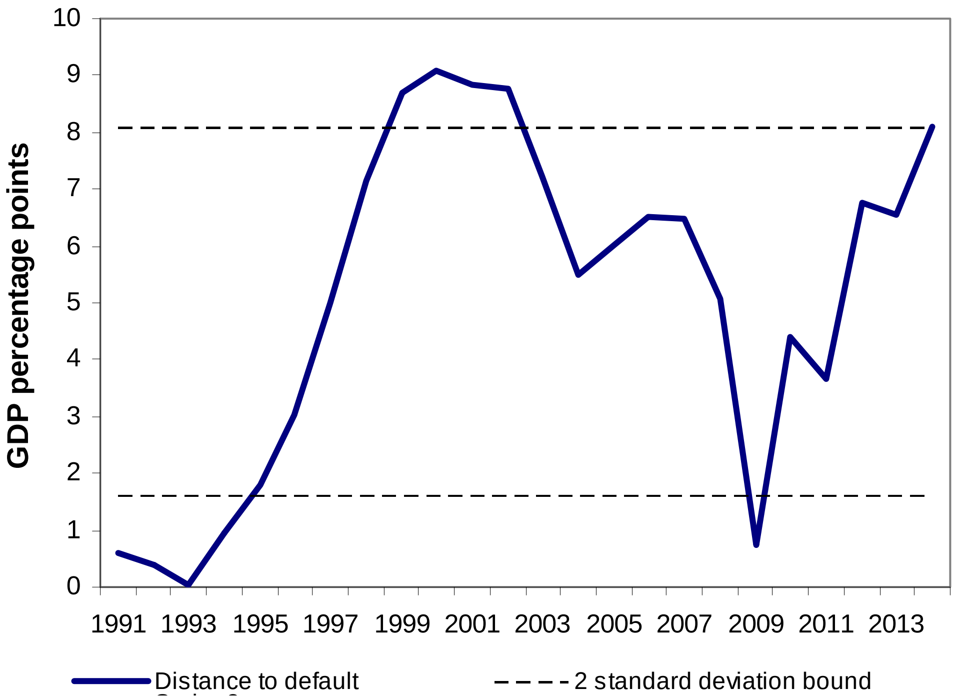
Table 5: Economic Distance to Default (% of GDP)

	Average 91-08	2009	2010	2011	2012	2013	2014
A. Total revenue/GDP	12.6	5.7	10.0	10.2	14.2	14.5	16.5
B. Interest/GDP	7.5	5.0	5.6	6.6	7.5	8.1	8.4
C. Distance to default (A-B)	**5.1**	**0.7**	**4.4**	**3.6**	**6.7**	**6.4**	**8.1**

Source: Eurobank EFG Research

Note: 2010-2014 estimates based on central EU/IMF scenario for growth, inflation and budget

Figure 2: Greece: Economic Distance to Default



Source: EUROBANK EFG Research

2.4 Can Greece stabilize its public-debt dynamics within a reasonable time span?

Greece can stabilize its debt ratio earlier (and at a lower level) than projected in the EU/IMF stabilization program, even assuming a further significant upward revision to the 2009 debt level. The EU/IMF programme's assumptions about domestic inflation and medium-term growth are rather conservative. The stabilization programme incorporates a sizeable revenue cushion, is front-loaded and well balanced between expenditures and receipts. For example, primary surpluses could be higher than IMF projections. The programme does not fully account for potential privatization receipts or for a significant revision in the GDP level (as high as 10%- 20%).

In addition, the EU/IMF program expects Greece's debt servicing to be very demanding but manageable. Tangible evidence of successful implementation of the programme can help improve market confidence and de-escalate borrowing costs significantly. Servicing costs are projected to peak at 8.4% of GDP in 2014, yet they have been much higher in the early 90s (> 12%-of-GDP). Greece's roll-over needs will be fully covered by the existing EU/IMF lending programme until at least early 2012.

Taking all the above into account, Eurobank EFG's baseline scenario for debt dynamics is presented in Table 6. This is considered to be a plausible, *yet still conservative scenario*, relative to the IMF baseline. According to this scenario, Greece manages to stabilize the debt-to-GDP ratio sooner and bring it at 90% of GDP by 2020 *i.e.,* ca 29ppts-of-GDP lower than projected by the IMF. Assumptions underlying this scenario are: a) average annual real GDP growth in line with the IMF baseline in the long run, milder contraction in 2010, deeper contraction in 2011 compared to IMF projections b) average annual inflation 0.85ppts higher than the IMF baseline; in particular, a GDP deflator of 3.5% (1%) in 2010 (2011) due to the impact of indirect taxes hikes c) annual degree of implementation of revenue-side measures ca 0.75%, d) elasticity of tax revenue w.r.t. nominal GDP ca 1.0 (in line with long-term average).[4]

[4] Elasticity excluding the effects of IMF program measures.

Table7 presents our alternative, more optimistic but *considered realistic*, scenario. This assumes: a) average annual real GDP 0.5ppts higher than the IMF baseline, by virtue of the growth drivers we consider below b) average annual inflation ca 0.25ppts higher than our baseline, c) annual degree of implementation of revenue-side measures of ca 75%, d) elasticity (excluding the effect of EU/IMF measures) of tax revenue wrt nominal GDP ca 1.0. It has to be noted that these assumptions reflect nothing more than the historic norm of the Greek economy. With these assumptions, the debt-to-GDP ratio is shown to deescalate to 72% by 2020.

Table 6: Baseline Scenario for Debt Dynamics

Eurobank EFG Scenario

(Considered conservative)

	2009	2010	2011	2012	2013	2014	2015	2020
Real GDP (%)	-2.0	-3.6	-2.9	1.5	2.2	2.5	2.7	2.7
GDP deflator (%)	1.4	3.5	1.0	1.5	1.8	2.0	2.0	2.0
Nominal GDP (€bn)	237.5	237.0	232.3	239.3	249.0	260.3	272.7	344.0
Nominal GDP(%)	-0.7	-0.2	-2.0	3.0	4.0	4.5	4.8	4.8
primary balance (€bn)	-20.4	-3.0	1.9	6.7	11.6	20.0	21.0	27.5
primary balance (% GDP)	-8.6	-1.3	0.8	2.8	4.7	7.7	7.7	8.0
Interest costs (%GDP)	5.0	5.9	6.3	7.1	7.4	7.5	7.2	5.4
Interest costs (% Revenue)	13.6	14.6	14.9	16.7	17.6	17.9	17.5	14.7
DEBT (% GDP)	**122.0**	**129.4**	**137.6**	**137.8**	**135.2**	**129.1**	**122.7**	**90.0**

Source: EU/IMF/ECB programme, Eurobank EFG Research projections

Table 7: Optimistic scenario for Debt Dynamics

Eurobank EFG Scenario

(Considered feasible)

	2009	2010	2011	2012	2013	2014	2015	2020
Real GDP (%)	-2.0	-3.1	-2.4	2.0	2.7	3.0	3.2	3.2
GDP deflator (%)	1.4	3.8	1.2	1.8	2.1	2.3	2.3	2.3
Nominal GDP (€bn)	237.5	238.8	235.9	244.8	256.5	270.2	285.1	373.0
Nominal GDP(%)	-0.7	0.5	-1.2	3.8	4.8	5.3	5.5	5.5
primary balance (€bn)	-20.4	-2.6	2.6	7.9	13.3	22.2	23.8	34.0
primary balance (% GDP)	-8.6	-1.1	1.1	3.2	5.2	8.2	8.3	9.1
Interest costs (%GDP)	5.0	5.8	6.2	6.9	7.1	7.1	6.7	4.5
Interest costs (% Revenue)	13.6	14.6	14.7	16.4	17.2	17.4	16.7	12.5
DEBT (% GDP)	**122.0**	**128.3**	**135.0**	**133.7**	**129.5**	**121.9**	**113.9**	**71.8**

Source: EU/IMF/ECB programme, Eurobank EFG Research projections

2. Implementation risks exist, but offsetting factors available

The markets' major concerns, expressed by the recent developments in the 5-yr CDS market, relate to both the idiosyncratic risk component of the EU/IMF adjustment programme, as well as its systemic part. Idiosyncratic risks stem from:

a) possible lack of political will in individual ministries (e.g. attempts to fake reforms)
b) a lack of expertise or incentives in the public bureaucracy to support the reforms
c) delays & budget overruns as political time is a lot slower than market time, which may nevertheless create vicious cycles and further stall the process

Even though all of the above concerns are legitimate, the Greek government has the ability to pass corrective legislature early on in case of slippages. Technically, the legal process to pass legislation in Parliament is not that lengthy; legislation by ministerial decisions is even quicker and straightforward, as it does not require parliamentary validation. Politically, legislation ability is enhanced by the ruling party´s (PASOK) land-sliding majority in the October 2009 election, the understanding among the political establishment of the seriousness of the crisis (with the exception of the far left), and the realization by the public that the confrontation of the crisis needs drastic measures. The lack of incentives or potential inability of the public bureaucracy to implement the reforms is a crucial factor that might undermine the achievement of the specific targets of the EU/IMF adjustment programme. The lack of incentives is enhanced by the cuts in public employees' salaries and bonuses. Ways to mediate these risks include close monitoring of civil servants, efforts to communicate to them the seriousness of the situation and the drastic need of reforms, as well as non-remuneration measures to increase their productivity. Finally, the embedded cushion[5] in expected revenues of the EU/IMF programme might act as a buffer against implementation inefficiencies.

The difference between market time and political time can be confronted by the ease with which many cost cutting measures might be applied currently, given that the public understands the seriousness of the situation. Evidence of good execution of the budget so far (see below) lends support to the rationale given above.

An additional idiosyncratic risk is that high unemployment may cause a civilian backlash in a year or so, especially if the government does not deliver the promised reforms on time. Stimulating a swift supply boost via the structural reforms is very important in order to avoid reform fatigue that would be brought about from a prolongation of the recession. This risk is mediated by the fact that the programme is frontloaded, i.e. most painful measures are already implemented in 2010. Close monitoring by the EU/IMF of the targets set out in the programme limits the scope for government non-compliance.

Turning to the systemic part of the risks implied by the EU/IMF adjustment programme, one of the major external risks is a slowdown of European growth. As European belt-tightening is currently taking place, a weak economic recovery in the euro area may cause Greek growth to stall. Yet, scope for macro contagion is limited by the fact that Greece is a relatively closed economy; exports plus imports as a percentage of GDP currently stand at 48%, against an EA average of 70%. In addition, nearly 60% of Greece's exports are channeled outside the Euro Area, mostly in emerging economies which are projected to rebound strongly in 2010. Finally, high risk premia may persist, which could prohibit Greece from tapping the bond market in two years or so. However, historic experience with other countries that followed IMF-sponsored stabilization programmes shows that if the program is successful, risk premia will decline. In addition, a lengthening of the maturity of the EMU €110 bn loan is likely (IMF suggested 5 years).

[5] See the analysis below for the cushion in expected revenue.

3. Market presently underestimates a number of positive factors

While downside risks seem to be fully discounted in GGB market prices, there are also upside risks. Markets do not seem to adequately account for these positive factors. To begin with, the EU/IMF programme is so far executed on time and the budget may surprise on the upside; 2010 fiscal measures outstrip the target by 2.2% of GDP. Moreover, the proposed reforms are drastic, particularly the fiscal, pension & labor market reform. For example, the public wages & pensions bill is down -15% yoy in 2010 (or -1.6% of GDP) and the annual pension expenditure will be scaled back by 10 pps of GDP in the long term as a result of the pension reform.

