Eurobank Research
www.eurobank.gr/research
research@eurobank.gr

Eurobank EFG

GREECE MACRO MONITOR

May 23, 2011

Focus notes: Greece

Latest macro & market developments

Written By:

Dr. Platon Monokroussos
Assistant General Manager
Head of Financial Markets Research

Dr. Theodoros Stamatiou
Research Economist

Paraskevi Petropoulou
G10 Markets Analyst

DISCLAIMER
This report has been issued by EFG Eurobank Ergasias S.A. (Eurobank EFG), and may not be reproduced or publicized in any manner. The information contained and the opinions expressed herein are for informative purposes only and they do not constitute a solicitation to buy or sell any securities or effect any other investment. EFG Eurobank Ergasias S.A. (Eurobank EFG), as well as its directors, officers and employees may perform for their own account, for clients or third party persons, investments concurrent or opposed to the opinions expressed in the report. This report is based on information obtained from sources believed to be reliable and all due diligence has been taken for its process. However, the data have not been verified by EFG Eurobank Ergasias S.A. (Eurobank EFG), and no warranty expressed or implicit is made as to their accuracy, completeness, or timeliness. All opinions and estimates are valid as of the date of the report and remain subject to change without notice. Investment decisions must be made upon investor's individual judgement and based on own information and evaluation of undertaken risk. The investments mentioned or suggested in the report may not be suitable for certain investors depending on their investment objectives and financial condition. The aforesaid brief statements do not describe comprehensively the risks and other significant aspects relating to an investment choice. EFG Eurobank Ergasias S.A. (Eurobank EFG), as well as its directors, officers and employees accept no liability for any loss or damage, direct or indirect, that may occur from the use of this report.

Contents

Part I – Latest on the euro area sovereign debt crisis

May 16th-17th Eurogroup/Ecofin meetings consider possible future adjustments in Greece's fiscal programme; final agreement still pending

Amid lingering market uncertainty over Greece's ability to promote much needed reforms to ensure fiscal sustainability, the pace of implementation of the country's present adjustment programme was debated at the May 16/17 Eurogroup and Ecofin meetings. As expected, no formal agreement was reached. Several EU policymakers have made clear over the last few sessions that no final decision on potential additional assistance to Greece will be made before the completion of the 4th EU/IMF programme review (due on May 31) and a special study on the sustainability of the country's fiscal position, expected in late June.

On the sidelines of the Eurogroup/Ecofin meetings, a number of high-level EU officials suggested that the majority of participants strongly opposed an outright restructuring of Greek debt, on the view that the costs of such an operation would greatly outweigh any potential benefits. However, German Finance Minister Wolfgang Schaeuble and Eurogroup chairman Jean-Claude Juncker acknowledged publicly that a voluntary "reprofiling" of Greek debt is one of the options under consideration to address market worries over the country's debt dynamics. According to these officials, such a scheme could be part of a package including additional EU/IMF financing in exchange for tougher fiscal measures and stronger conditionality with respect to the implementation of structural reform and privatization.

On the other hand, it appears that the ECB continues to strongly oppose any form of debt restructuring for Greece, either "hard" *(i.e., involving, among others, outright haircuts)* or "soft" (*i.e., voluntary lengthening of maturities of privately-held debt securities),* on the basis that such an operation would have devastating consequences for the country itself and financial stability in the euro area. In these lines, ECB Executive Board member Lorenzo Bini Smaghi early last week characterized market talk of a so-called "soft restructuring" of Greek debt as "empty slogans" and instead urged Greece to press ahead with fiscal consolidation and privatizations.

The idea of a voluntary maturity extension of Greek debt has also been opposed publically by a number of other top ECB policymakers, including Bundesbank's new chief, Jens Weidmann and ECB Executive Board member Juergen Stark. As Mr. Weidmann told a central bank conference in Hamburg late last week, "a prolongation of Greek bonds in an environment of prevailing strong doubts about the sustainability of public finances would make it impossible to accept them as collateral for refinancing operations under the existing rules of the Eurosystem's collateral framework".

In similar lines, two major credit rating agencies, Standard & Poor's and Fitch, have already warned that any kind of sovereign debt restructuring in the euro area would be tantamount to default. In a statement released by Fitch on May 20th, commenting on a decision to downgrade Greece's long-term foreign and local currency issuer default ratings by three notches, to "B+" from "BB+" with ratings watch negative, the agency stated that "An extension of the maturity of existing bonds would be considered by Fitch to be a default event and Greece and its obligations would be rated accordingly".