Tax evasion is huge and would gradually be captured by the new tax law and reforms suggested by the IMF. To give an indication, 36% of the labor force are self employed but contribute only 4% of personal income tax. This explains to a large extent why personal income tax revenues in Greece as a fraction of GDP is 4 ppts lower than the European average. On the expenditure side, the reduction of the huge public waste has begun from the health care sector and the drug expenses (annual drug expenses of €9 bn were 3 times bigger per capita than in Spain in 2009). Reports from the Ministry of Healthcare already show a reduction of the respective expenses by 1.5% in April and 5% in May.

Fiscal consolidation factors are supported by a number of structural factors. Firstly, the public sector owns assets worth over € 300 bn, while privatizations and land and property development are already announced and can take hold in a bigger wave later on. Secondly, the private sector is under levered, deposits are 110%-of-GDP, private sector debt is 81% of GDP, among the lowest in the EU, and there is a lot of private wealth. Thirdly, and most importantly, reforms have the potential to spur a new virtuous cycle of economic growth. Greece has already been a strong growth story with productivity growth in the last decade being 3 times bigger than in Germany or Spain. The process of restoring competitiveness losses through an internal devaluation is not as onerous as often thought.

A final critical factor invoked in all foreign press reports concerns fears about social unrest due to the proposed reforms of the EU/IMF programme. In the past, major reforms, such as the Pensions Reform of 2001, were finally taken back by the government because of a wave of massive public and private sectors employees strikes, demonstrations etc. Currently, even though there is dissatisfaction among the society, consensus on the need for reforms is apparent. It is not by coincidence that demonstrations gather only a 1/20 to 1/10 of their respective size in earlier decades when much milder reforms were attempted. The following sections elaborate further on what we view as the main upside risks.

3.1 Budget Execution Satisfactory So Far, Positive Surprises Expected in the Period Ahead

Data on the execution of the central government budget (Table 8) is broadly satisfactory thus far. The Central Gov deficit is down 38.7% YoY in January-May *Vs.* an annual target of -35.1% YoY. Net current revenues are up 8.3% YoY in January- May *vs* an annual target of +11.7% YoY. Primary expenditure is down 10.5% YoY in January-May *Vs* an annual target of – 4.8% YoY.

Table 8: Budget, January-May 2010

Ordinary Budget	January-May 2010 (€bn)	January-May 2010 % YoY	Annual target % YoY
1. Net Revenue (a-b)	**19.8**	**8.3**	**11.7**
a. Gross Revenue	21.5	5.7	10.9
b. Tax Returns	1.8	-17.2	3
2. Expenditure	**25.8**	**-10.5**	**-4.8**
α. Primary Expenditure	20.4	-11.3	-4.4
β.Interest Costs	5.4	-7.5	-5.1
Public Investment Budget			
3. Revenue	0.3	-43.2	89.1
4. Expenditure	3.2	-29.6	1.2
5. Central Government balance (1-2+3-4)	**-9.0**	**-38.7**	**-35.1**

Source: FinMin

Yet, concerns have been raised lately over the strength of tax revenues, especially VAT receipts. VAT receipts are up only by 0.7% YoY in January- May 2010 *Vs.* an annual target of +9.7% YoY.[6] However, they are still higher than a year earlier and are improving since February.[7]

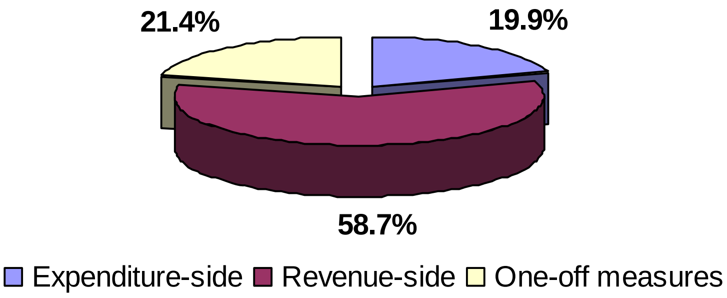
Moreover, there are two reasons why we expect budget data to surprise positively in the period ahead. Firstly, the bulk of revenue-enhancing measures *(e.g. the second installment of hikes in VAT rates and a range of special consumption taxes)* will not become fully effective until July 2010. Secondly, additional cost-cutting measures have been announced since early March & in the EU/IMF-agreed stabilization package.[8]

There is ground for possible fiscal out performance in 2010. The EU/IMF stabilization program envisions a 5.5% GDP reduction in the 2010 general government budget deficit (to 8.1%-of-GDP from 13.6% in 2009). This target is pursued by measures worth 7.7ppts of GDP, namely, a fiscal package introduced earlier in 2010(Figure 3), estimated ca €12.3bn or 5.2% GDP, and additional fiscal measures agreed with the EC/ECB/IMF, worth 2.5% GDP(Figure 4).

Note that ca 3% of GDP from the 7.7% of GDP total of fiscal consolidation measures in 2010 has already been implemented: one-off items, worth around 1.4% GDP, and a 1.6% GDP (permanent) cut in the total bill for wage & pensions. Hence, we are left with an estimated 4.7% GDP worth of measures to generate the remaining 2.5% GDP fiscal consolidation needed to fulfill the 2010 deficit target. As a result, in the absence of a much larger than expected economic contraction this year and/or complete program implementation failure, the 2010 fiscal target is perfectly achievable.

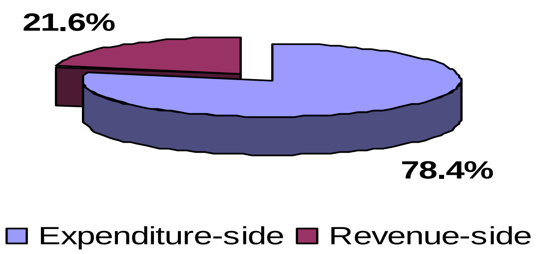
[6] SGP + March 2010 auxiliary budget.
[7] VAT revenue: +7.5% YoY in April vs. -9.1%YoY in January 2010
[8] The EU/IMF program envisions a further (permanent) cut of €3.4bn or 1.4%-of-GDP in the government's total wage and pensions bill.

Figure 3: Fiscal measures in SGP + March 2010 auxiliary budget (% of total)
(Total package = € 12.3bn or 5.2% of 2009 GDP)



Source: Greek SGP, FinMin, IMF, Eurobank EFG Research

Figure 4: EU/IMF fiscal measures (% of total)
(Total package = € 5.8bn or 2.5% of GDP)



Source: Greek SGP, FinMin, IMF, Eurobank EFG Research

Apart from fiscal consolidation, structural reforms progress at a quick pace. Major reforms have already been implemented. These include:

1. Fiscal Measures (revenue increasing & cost cutting measures)
2. Competitiveness & Business environment measures (business start-ups, adoption of the services directive etc.)
3. Adoption of legislation reforming public administration at the local level
4. Adoption of a new tax law

In addition, the pensions and labor reforms are expected to be completed by the end of June, well before the respective deadlines specified in the EU/ECB/IMF adjustment programme.

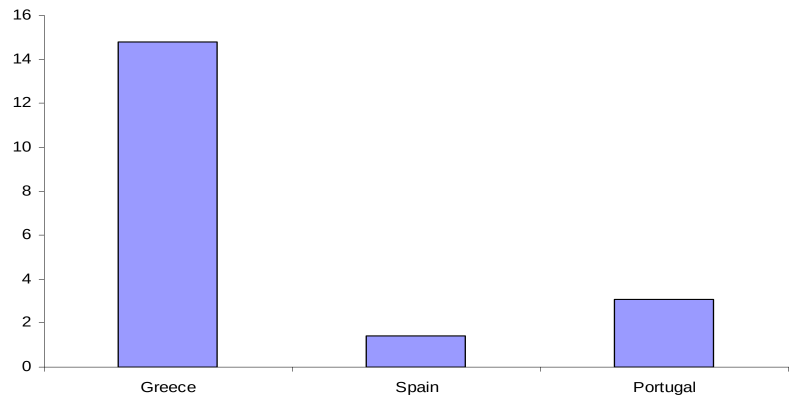
More reforms are scheduled to be completed by the end of 2010. These include:

1. The actual implementation of the local administration's reform
2. The actual implementation of the Services Directive
3. The opening up of the closed professions
4. The operation of a single payment authority in the public sector
5. Measures to facilitate FDI and investment in strategic sectors of the Greek economy
6. Specification of the targets for payment claims of Structural and Cohesion Funds and their respective deadlines.

3.2 Are the EU/IMF-agreed measures drastic enough to promote sustained fiscal consolidation?

The Greek EU/IMF stabilization program for the period 2010-2014 is much stronger than the corresponding programmes recently introduced in both Portugal and Spain as Figure 5 bellow presents. Total measures up to year 2014, envisioned under the Greek SGP, the March 2010 auxiliary budget and the EU/IMF program amount to ca €42.5bn or ca 17.8% of 2009 GDP. In addition, Figure 6 below shows that measures are distributed equally between revenues and expenditures.

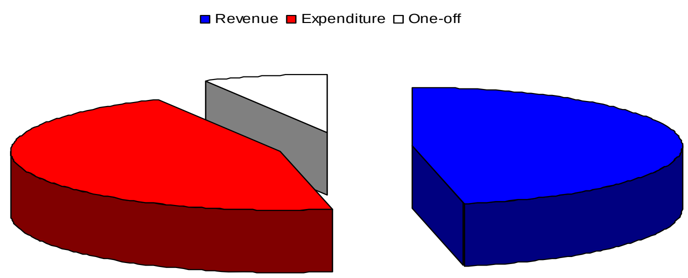
Figure 5: Measures taken recently (in addition to these envisioned in respective country SGPs) to reduce the fiscal deficit in 2010-2014 (cumulative in ppts of GDP).



Source: Government, IMF, EU, Eurobank EFG Research

The programme is strong enough in order for its targets to be achieved –or outperformed- even with sizable slippages in revenues and expenditures due to the projected recession. From the quantification of the EU/IMF programme's measures and under the scenaria described in Table 9, there is a potentially large fiscal safety cushion.

Figure 6: Contribution to targeted fiscal adjustment in 2010-2014



Source: Government, IMF, EU, Eurobank EFG Research

Table 9: Assumptions of the fiscal safety Cushion

	Assumptions of the fiscal safety Cushion
Scenario I	GDP & Inflation assumptions as in IMF baseline program - full implementation of expenditure measures
Scenario II	GDP as in IMF baseline & 0.75ppts/annum higher inflation - full implementation of expenditure measures
Scenario III	0.5ppts/annum higher GDP growth & 0.75ppts/annum higher inflation - full implementation of expenditure measures

Source: IMF, Eurobank EFG Research

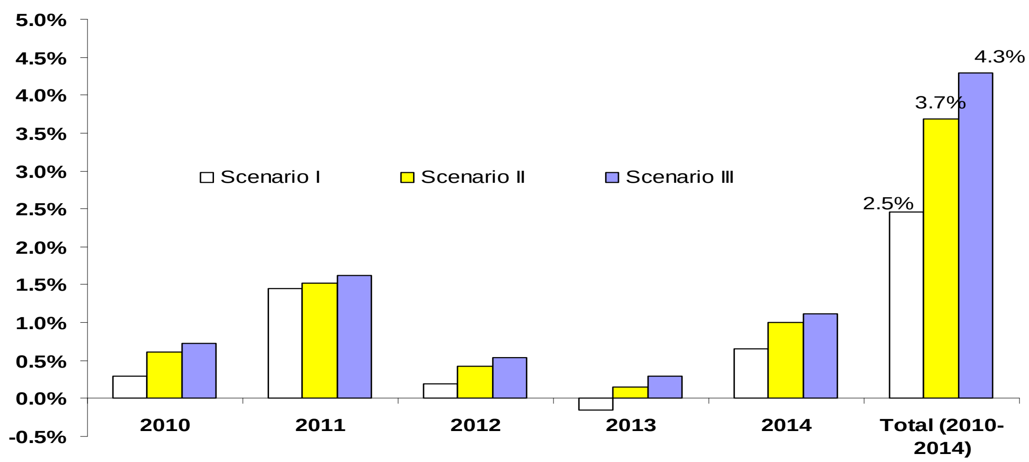
Figure 7 presents the safety cushion for each of the respective scenario. Observe that in all three scenaria the fiscal cushion reaches a peak in 2011 and then moves to smaller levels in 2012 and 2013.

3.3 Are the pension & labor reforms drastic enough?

The current pension system is unsustainable. According to EU calculations, pension expenditure would increase by at least 12ppts of GDP by 2060 under present conditions. A comprehensive pension reform will be adopted that reduces the projected increase in public spending on pensions over the period 2010-60 to 2.5% of GDP, in line with projections for the rest of the Euro Area.

The sustainability of the pension system is already benefiting from fiscal measures already implemented. According with the EU/IMF adjustment programme, the Christmas, Easter and Summer Bonuses have been eliminated for pensioners receiving more than €2500 a month and replaced by flat bonuses of €400 for the rest. However, the comprehensive reform of the pension system will be achieved with the new draft law on pensions, which has to be presented to the Parliament by the end of June 2010. Additionally, a report from the National Actuarial Authority will be submitted, verifying that the parameters of the new system ensure long-term actuarial balance. The Parliament should adopt the pension reform by the end of September 2010 and the new universally binding rules should apply from January 1st 2013. Workers retiring in and after 2015 will collect benefits from the new system.

Figure 7: Projected cushion with respect to revenue-side measures (%GDP)



Source: Eurobank EFG Research

The general measures of the Pensions reform include the merging of the existing 13 pension funds in three funds by 2018. A means-tested social pension will be included for all citizens above the normal retirement age, so that an important safety net is provided, consistent with fiscal sustainability. Normal retirement age will be set to 65 years by 2015. After 2020 and every three years there will be increases in the normal retirement age in line with life expectancy. Early retirement will be restricted, with the minimum age for early retirement being increased to 60 by 2011 for *all* prospective pensioners.[9] There will be a gradual increase in the minimum contributory period for retirement on a full benefit from 37 to 40 years by 2015. With regards to benefits, there will be a strengthening of their link with contributions, with uniform rules that will apply pro-rata to all current and future workers. Benefits will be indexed to prices, starting in 2014.[10] Years over which the pensionable earnings base is calculated will be increased, from the top 5 out of the last 10 years of earnings counting today, to lifetime earnings. The accrual rate will be limited to an average annual rate of 1.2% instead of 2% today.

At the same time there will be a reduction of the upper limit on pensions together with a reduction of pension benefits (by 6% per year) for people entering retirement between the ages of 60 and 65 with a contributory period of less than 40 years. The list of heavy and arduous professions will be drastically reduced. Finally, there will be a review of the conditions for disability pensions by the end of March of 2011 and introduction of stricter conditions for eligibility by December of 2011, including periodic re-examination of those with disability pensions.

Labor markets reforms are equally critical for the achievement of the targets specified in the EU/IMF adjustment programme. Given that the abolishment of the 13th and 14th salaries of private sector workers was not judged to be necessary, the Programme relies on the structural reforms in order to achieve a more efficient and flexible adjustment of labor cost to productivity and demand conditions, and thus to increase price competitiveness. The pursued reform is ambitious. A social dialogue started between the government and social partners in order to revise private sector wage bargaining and contractual arrangements but with no hope for compromise. Table 10 below presents the basic lines of the – expected – labor market reform and the respective deadlines according with the EU/IMF/ECB adjustment programme. Note that the labor reform is expected to be completed by early July 2010 well ahead of the respective deadlines.

[9] Under the current Pension system, those insured before 1993 were enjoying preferential treatment.
[10] According with the EU/IMF programme benefits will be frozen for the 2010–2013 period.

Table 10: Basic Measures of the Expected Labor Reform

Basic Measures of the Expected Labor Reform	
Reform Employment Protection Legislation (December 2010)	- extend the probationary period for new jobs to one year - reduce the overall level of severance payments which should apply equally to blue and white collar workers - raise the minimum threshold for activating rules on collective dismissals especially for larger companies (proposed increase to 4% from 2%) - facilitate use of temporary contracts and part-time work
Reform minimum wages (December 2010)	- legislation on minimum wages to introduce sub-minima for groups at risk such as the young and long term unemployed - guarantee that current minimum wages remain fixed in nominal terms for three years
Reform private wage bargaining system (December 2010):	- adopt legislation to reform wage bargaining system in the private sector, including local territorial pacts to set wage growth below sectoral agreements - introduce variable pay to link wages to productivity performance at the firm level - amend regulation of the arbitration system, so that both parties can resort to arbitration if they disagree with the proposal of the mediator
Increase the flexibility of working hours (December 2010):	- adjust legislation to introduce annual time accounts - reduce overtime pay
Fight undeclared work (June 2011):	- ensure the Labour Inspectorate is fully staffed and quantitative targets on the number of controls to be executed are in place - strengthen legislation to enforce the registration of new employees before they start working.
Review social safety net (June 2011)	- review the scope for improvements in the targeting of social expenditures to enhance the social safety net for the most vulnerable

Source : EU/IMF/ECB adjustment programme, EUROBANK EFG Research

3.4 Measures against tax evasion

The Greek Parliament adopted on April 15th a new tax bill aiming to boost budgetary revenues, fight widespread tax avoidance and shift the fiscal burden to higher-income earners. The new law includes a new progressive and uniform tax scheme, which abolishes a wide range of tax exemptions and encompasses all sources of income, including dividends and income generated by offshore companies. Special tax regimes abolished include flat tax rates *(ranging from 5 to 20 percent)* on public sector allowances and certain professional groups. The highest personal income tax rate is raised to 45 percent from 40 percent, previously. The new top tax rate will apply to annual incomes above €100k. The prior top tax rate of 40 percent will now apply on incomes between €60k and €100k, instead of the previous annual threshold of €70k.

The new tax scale shifts the tax burden to annual incomes of more than €40k. According to Fin-Min, about 95 percent of individual tax filings are below €30k! This is a clear manifestation of the extent of tax avoidance in Greece. The current €12k threshold for income tax exemption will be maintained, but everyone needs to submit retail receipts for goods or services to qualify. Receipts will presumably help the tax authority do crosschecks and capture domestic firms avoiding paying taxes. The measure was widely advertised in the local media well ahead of its introduction, reportedly stimulating a big drive by Greek consumer to collect retail receipts for goods and services consumed. The, so-called, "receipts movement" forced enterprises to reveal their true incomes and it is partly responsible for the increase in VAT revenues as well as relatively strong retail sales data reported in the first three months of this year (latest available data). Additionally, the new tax law also includes higher taxes on dividends, large real estate holdings, short-term stock market gains and offshore companies.

The new tax law also introduced incentives for the repatriation of resident deposits held in bank accounts outside Greece. Specifically, for a six-month period after the bill becomes effective, repatriated deposits will be taxed at 5 percent, without being subject to any checks on the sources of income.

The new tax law signals the government's commitment to combat tax evasion. It features measures which, for the first time in decades, render this target realistic: (1) the broadening of the VAT tax base,(2) the linking of household tax obligations to their living standards, (3) the forcing of households to show the means of having accumulated visible wealth, (4) the aforementioned linking of tax deductibility for households to receipts etc. As an illustration of the potential for capturing tax evasion, Table 11 shows the tax obligation of a private MD under the previous and the new tax law.

The new tax bill also provides for heavy penalties for tax evaders, ranging from fines to closure of shops and seizure of assets. Furthermore, business transactions with a value exceeding €1,500 will need to be done through checks or credit cards, not cash. A tax amnesty will be provided to individuals and businesses assisting in exposing corruption in public sector. So far, for H1 2010 only, 6000 charges by citizens were recorded, against a total of 4000 for the whole 2009.

Table 11: Tax Due of a Private MD Under the Previous and the New Tax Law

Private doctor, reporting annual **2009 income** of:	**EUR 20,000**
Tax paid:	**EUR 1,200**
Minimum **2010 income** will be calculated based on consumption habits:	
House of 250 m^2	= 42,100
Swimming pool (60 m^2)	= 12,000
2 cars (3,000 cc + 1,800 cc)	= 14,850
Country house 180 m^2	= 5,710
Pleasure boat (7 m)	= 8,000
2 kids private school	= 10,000
Housekeeping personnel (1 person)	= 8,000
Minimum income	= 5,000
Total income	= **EUR 105,660**
Tax due	= **EUR 34,500**

The fight against tax evasion has already started and polls show it corresponds to the public request for fairness in pain distribution. There are frequent reports in the media about civil servants how were fined or even faced prosecution for corruption because they were helping individuals or firms to tax evade. The tax evading behavior of certain types of self employed professionals (medical doctors, lawyers, the notary profession, singers etc) has also become a wide acknowledged problem for the Greek society. This was not the case in previous years. Overall, the EU/IMF adjustment programme assesses that the new tax bill is suitable for addressing the main problems that the Greek tax system faces.

3.5 Reduction of public waste

There is widespread understanding that the public sector is wasteful and inefficient. Hence, there is enormous room for cost improvement. A major source of financial waste is the National Health System. The example of drug costs is striking: €9.2 bn in 2009 compared to Spain's €12 bn and over 4 times the population. Reforms in the Health Ministry include the introduction of rigorous accounting systems and higher quality management in hospitals, a new procurement system, and a 20% reduction in drug prices. Currently, the 10 largest hospitals are audited by PWC. In Local government, cost saving of €1.5 bn are estimated to be achieved by the re-organization of sub-central government (the KALIKRATES plan) for reducing the number of local administrations (abolishing prefectures) and elected officials. The public sector enterprises with the highest indebtedness will be subjected to restructurings and privatizations; limits are imposed on State guarantees of their borrowing. The Single

Payment Authority is expected to be operational this year, helping to control the level and dynamics of compensation and employment in general government. Commitment registers have been in all line ministries and public law entities. Other measures include top-down budgeting with expenditure ceilings, contingency margins, implementation of a fiscal rule, and the monthly reporting of fiscal measures.

3.6 Would social unrest worsen?

There is certainly a lot of dissatisfaction among the society about the austerity measures and the planned reforms. However, it is fair to say that there is also widespread consensus on the need for deep reforms, provided that these reforms deliver tangible results in helping the economy come out of the recession fairly soon. In February, when the Prime Minister first addressed the nation and called for a wage freeze and gasoline tax increases, polls showed that 2 out of 3 Greeks agreed with the need for adjustment measures. Polls today show, *inter alia*, that 56% of citizens declare their willingness to accept a reduction in their wage for the country to avoid default, 55% agree with measures imposed by IMF/EU, 75% believe Greece should do what it takes to remain in the Euro Area, 71% call on political parties to find consensus. At the same time, ministers at the forefront of the stabilization program have not necessarily lost popularity; they rather top the list of popularity, a phenomenon unheard of in previous years, when the FinMin position put an end in many political careers. Furthermore, the Government enjoys comfortable parliamentary majority, and it has a fresh vote, having being elected only 8 months ago. The possibility of reform fatigue in a year from now or so will diminish if structural measures manage to engineer a supply rebound and drive the economy out of recession.