Reportedly, some of the issues discussed during the May 16/17 Eurogroup and Ecofin meetings included:

i) The option of a voluntary "reprofiling" of Greek debt

In the press conference that followed the conclusion of the Eurogroup meeting, Mr. Jean-Claude Juncker noted that he "wouldn't exclude" a *soft* reprofiling of the Greek debt on a voluntary basis. Mr. Juncker stated that key prerequisites for such an arrangement would include: **a)** a rigorous implementation of an ambitious programme of state asset sales and leases announced recently by the Greek government, aiming to generate as much as €50bn by 2015 to help reduce the public debt burden and **b)** implementation of additional measures necessary to ensure fulfillment of the budget deficit targets set out in the EU/IMF bailout out programme. The Eurogroup official added that the austerity program should be endorsed by all political parties in the Greek parliament, underlying the need of a broader political consensus.

Reportedly, under a Greek debt reprofiling scheme, privately held debt could be rescheduled on a voluntary basis, in tandem with a lengthening of the maturity of EU loans. More specifically, investors might exchange, on a voluntary basis, their existing holdings of Greek government bonds (GGBs) with new debt instruments of longer maturities. Such an option would allow Greece to reduce its financing needs over the next few years, giving some breathing space to the government to deliver on its fiscal/structural reform efforts to boost potential growth and enhance competitiveness. In order for private holders to be encouraged to make such a switch, some form of credit enhancement could reportedly be provided to new debt instruments by *e.g.* the EFSF or the government in the from of collateralization. According to press leaks, Netherlands has been pushing for the establishment of a trust which would hold Greek state assets as collateral. Finland also favors this option. Finland's parliament decided earlier this week that participation in any further bailout plans would require the debtor country to provide collateral for any new EU loans received.

Even in the case of a voluntary debt reprofiling, however, uncertainty remains as to whether such a scheme would trigger a "credit event", forcing the paying-out of sovereign credit default swaps contracts (CDSs). The terms of the International Swaps and Derivates Association (ISDA) read that a credit event is defined as i) failure to pay a coupon interest payment or principal ii) a restructuring- amendment to the terms of the original obligation and iii) repudiation/moratorium of the debt. Ultimately, the decision on whether a reprofling/restructuring constitutes a credit event or not would be up to the so-called CDS Determinations Committee which meets under the auspices of ISDA and consists of representatives from the world's biggest banks and the hedge funds industry.

Besides these technicalities as well as a number of other complex technical and legal issues, we reiterate that the ECB continues to strongly oppose any form of restructuring of Greek public debt, either "hard" or "soft" and on a voluntary basis. These considerations appear to suggest that a likely outcome in the EU/IMF policymakers' effort to address the lingering sovereign crisis going forward would be the provision of additional financing to Greece in order to secure fulfillment of the country's borrowing needs until at least mid-2013, when the ESM mechanism comes into effect. Such additional financing would likely come with stronger conditionality with respect to Greece's structural reforms and privatisation programme. (For more analysis on the latter issue please see *Eurobank EFG research Greece Macro Monitor, May 13, 2011).*

ii) Approval of Portugal's $78bn EU/IMF bail-out package

One-third of Portugal's rescue loans will come from the IMF while the rest be split equally among Europe's two bailout funds, the European Financial Stabilisation Mechanism (EFSM) backed by the EU budget and the European Financial Stabilsation Mechanism (EFSM) backed by loan guarantees borne by the participating euro-zone member states. The average maturity of the rescue loans will be 7 ½ years and come at an interest rate of around 5.7%. In the accompanying statement, Eurozone FinMins said that the Portuguese authorities agreed to "encourage" private investors to maintain their exposure to the country "on a voluntary basis" for as long the EU/IMF adjustment program is in place. That was a key demand by Finland, which had a hard time getting approval for Portugal's rescue package from its parliament last week. Social Democrats -the second largest political party which is expected to play a powerful role in the new Finnish government- laid out a number of conditions in exchange for their support including that banks and private investors have to share some of the burden in case of any further bailout package.

iii) EU finance ministers unanimously backed Italian central bank president Mario Draghi as the next ECB president

This was the first formal approval necessary for Mr. Draghi before he can take the post in October when Mr. Jean-Claude Trichet's term expires.

Part II - Latest domestic macro and market developments

Greece's 13-week T-bill auction was well received

Greece's Public Debt Management successfully sold earlier this week €1.625bn of 13-week T-bills, including €375mn in non-competitive bids. The auction produced an average yield of 4.06%, 4bps lower from a previous auction of similar maturity paper in mid-April. Investors bid 3.3 times the T-bills offered compared with a bid-to-cover ratio of 3.45 in the April 19 auction. Around 31% of the T-bills sold were purchased by foreign investors, slightly lower from 35% last month.