3.7 Reduction of Government debt through privatizations and assets utilization

Privatizations could easily bring more than € 10 bn over a 4-year period. Main areas are ports (privatization or concession contracts), gambling (new casino licenses, internet gambling, 34% stake on OPAP), the energy sector (natural gas companies), and real estate. Presently, the Government targets to retain at least 51% in some Public utilities that are considered to be of strategic importance (e.g. PPC). Concession contacts will be used for real estate holdings, ports and airports. The first planned privatizations are:

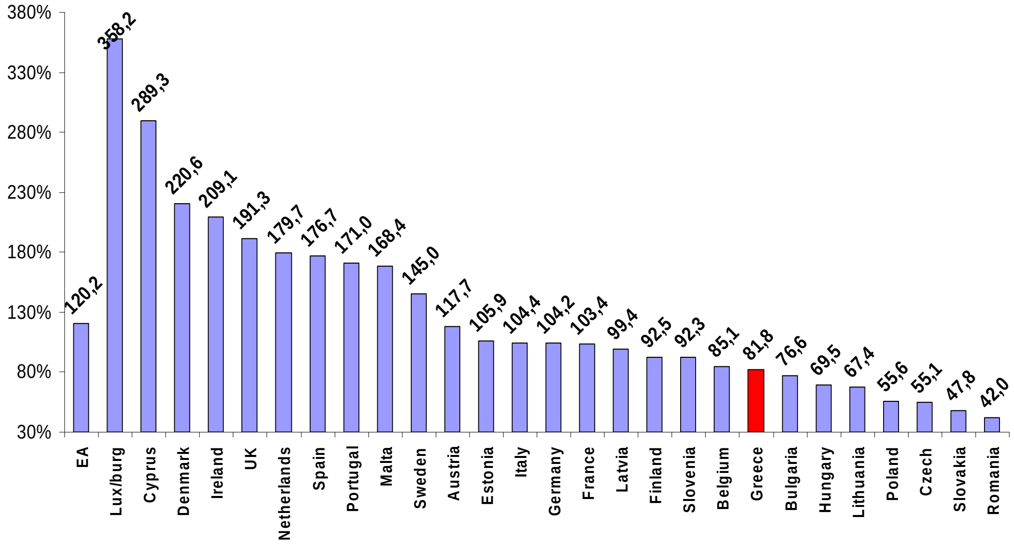
- full privatization of casinos
- stock market listing through SPVs for 10 ports
- Concession contracts for the highway system
- sell of EYDAP’s 10% (Athens water and sewerage), sell of EYATH’s 23% (Thessalonica water and sewerage)
- sell of Hellenic Posts’ 39%,
- sell of TRAINOSE’s 49% (passengers and freight services)
- real estate development through SPVs
- concession contracts for the Athens and Thessalonica freight terminals

So far, there is a slow start, yet speed will pick up once pension and labor reforms are through. The EU/ IMF adjustment programme assumes €1bn per year for the 2011-2015 period while the State (Ministry of Finance) owns real estate assets worth close to €300 bn. Most of it could be deployed through long-term leases. In fact, if State-owned assets are accounted for, Net Gov Debt falls to 86.1% of GDP, a lot lower than gross debt and a lot better than that e.g. of Italy.

3.8 Is overdebtness a characteristic of the private sector in Greece as well?

Overindebtedness is a problem of the public sector only. By contrast, private leverage as a percentage of GDP is small compared to EU averages (see Figure 8). Unlike the US or Western Europe, the Greek banking sector did not cause the 2008-2009 recession; it was rather affected by the problems created by the public sector. The amount of private wealth available for tax raising and investment spending is evident in Greek bank deposits, which total 1.1 times GDP.[11]
In addition, Greeks own a large fraction of international shipping.

Figure 8: Private Loans / GDP



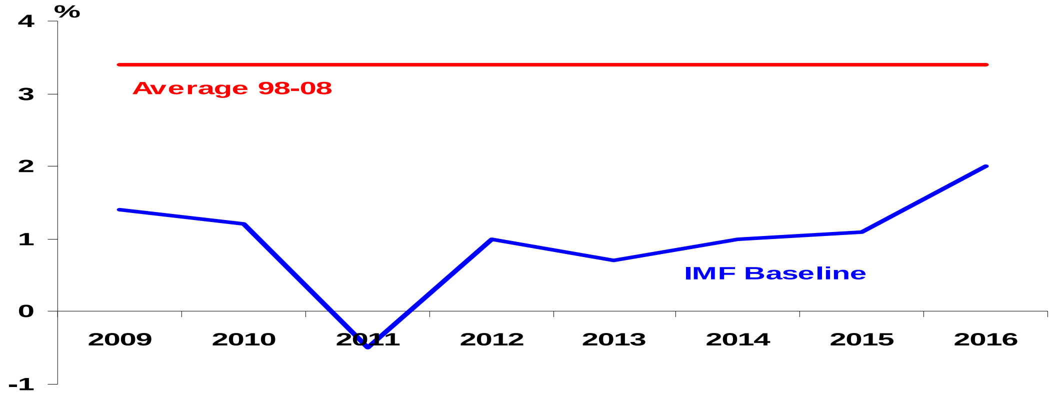
Source: ECB

3.9 Inflation expected higher than in EU/IMF baseline scenario

The IMF/EU Programme assumes subdued inflation throughout its duration (see Figure 9). Although this is a deliberate result of measures that aim in restoring price competitiveness, they also reduce nominal GDP and thus burden the debt-to-GDP ratio. Especially for 2010 the Programme predicts a GDP deflator of 1.2% and for 2011 a slight deflation of -0.5%. However, VAT tax increases have driven yoy inflation up to 5.4% in May 2010. Given that a second hike in VAT rates will be effective from July and that lagged effects should persist until H1 of 2011 at least, IMF's projections do not seem realistic. We, instead assume a GDP deflator of 3.5% and 1% for 2010 and 2011 respectively. One also has to bear in mind that average inflation over the past 10 years has been 3.4% per annum. This partly relates to the Balassa-Samuelson effect, partly to the credit-supported demand expansion, and partly to the inefficiencies and rigidities of the product and labor markets. The latter two factors are addressed by the programme but they cannot be remedied in a very short period of time. In any case, higher inflation becomes likelier if real GDP also grows faster. A reasonably high rate of inflation will have the positive side effect of making the reversal of the Debt-to-GDP ratio easier than currently anticipated. At the same time, if the ECB is forced to maintain a more expansionary stance in monetary policy in order to balance out the effects of necessary fiscal consolidation in many states from hurting the –still weak- economic recovery, inflation might rise at a European level. Hence, the price competitiveness of the Greek economy will not deteriorate. In any case, in our baseline scenario we keep the long-term inflation rate at 2%, in line with ECB's target of price stability. Hence, given the faster growth of productivity of the Greek economy historically, this assumption cannot be said to have a substantial impact on price competitiveness.

[11] *Large, albeit difficult to quantify, Greek assets are also placed in banks abroad, a pool from which substantial investment capital –if not tax revenue- can accrue when the economic environment improves.*

Figure 9: GDP deflator



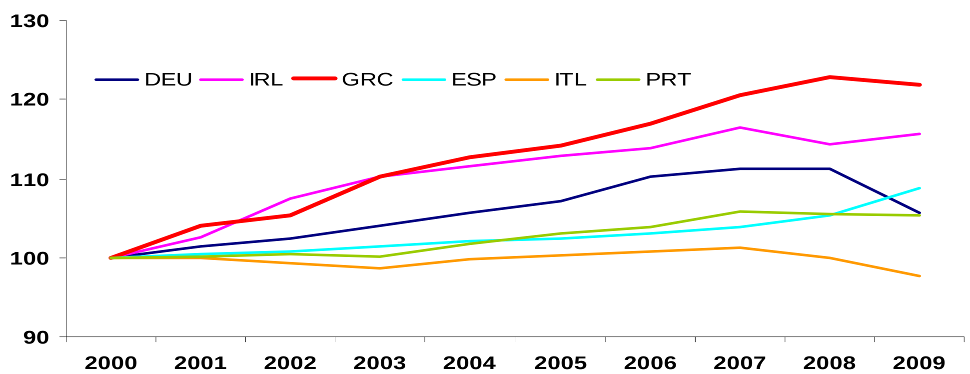
Source:EC Ameco

4. Is there a strong growth story in Greece?

The most important parameter for the success of the stabilization effort is the long-term ability of the economy to generate wealth and thus to repay its debts. Greece grew strongly from 1996 to 2009 with an average annual rate of 3.7% of GDP growth. After EMU entry, growth accelerated even further to a 4.2% average rate, exactly double the EMU average. Still, the IMF/EU programme projects a longer-term trend growth of 2.7%. A common view is that Greek growth was exclusively demand-driven, supported by low interest rates and credit expansion. There is truth to this argument, to the extent that private consumption rose above 70% of GDP, the highest in the EA (EA average of 58%), contributing to high external deficits and a gross external debt that exceeds 180% of GDP.

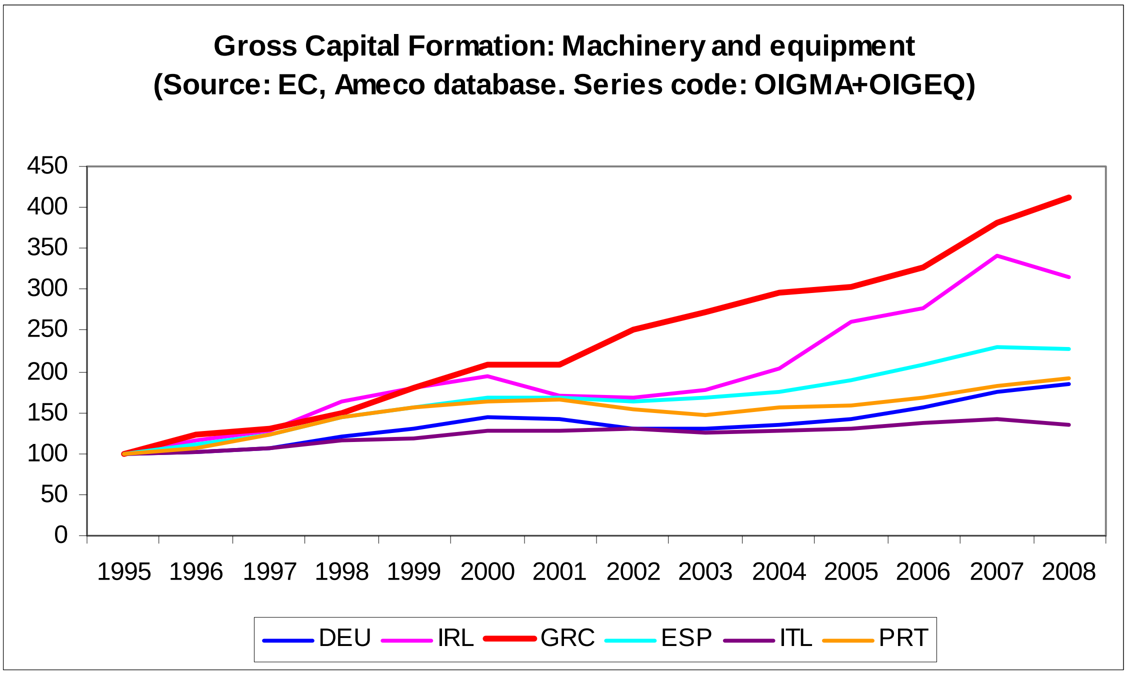
However, Greek growth also relates to productivity. Average annual productivity growth in 2000-2009 was 2.4%, or three times larger than the corresponding growth in Germany, Spain or Portugal and even faster than in Ireland (see Figure 10). Productivity benefited from the macroeconomic and financial stability and institutions building brought about by EMU participation. Moreover, it is related to the fact that investment grew rapidly in the last 15 years. While the least productive part of investment, namely housing, constituted harshly 1/3 of it, Investment in Machinery and Equipment also grew rapidly (see Figure 11, Table 12). As explained above, this catch-up process is partly to blame for the consistent positive inflation differentials vis-ΰ-vis the EA, which deteriorated the price competitiveness of the Greek economy.

Figure 10: Productivity (Real GDP per person employed)



Source: EC Ameco

Figure 11: Gross Capital Formation: Machinery and equipment



Source: EC Ameco

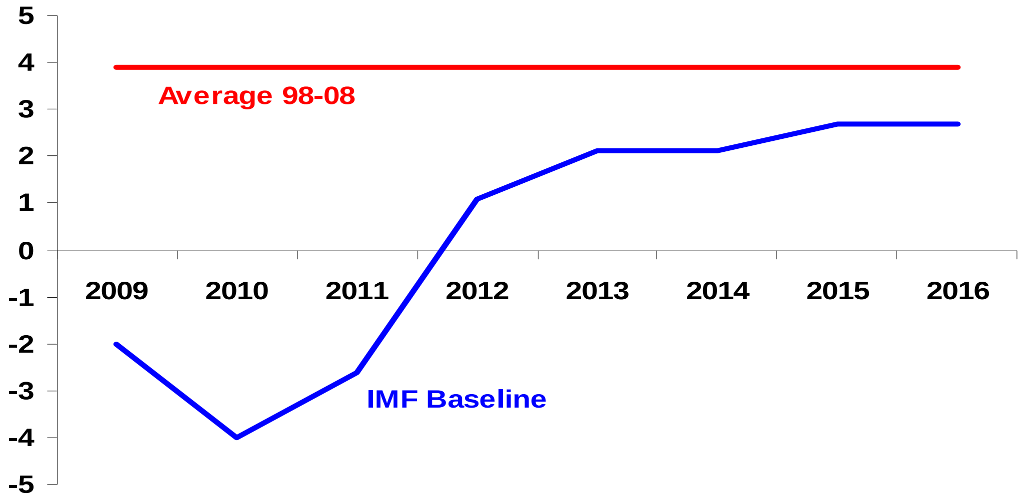
Table 12: Gross Fixed Capital Formation

GFCF: Machinery and equipment growth (average y-o-y)		
Country	**Average 1996-2008**	**Average 2000-2008**
Germany	5	4.1
Ireland	9.9	7.2
Greece	11.8	9.8
Spain	6.6	4.2
Italy	2.4	1.5
Portugal	5.3	2.3

Source: European Commission, Ameco database. Series codes: OIGMA+OIGEQ

There are strong reasons to believe that high productivity growth will continue in the future, once the recession is over, driving a GDP growth rate that will likely outperform the IMF/EU projection (Figure 12). The most important ones are analyzed below.

Figure 12: IMF Projections for Real GDP Growth



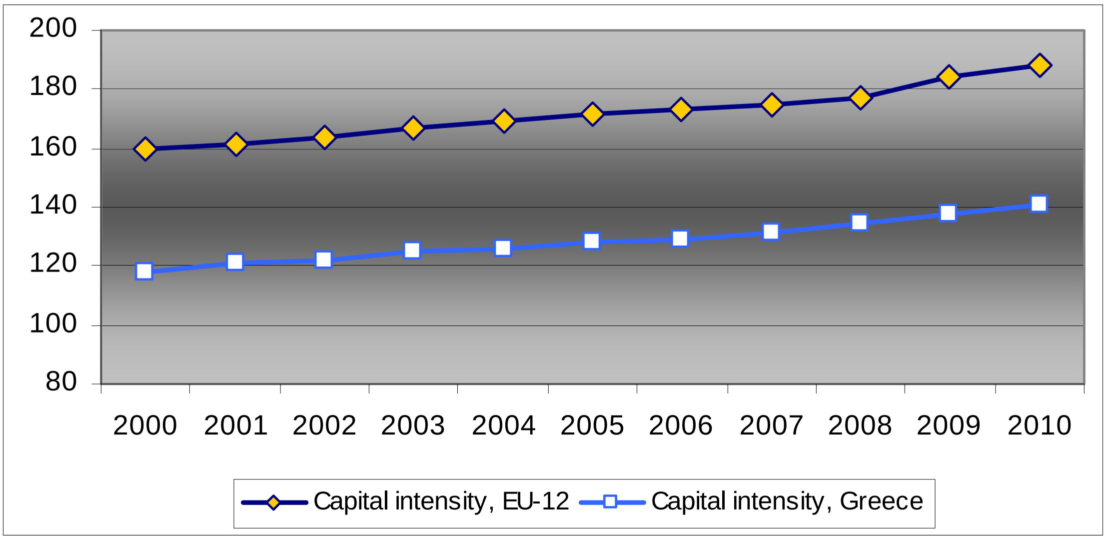
Source: EC Ameco

4.1 Long-run Drivers of High Productivity Growth

a) Capital Intensity

Despite heavy investment of the previous years, the capital intensity of the Greek economy remains below the EA average (see Figure 13). This indicates there is scope for further investment rapid expansion of investment, and thus growth, in the future when the economic environment and interest rates funding the Greek economy normalize.

Figure 13: Capital intensity EU12- Greece



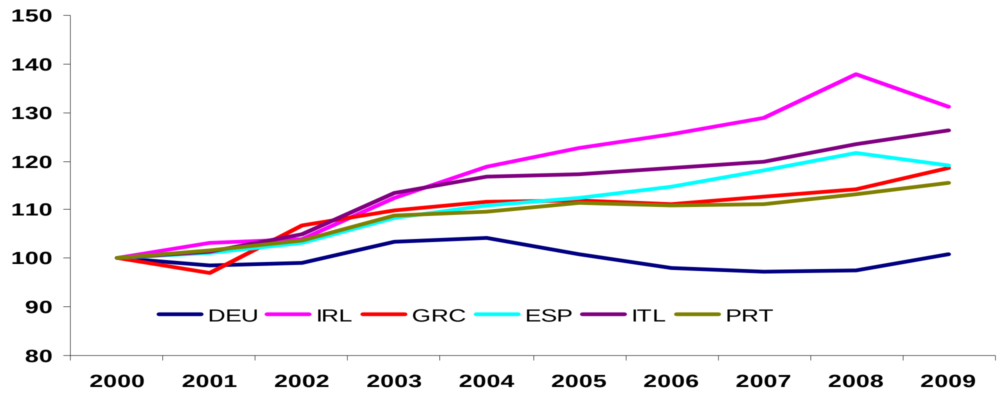
Source: EC Ameco

b) Low Real wages, which do not overwhelm productivity rises

One of the main arguments of those supporting the need to improve of competitiveness via reductions in the labor cost is a presumed increase in *nominal* wages in previous years. Indeed, nominal wages have increased faster than productivity (see Figure 14 and Table 13). As a result, nominal unit labor costs relative to 35 trading partners have increased by ca 20% since 2000. However, Spain and Portugal have witnessed a similar deterioration in their competitive position. Italy and Ireland did even worse. In fact, only Germany has slightly improved its competitive position. If one examines the period from 1996, Greece, Ireland and Portugal witnessed a similar deterioration in competitiveness (ca 1.2% per annum). Spain did slightly better (ca 0.9% p.a.), whereas Italy did worse (ca 2% p.a.). Equally importantly, the deterioration of Unit Labor Cost (ULC) is not uniform across sectors. Most of nominal ULC increases have been in the construction sector and the public sector, both classifying as non-tradeables. This is compatible with the Balassa-Samuelson type of explanation for price increases. If this is the case, this is benign and it should correct itself as real convergence is achieved. By contrast, manufacturing, which admittedly comprises mostly internationally tradeable goods, has witnessed the lowest increase in nominal ULCs, ca 5% since 2000, compared to ca 30% in Italy and Spain. Hence, no substantive competitiveness loss has accrued in this sector.

Furthermore, if one looks at *real* wages, one would discover that they increased cumulatively in 2000-2009 by roughly 4% above productivity, similar to Ireland. As a measure of comparison, the equivalent gap in Italy was 8%, in Portugal 5%, and in Spain 0.6%(see Table 14). It can be concluded that competitiveness deteriorated, not because of higher real wages, but because of higher inflation.

Figure 14: Nominal Unit Labor Costs relative to 35 Trading Partners



Source: EC Ameco

Currently, a real wage decline is underway, as public sector wage cuts give the example (the State is a major employer anyway) and the recession-induced unemployment exercises pressures on employees and trade unions to agree –at best- nominal freezes (i.e. real decreases of wages) for the coming two to three years. More likely, average nominal wages will decline by ca 5%. If one adds to this picture the devaluation of the Euro by ca 15%, which is reasonable to persist in the medium term and which favors exports outside the Eurozone, a considerable improvement of price competitiveness is likely to occur over the next two years.

Table 13: Nominal ULC growth (average YoY)

Country	Average 1996-2009	Average 2000-2009
Germany	-1.47	-0.53
Ireland	1.34	2.34
Greece	1.16	1.11
Spain	0.88	1.53
Italy	1.95	1.79
Portugal	1.38	1.44

Source: European Commission, Ameco database. Series codes: OIGMA+OIGEQ

Table 14: Total % increase in real wages and productivity 2000-2009

Country	Real wage per employee increase 2000-2009	Labor productivity increase 2000-2009
Germany	1.1	5.6
Ireland	19	15.5
Greece	25.8	22
Spain	9.4	8.8
Italy	5.5	-2.4
Portugal	10.5	5.3

Source: European Commission, Ameco database. Series codes: RWCDC, RWGDE

As for profit margins, their growth post-EMU has been quicker than the EA average but this was matched by an equiproportionate growth of capital productivity, thereby not worsening production costs. However, the capital productivity of the Greek economy remains lower compared to the EA average. Given the lower capital intensity, the opposite should be observed. This indicates that there is ample space for productivity gains: it is not so much the stock of production factors that limits competitiveness but the organization of production. In this respect, competition-enhancing and structural measures included in the programme, such as the strengthening of the competition watchdog and the removal of obstacles to entry will greatly help.

c) <u>Structural reforms & institutions building</u>

Research shows that above 50% of Total Factor Productivity comes from factors related to the quality of institutions. If institutions building in the past came from EMU participation, future productivity increases will originate from structural reforms. The effects were quantified by the Foundation for Economic & Industrial Research (IOBE) to surpass 20% of GDP

- Reducing administrative burden to EU-16 avg: ≈ 2%-3% of GDP
- Opening closed professions: ≈ 1% of GDP
- Abolishing obstacles to entry & operation of enterprises: ≈ 2% of GDP
- Improving OECD's PISA educational ranking by 3.5%: ≈ 1% of GDP
- Reduction of mark-up in labour and product markets to EU-16 average could result in a permanent increase of GDP by 17 ppts

Reforms to be undertaken but not evaluated yet include, *inter alia,* the computerisation of public administration, the exploitation of public property, and a potential increase of FDI.

d) <u>Public sector crowding in</u>

The EU/IMF support mechanism is built around the objective of reducing the size of the public sector and increasing the propensity to save, both of the public and the private sectors. These savings will liberate resources and hence translate into increased investment and exports. This, so-called, process of crowding-in can mediate the recession induced by fiscal consolidation (fiscal drag). More importantly, it can create efficiency gains, to the extent that public consumption has a low multiplicatory effect on the GDP, and boost future productivity.

Investment will resume in high rates when markets' confidence is gradually restored, interest rate spreads normalise and business climate improves. As far as exports are concerned, it has already been mentioned that the stabilization program improves price competitiveness, facilitates switch towards tradeables' sectors, and spurs import reduction and substitution by domestically produced goods & services.

e) Capturing the underground economy

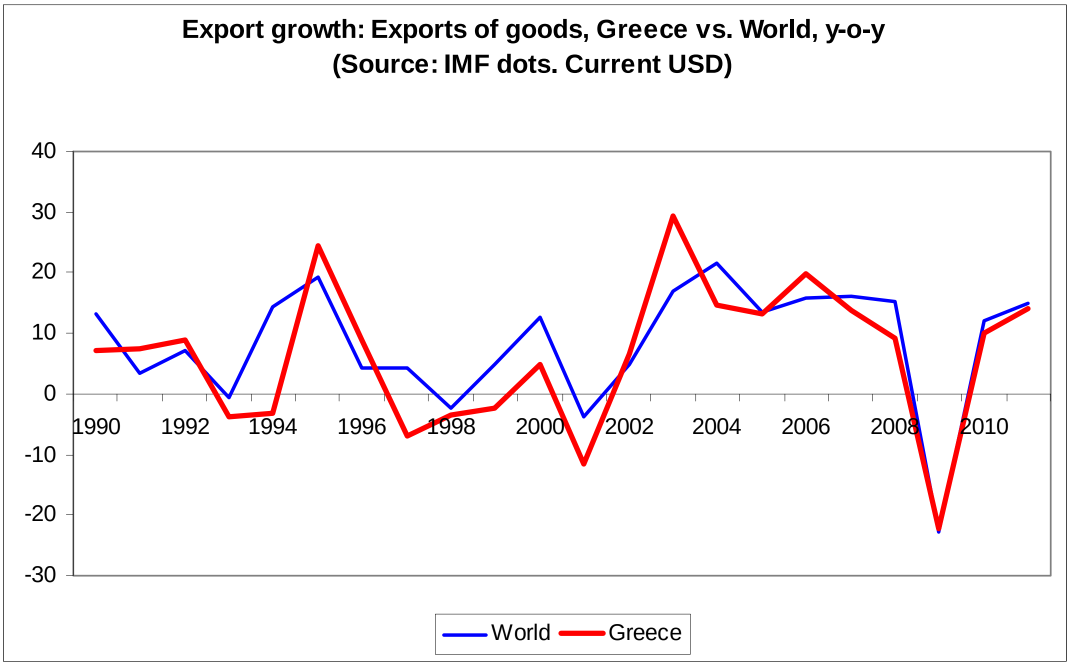
The unofficial economy in Greece is very large. Estimates vary between 20% and 50% of the official GDP, most suggesting it is around 30%. It was mentioned above that the new tax law features numerous measures combating tax evasion. The IMF currently suggests some extra measures, such as immediate prosecution of large offenders, name-and-shame, increase of the portions of fines that have to be deposited before alleged offenders take the case to the courts. Apart from the obvious benefits to revenue generation, if measures succeed in uncovering even a small portion of the grey economy, the recession registered in official statistics can be significantly mediated. Uncovering a truly larger GDP will improve the much attended official debt-to-GDP ratio. Eurostat is likely to account for some of the grey economy in its periodic (5-year) revisions of GDP's in 2011. An upward revision of 10% should not be a surprise as Greece asked for a 26% revision of GDP some years ago before agreeing with Eurostat on a 9.6% revision. To give an extreme example, a 20% upward revision in nominal GDP would bring down the Debt-to-GDP ratio in the EU/IMF baseline scenario to 99.3% in 2020.

4.2 Medium-run Drivers of High Productivity Growth

Some analysts argue that it is not the long term potential of the Greek economy that is crucial for the success of the stabilization effort but its ability to produce a supply boost quickly enough in order to avoid reform fatigue of the population. However, the aforementioned long-term factors can produce tangible results within months, if implemented expeditiously and rigorously. In addition, there are conjectural factors that advocate for a strong growth story in Greece in the medium term.

Firstly, the external sector already smoothens the drastic drop in consumption, with imports declining above 6% YtD in 2010 and exports recording a marginal increase. Net exports are expected to lead the recovery. In 2010-11, we expect imports to decline cumulatively by 20% as a result of disposable income reduction and substitution by domestically produced goods and services. The faster decline of imports compared to aggregate demand is in line with historic elasticities, given that a large portion of imports concerns goods of high income elasticity (big ticket items such as cars and electronics). Provided that the global economy does not go into a double-dip recession (our main scenario), world exports are likely to increase by 10-15% over the period 2010-11, leading to a similar increase in Greek exports of goods without counting the competitiveness push, purely as a result of the global trade recovery. Historically, Greek exports grew in line with world demand (see Figure 15).

Figure 15: Export Growth: Exports of Goods, Greece vs. World, YoY



The second pillar of medium-term growth consists of the investment initiative of the Greek economy. As long as private investment is concerned, given the wide availability of funds discussed above, net investment ought to accelerate the moment economic climate stabilizes and interest rates funding the Greek economy fall. Further, investment will be boosted due to the use of the available EU funds of the National Strategic Reference Framework (NSRF). Under the NSRF, Greece has € 20.4 bn of EU funds available to absorb until 2015 from the Structural and Cohesion Funds. These, together with € 11.2 bn of national funds and € 3.6 bn of private funds form a € 37 bn investment program. The national and private funds are under the present circumstances doubtful. From the EU funds, Greece has absorbed (Ministry Press Conf - Feb) only 5% – with 2/5 being down payments.

A number of measures and adjustments to the administrative system were implemented (Law 3840/2010). All sectoral and regional programs submitted now require more specific operational plans, including timetables. Reallocation of funds can be made at any time between programs and even between subprograms. A number of procedures and organizations are cancelled, thereby reducing bureaucracy. Regional projects, with a budget up to € 50mn, do not require approval (the limit was raised from €5mn). EU co-financed projects have now an absolute priority over nationally-funded projects.

The MoU with the IMF includes a set of relevant absorption measures to be implemented by June 2010. Binding targets have to be made for payment claims of Structural and Cohesion Funds (by 2013 Greece has to absorb €13.7bn, see Table 15). Six-monthly targets from 2011. Also, binding targets have to be made for the submission of large projects - a minimum of ten major projects per annum. A "fast track project production" system is enacted, which includes deadlines for approval and implementation. A Task Force with the Commission is being set up to speed-up the development of high quality projects, through better coordination to ensure rapid implementation of a) major projects in transport sectors, b) environmental projects; c) financial engineering instruments and d) public administration reform. Finally, projects benefiting from EU funds will be prioritized, including the introduction of a central bank account.

Table 15: NSRF - Payment claims to be submitted between 2010 and 2013

Programming period 2007-2013	Payment claims to be submitted between 2010 and 2013			
(in billions of euro)	2010	2011	2012	2013
European Regional Fund and Cohesion Funds	2.3	2.6	2.8	3
European Social Fund	0.4	0.7	0.9	0.9
Target of first half of the year	….	1.1	1.2	1.3
Target of second half of the year	….	2.2	2.5	2.6
Total annual target	2.7	3.3	3.7	3.9

Source : EU/IMF/ECB adjustment programme

Additional absorption measures should be implemented by December 2011. A web-based open access monitoring tool will be created for approval of proposals and implementation of projects. Managing Authorities & Intermediate Bodies of operational programs will have to be certified by the International Organization for Standardization according to the standard ISO 9001:2008 (Quality Management).

According to the MoU, in order to promote investments and exports, the Government has to take measures by September 2010, in line with EU competition rules, to facilitate FDI and investment in innovation in strategic sectors (green industries, ICT etc...). Measures will be taken through a revision of the Investment Law, the adoption of measures to facilitate PPPs, action to fast-track large FDI projects and measures to strengthen export promotion policy. Public consultation has finished and the law is expected to be submitted to Parliament by the end of June. Under the new law, an estimated total of € 2.8 bn of national funds will be available for investment projects in 2011 – 2013. Together with private funds, Greek investments total to an estimated € 4.9 – 6.6 bn. The new law includes a new electronic system for project evaluation, timetables for all procedures, submission of proposals every six months, a new set of criteria emphasizing innovation, exports orientation and the green economy.

4.3 Quantification of Exports Contribution to GDP Growth

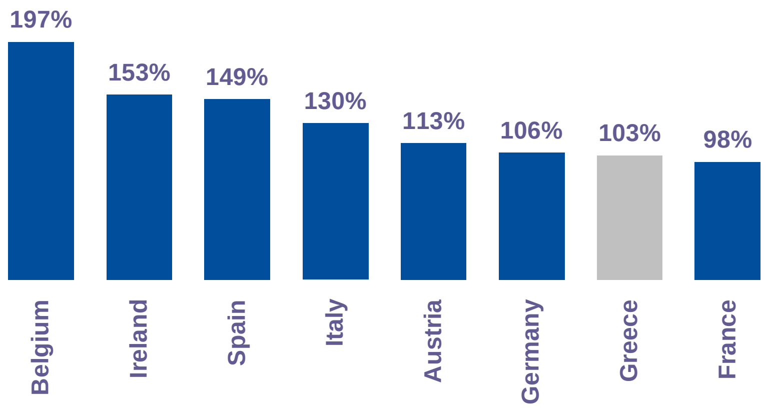
It was explained above that exports are expected to grow by a total of 10-15% in real terms over the period 2010-11 due to the recovery of global trade alone. However, increase in productivity (3%) and wage cuts in the private sector (5%) are expected to improve ULCs by ca 8% over the same period. With the euro remaining ca 10% cheaper relative to 2009 (ca 1.30 against USD), competitiveness of Greek exports is expected to increase by ca 14%. Assuming a one-to-one relation between price competitiveness and exports value, exports would grow by a total of 25-30% over the same period. The BoG has estimated that a 1% increase in exports increases in the medium term GDP by 0.23 ppts on a permanent basis. Hence, the contribution to GDP from exports can be potentially as high as 5.5-7%, i.e. 3.5% per annum. In addition, a decline of imports by 20% over 2010-2011, will contribute 6% to GDP growth over the same period. Thus, the total contribution of net exports on GDP can exceed 10% (5% per annum), counterbalancing a substantial part of the decline in domestic demand and contributing to a flatter recession than currently expected.

5. The Greek Banking System

Fortunately, the Greek banking sector has entered the period of the debt crisis with solid fundamentals. Greek banks are strongly capitalized, have ample liquidity buffers, avoided excesses or exposure to toxic assets during the boom years, are not over-leveraged, their asset's quality is manageable and their exposure to Southeastern and Central Europe partly offsets the Greek strain.

More analytically, Greek banks have annual net revenue buffers in excess of € 3.5bn, including a 2010 profitability run-rate, further re-pricing in Greek loan segments, streamlining of operations and cost containment as well as synergies from potential sector consolidation. The Greek banking system enjoys strong liquidity buffers in the face of adverse macro conditions. It is largely self-funded, thanks to a strong deposits base. The Loans to Deposits ratio stands at 103% for 2009, one of the lowest in Europe (Figure 16). In addition, the ECB offers strong support by accepting GGBs as collateral irrespective of their rating. Contingent liquidity, of approx. 15% of total deposits, will be further boosted by the use of covered bonds and other actions. The government's liquidity scheme can provide an additional €15bn, on top of €17bn remaining from the previous liquidity scheme. Furthermore, there are limited refinancing requirements for 2010 and timid lending growth expectations.

Figure 16: FY 09 L/D ratios



Greek banks are strongly capitalized. Greek capital ratios are among the highest in Europe despite limited government support. For 2009, the Tier I ratio stands at 11%, especially strong vs its EU peers (Figure 17). Greek banks boosted their capital position both organically and through markets, with rights & hybrids issues and buyback of preferred shares. The government support scheme did help, despite being one of the smallest in the EU (Figure 18). Under the EU/ IMF package, an additional €10bn of equity support are provided through the Financial Stability Fund.

Figure 17: FY09 Tier 1 ratios

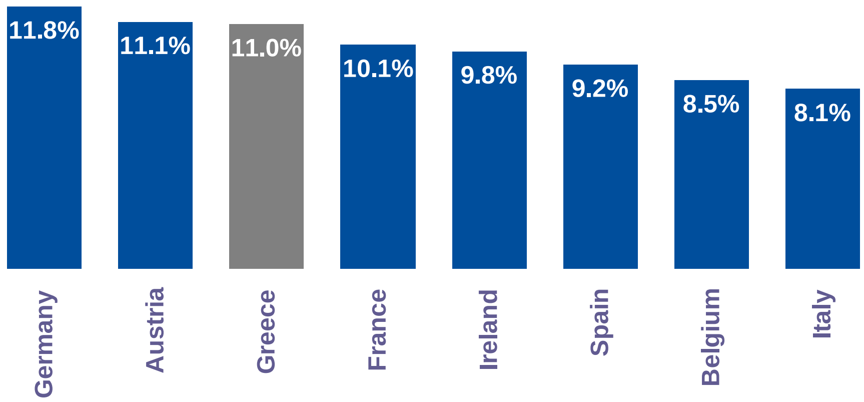
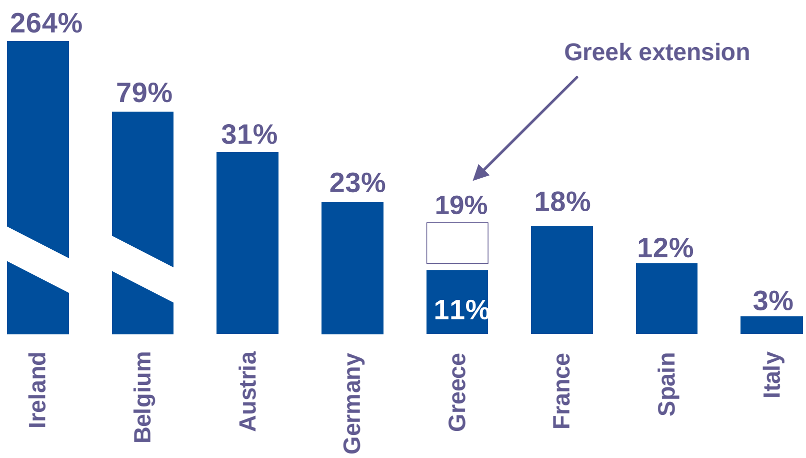
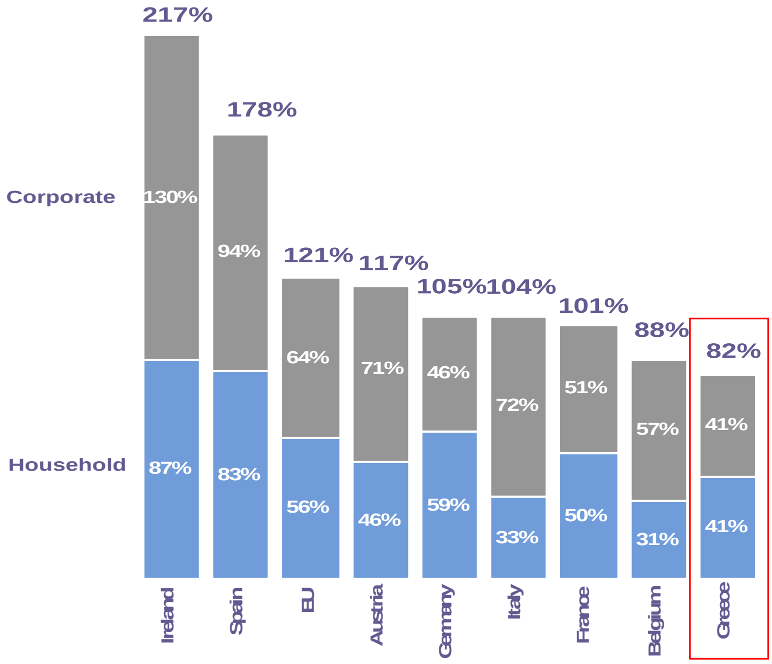


Figure 18: Government support scheme / GDP



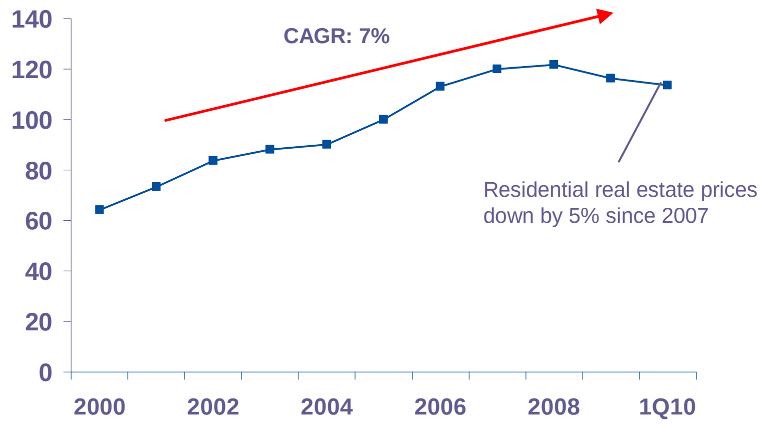
The Greek banking sector is not over-leveraged, with lending penetration remaining at reasonable levels. Lending to households and corporations for 2008 – 2009 reached 82% of GDP (ECB data, excluding securitizations), one of the lowest in the EU (Figur19). Greek banks have not invested in sub-prime/ toxic assets. The government support program was pre-emptive and aimed to supply liquidity to the economy. Furthermore Greece has not experienced a real estate bubble in the sense e.g. Spain has. Therefore, risks for collateral devaluation are limited. Residential real estate prices are down only 5% since 2007 (Figure 20).

Figure 19: Lending (as % of GDP, 2008/2009)



Source: ECB, excludes securitizations

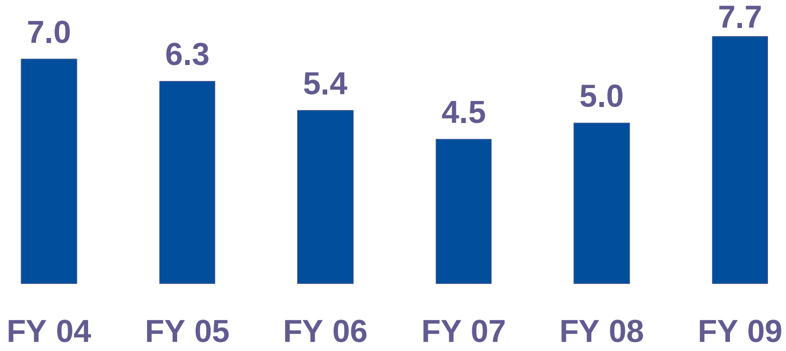
Figure 20: No real estate bubble in Greece (Nominal asset prices, 100=2005)



Source: Real Estate Prices, BoG

As a result, asset quality is manageable. Worries seem overblown, since two years of crisis have pushed NPLs to only 7.7% in 2009 (Figure 21). Solid pre-provision income is the first line of defense for asset quality. Pre-provision margins, at 268bps in 2009, are 40% wider than the European average (191bps). The PPM fully covers the cost of risk for 2009 of 156bps. Pre-provision profit can accommodate NPLs rising to 20% in the next three years before capital is hit.

Figure 21: NPLs on the rise but at reasonable levels



Source: BoG

The Greek banking system also finds strength in its substantial CEE/SEE exposure, which substantially offsets the Greek strain. Profits will track the economic recovery in the region (Figure 22). Currently, the region represents 1/4 of total lending for the Greek banks (four largest players) and corresponds to ca 40% of total revenues. All countries in SEE, including Turkey, are expected to register growth in 2010. Furthermore, local markets remain underleveraged with ample room for credit expansion (Figure 23). The normalization of funding and risk costs is expected to boost profitability.

Figure 22: Sector's SEE earnings follow GDP growth trend

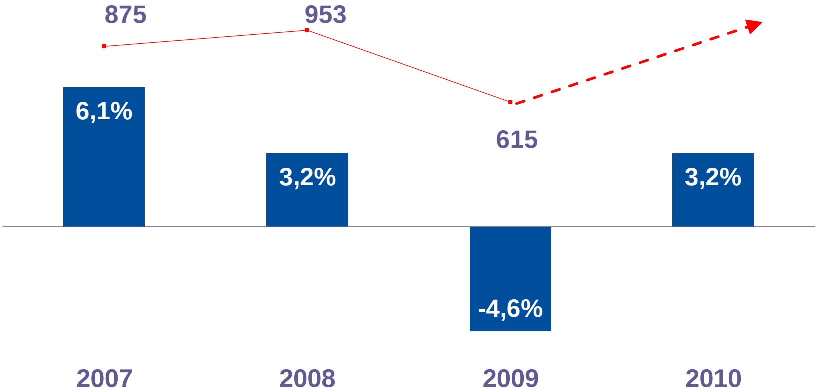
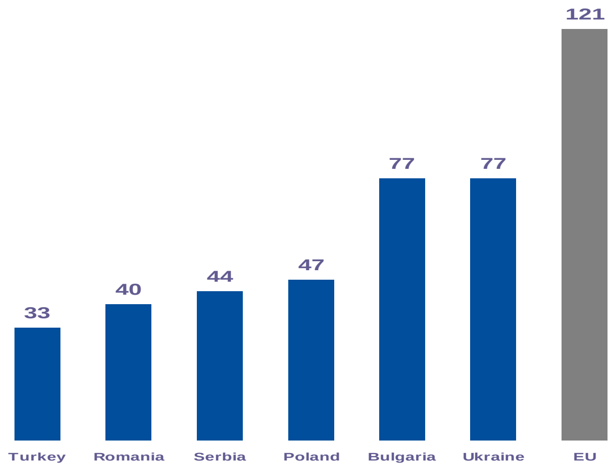


Figure 23: Private sector lending penetration in SEE in FY09 ***(loans as % of GDP)***



Source: Eurobank Research, ECB - excludes securitizations

6. Conclusions

Markets presently discount a significant haircut in GGBs. This seems to be an overreaction. Any restructuring of the Greek debt, a possibility currently discounted by markets, does not seem either likely or necessary. Furthermore, the EU/IMF Programme has a high chance to succeed as Pros outweigh the Cons by a significant margin. Our baseline scenario predicts a debt-to-GDP ratio of 90% in 2020 relative to EU/IMF's 119%. If growth gradually reaches historical norms by 2015, the ratio can decline below 72%. A sensible privatization programme can lead to a further decline of the public debt burden. The Greek economy has hidden strengths that are largely ignored by markets so far. In summary, strong productivity growth can continue to come from faster capital accumulation, higher labor market flexibility, public sector crowding in, structural reforms and institutions' building, plus the gradual capturing of the underground economy. The external sector has a potential for expansion as the downward adjustment of wage costs and the weak euro will boost competitiveness. The EU/IMF Programme has a significant fiscal cushion embedded that allows for fiscal targets to be reached even if recession inflicts blows on revenues. The leverage of the private sector is low, a fact which is likely to contain the effect of the recession on the banking system. Finally, the Greek banking sector is well capitalized and not over-levered.

This is commencement time for the Greek economy, but a new beginning should be built on consensus. The crisis can prove to be the chance for the Greek economy to correct imbalances that were accumulating and were not dealt with for decades, thereby paving the way for a return to sustainable growth.

APPENDIX 1: Specification of the Programme's Measures

Fiscal adjustment is achieved with the use of revenue increasing and cost decreasing measures at roughly equal proportions. Revenue measures include:

- Increase in the main VAT rate to 23%, from 21% presently, respective hikes in the two lower tax rates (from 10% to 11% and from 5% to 5.5%), and transfer of many goods & services to the normal VAT rate
- Measures to broaden the VAT tax base
- A 10ppts hike in excise taxes on fuels, tobacco products and alcoholic beverages
- A rise of 10ppts in the special tax applied to a range of luxury goods
- A one-off tax on profitable domestic firms
- Licensing and taxation of domestic betting and gaming firms
- Introduction of a ''green'' tax

Cost cutting measures include:

- The 13th and 14th annual salary installments are abolished for civil servants earning a gross salary in excess of €3,000 per month. For those earning less than the latter amount, the 13th and 14th salary installments are each replaced by a flat €500 benefit per employee. Special allowances, which constitute a significant part of the total wage bill, will be cut by a further 8% for civil servants (20% in total) and by 3% for employees in state-controlled public corporations
- A 3-year freeze in wages and pensions
- State- and private-sector pensioners receiving monthly pensions in excess of €2,500 will lose their 13th and 14th annual pension payments. The rest will be receiving €400 for the 14th installment (Christmas bonus) and another €400 for the 13th installment (€200 in the form of an Eastern bonus plus €200 for the Summer holiday bonus)
- The Public Investment Budget (PIB) for 2010 will be reduced by €0.5bn (or 0.2% of GDP)
- Private-sector employees will continue to receive their 14h and 13th annual salary payments
- Cancellation of the second tranche of a *solidarity* bonus *(to around 2.5mn lower-income earners)*
- Further cutbacks in central government operational costs
- Objective values on property will be raised and will be brought closer to current market levels, in a bid to boost taxable income
- A tax will be introduced for the legalization of *semi-open* building spaces

Measures that aim to incur structural changes in the Greek economy and boost its competitiveness encompass the following main areas:

- Public Administration reforms
- Labor market reforms
- Pensions Reform
- Healthcare reforms
- Improvement of the business environment
- Measures that aim in strengthening investments and exports
- Reforms on the Structural and Cohesion Funds Implementation framework

Finally, measures that aim in strengthening liquidity and capitalization of domestic banks include:

- Creation of a Financial Stability Fund with €10bn allotted from the EU/IMF programme for dealing with potential repercussions of the recession on bank capitalization.
- The remaining €17bn from the Greek Government's 2008-2009 support package for the banking sector, plus an extension of €15bn for supporting the banking sector's liquidity.
- Intensification of the supervisory role of the Bank of Greece.

APPENDIX 2: Conditionalities for 2010 and Progress Made So Far

Table 2.1: Fiscal Changes done so far according with the EU/IMF ECB programme

Fiscal Changes – Done So Far	
Measures	**Comments**
March 3rd extra-package	
↑ VAT by 2ppts to 21% from 19% & analogous ↑ in 2 other brackets	€ 1.3bn
↑ excise taxes on tobacco, gasoline, electricity and luxury goods	€ 1.1bn
1% levy on those who declared incomes in excess of €100k in FY 2009	
Tax on property worth over € 5mn will be raised to 2.0% from 0.1%	€ 0.2 bn
↑ tax on real estate owned by offshore companies to 15% from 3%	
Taxation of church property and income	
Cuts in the Public Investments Programme	€ 0.5 bn
Cuts in the investment program of the Ministry of Education	€ 0.2 bn
12% cuts in special civil servant allowances.	€ 0.1 bn
30% ↓ in salary bonuses for Xmas, Easter and summer vacation	€ 0.5 bn
↓subsidies to OTE and PPC pension funds (by €150mn per annum)	€ 0.2 bn
Horizontal freeze in state pensions, Cuts in special budget transfers to local govs & others in broader public sector, Abolition of special public-sector committees earning income, 30% cut in overtime pay, 50% reduction in board compensations & elimination of bonuses in the broader public sector	

Source : EU/IMF/ECB adjustment programme, EUROBANK EFG Research

Table 2.2: Structural Changes done so far according with the EU/IMF ECB programme

Structural Measures – Done So Far	
Measures	**Comments**
EU/IMF Package	
↓ of the Easter, Christmas, Summer pension bonuses	€ 1.5 bn
↓ in public sector 's wage expenditure by decreasing Easter, Christmas and Summer salary bonuses and the special allowances of the public sector	€ 1.1bn
↑in VAT Rates to 23% from 21%	€ 0.8 bn
↑ in excise taxes of fuel, tobacco and alcohol	€ 0.45 bn
↓ of Special Budget Inventories	€ 0.7 bn
↓ of higher pensions	€ 0.4 bn
↓ of the budget figures concerning the solidarity allowances	€ 0.4 bn
↓ in the Public Investments Programme	€ 0.5 bn
Simplification of start up of new businesses and making the General Commercial Registry (GEMI) fully operational	Respective bills submitted to the parliament
Adoption of horizontal legislation for the Services Directive, finalization of the sectoral legislation screening.	
Adoption of legislation reforming public administration at local level.	

Source : EU/IMF/ECB adjustment programme, EUROBANK EFG Research

Table 2.3: Structural Changes scheduled to be completed by the end of June 2010 according with the EU/IMF ECB programme

Structural Measures – end of June 2010	
Measures	**Progress**
↑ VAT Rates to 23% from 21%	As of July 1st, 2010 - Value € 0.8 bn
↑ in excise taxes of fuel, tobacco and alcohol	Implemented already - Value € 0.5 bn
↓ in public sector 's wage expenditure by decreasing Easter , Christmas and Summer salary bonuses and the special allowances of the public sector	Implemented already - Value € 1.1 bn
↓ of the Easter, Christmas, Summer pension bonuses	Implemented already - Value € 1.5 bn
↓ of Special Budget Inventories	Implemented already - Value € 0.7 bn
↓ of higher pensions	Implemented already - Value € 0.4 bn
↓ of solidarity allowances	Implemented already - Value € 0.4 bn
↓ in the Public Investments Programme	Implemented already - Value € 0.5 bn
Abolishment of special tax rates for certain professionals & introduction of a uniform progressive tax law.	Implemented already
Finacial Stability Fund	Final Legislation is expected by mid-June
Draft Bill on Pension Reform	Under Discussion
Horizontal legislation for the Services Directive, finalization of the sectoral legislation screening.	Already voted by the parliament
Simplification of start up of new businesses and making the General Commercial Registry (GEMI) fully operational	Respective bills submitted to the parliament
Adoption of horizontal legislation for the Services Directive, finalization of the sectoral legislation screening.	Already voted by the parliament
Absorption of Structural and Cohesion Funds	New Investment Law expected by end of June
Preparation of a recovery plan for the railway sector in order to restore profitability to operational services. Specification of a timetable for the restructuring of the holding company including the sale of land and other assets	A Bill is expected in the following days concerning: - Privatization of TRAINOSE - Privatization of logistic terminals - Real estate development - Termination of costly railway routes, etc
Preparation of the revision of private sector wage bargaining and contractual arrangements	Under discussion
Legislation and measures to rationalize the use of resources, the organization of the public administration and the effectiveness of social programmes	No progress so far
Online publication of government expenditure decisions	No progress so far
Reforming public administration at the local level.	Already voted, implementation 1/1/2011

Source : EU/IMF/ECB adjustment programme, EUROBANK EFG Research

Table 2.4: Structural Changes scheduled to be completed by the end of September 2010 according with the EU/IMF ECB programme

Structural Measures – end of September 2010	
Measures	**Progress**
Draft 2011 Budget including Measures specified in the MoU	No progress so far
Launch a process to create a simplified remuneration system to cover basic wages and all allowances applying to all public sector employees and ensuring that remuneration reflects productivity and tasks	No progress so far
Independent and external review of the organization and functioning of the central administration	No progress so far
The General Commercial Registry (GEMI) fully operational	Bill submited to Parliament
Single points of contact - in Services Directive -operational	Already voted by the parliament. Implementation is under way.
Liberalize road freight transport by removing all unnecessary restrictions on admission to the occupation of road haulage, including minimum fixed prices	Discussion already started.
Finalize plans for the liberalization of the wholesale electricity market and commence with rationalization of consumer tariffs	No progress so far
Government to take measures to facilitate FDI and investment in innovation in strategic sectors (green industries, ICT etc...), through a revision of the Investment Law, the adoption of measures to facilitate PPPs, action to fast-track large FDI projects and measures to strengthen export promotion policy	No progress so far
Bill on Pension Reform	Discussion already started. Expected to be voted by the Parliament by early July.

Source : EU/IMF/ECB adjustment programme, EUROBANK EFG Research

Table 2.5: Structural Changes scheduled to be completed by the end of December 2010 according with the EU/IMF ECB programme

Structural Measures – end of December 2010	
Measures	**Progress**
Single Payment Authority	No progress so far
First phase of the public procurement system - a fully operational electronic platform introducing the use of e-auctioning systems	No progress so far
Reform Employment Protection Legislation	Discussion already started. Expected to be voted by the Parliament by early July.
Reform minimum wages	Discussion already started. Expected to be voted by the Parliament by early July.
Reform private wage bargaining system to ensure wage moderation	Discussion already started. Expected to be voted by the Parliament by early July.
Increase the flexibility of working hours	Discussion already started. Expected to be voted by the Parliament by early July.
Healthcare reform	No progress so far
Simplify and accelerate the process of licensing enterprises, industrial activities and professions through legislation and by making the spatial plans operational	The respective bills submitted to the Parliament.
Implement the Services Directive in key service sectors such as tourism, retail and education	Voted by the parliament. No news on its implementation.
Modify institutional framework of the Hellenic Competition Commission.	No progress so far
Evaluation of all R&D and innovation actions, including various Operational Programmes	No progress so far
Advisory Council to foster innovation, strengthen links between public research and industries and develop of regional industrial clusters	No progress so far
Meet targets for payment claims of Structural and Cohesion Funds (measured against certified data) and large projects.	From December 2010 and every six months afterwards.

Source: EU/IMF/ECB adjustment programme, EUROBANK EFG Research

Table 2.6 Greece: Quantitative Performance Criteria (in billions of euros, unless otherwise indicated

Quantitative Performance Criteria						
	Performance Criteria			Indicative Targets		
	Jun-10	Sep-10	Dec-10	Jun-10	Sep-10	Dec-10
	1/	1/	1/	2/	3/	4/
1. Floor on the modified general government primary cash balance	-5.0	-4.0	-5.7	-2.1	2.4	7.4
2. Ceiling on State Budget Primary Spending	34	50	67	67	68	69
3. Ceiling on the accumulation of new domestic arrears by the general government 5/	…	…	…	0	0	0
4. Ceiling on the overall stock of central government debt	342	342	342	365	…	…
5. Ceiling on the new guarantees granted by the central government	2.0	2.0	2.0	1.0	0.0	0.0
6. Ceiling on the accumulation of new external payments arrears on external debt contracted or guaranteed by general government from multilateral or bilateral official creditors 5/	0	0	0	0	0	0

Source : EU/IMF/ECB adjustment programme

1/ Cumulatively from January 1st, 2010 (unless otherwise indicated).

2/ Cumulatively from January 1st, 2011 (unless otherwise indicated).

3/ Cumulatively from January 1st, 2012 (unless otherwise indicated).

4/ Cumulatively from January 1st, 2013 (unless otherwise indicated).

5/ Applies on a continuous basis from April 30, 2010 onward.

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