PDMA faces rollovers totaling €897mn this month: €480mn of 13-week-T-bill mature on May 20 while another €417mn of 10-yr notes comes due on May 31. For the remaining of this year, overall principal and interest payments amount to €35,199bn. Greece has raised $14.160bn via T-bill auctions so far this year and has received €53bn of total funding under the €110bn EU/IMF emergency package in four separate installments. In 2011, total IMF funding will amount to €11bn and will be partnered with €29bn committed by EU states. The IMF fifth quarterly adjustment program review with respect to the execution of Greece's stabilization program, is anticipated to be completed by the end of this month. The release of the €12bn fifth disbursement of the EU/IMF €110bn loan, scheduled for June, is conditional on the endorsement of this review.

The March 2011 update of the EU/IMF programme envisions that Greece will return to the international capital markets by Q1 2012. But with Greek borrowing rates remaining in a steep upward trend, the country may find it difficult to refinance itself in markets as soon as early next year.

Greece's real GDP up by 0.8% QoQ in Q1:2011, halting a nine-month string of negative growth

According to the flash GDP report released on May 13th, the Greek economy contracted by a preliminary 4.8% YoY in Q1:2011, with the corresponding seasonally adjusted quarter-on-quarter reading coming in at +0.8%. This was the first positive reading after nine consecutive quarters of contraction and follows a *downwardly revised* GDP print of -2.8% QoQ (-7.4% YoY) in the prior quarter. Although the flash GDP report does not provide a detailed breakdown of spending-side components, we suspect that the better-than-expected Q1:2011 figure was mainly due to the strong positive contribution from net exports. The latter view is also supported by the most recent readings in a range of higher frequency indicators of external sector performance. Among others, exports of goods as recorded in the Bank of Greece's balance of payment statistics grew by 20.8% YoY over the first two months of 2011, while exports of services increased by a modest 0.4% YoY over the corresponding period. The government projects full-year GDP to decline by 3.0% in 2011, in line with the latest (March 2011) EU/IMF baseline forecasts.

It needs to be noted that the Greek statistics office, EL.STAT, has recently changed the methodology it uses to compile quarterly data for the general government transaction. Specifically, quarterly estimates for the years 2009-2011 are now based on data mainly from direct sources, while for the period 2000-2008 estimates were made by allocating the annual results to the quarters. This affects the comparability of the 2008 and 2009 data, and EL.STAT warns that its quarterly GDP growth figures between these two years should be treated with caution. Furthermore, due to the relatively short time span of the available quarterly general government data in the period Q12:009-Q12:011, the previously implemented method for the seasonal adjustment did not provide satisfactory results. To address the problem, ELSTAT in consultation with Eurostat, has applied a new method of seasonal adjustment, which allows for seasonal breaks and is deemed to provide more reliable results. Nevertheless, data users should continue to use caution in using these results until *a longer time series is established.*

Year-to-April underperformance of budget revenue target remains a source of concern

According to preliminary data released by the General Accounting Office (GAO), the central government budget deficit for the first four months of 2011 rose by 13.5% yoy, reaching ca €7.24 bn. This compares with an official deficit projection of €6.92 bn for the corresponding period, implying a 4.5% overshooting of the respective budget target.

Specifically, year-to-April net ordinary budget revenues were lower by ca €1.47 bn (or 9.2% yoy) relative to the same period a year earlier, underperforming the corresponding budget target by 1.5%. According to the GAO, the underperformance in revenues in the first four months of 2011 can be attributed to:

a) The stronger-than-expected downturn of the domestic economy over the corresponding period.

b) The non repetition of an extension granted for the payment of last year's road duties. This inflated the January 2010 state receipts by an estimated €0.39 bn.

c) Lower tax receipts from an extraordinary tax on large company profits (impact: €0.04 bn)

d) Reduced revenue from a withholding personal income tax.

e) Larger than expected tax refunds for the settlement of last year's budget obligations.

In addition to these drivers, it appears that persisting disfunctionalities in the revenue collection mechanism and widespread tax evasion continued to weigh on budget revenues in the first four months of the year.

Military procurement expenditure in January-April 2011 was around €0.05 bn, compared with a €0.56bn budget target for the same period. On the other hand, Interest expenditures increased by 14.3% yoy, outpacing the respective budget target by ca €0.1 bn. Finally, Public Investment Budget (PIB) revenues increased by €0.3 bn year-to- April, outperforming the corresponding budget target by €0.6 bn, while PIB expenditure declined by 42.5% yoy.

Note that the March 2011 update of the EU/IMF stabilization programme for Greece identified a gap of ca 1¾ ppts-of-GDP in the country's 2011 fiscal plan. In the meantime, the recent upward revision in the 2010 fiscal deficit (to 10.5%-of-GDP, from 9.6%-of-GDP expected earlier), the underperformance of tax revenue during the first four months of the year and the likelihood of a sharper GDP contraction relative to what it is assumed in the 2011 budget plan necessitate the implementation of additional measures to ensure fulfillment of the 2011 deficit target (7.4%-of-GDP). These measures are currently under discussion with the EC/ECB/IMF mission to Greece for the 4th programme review. According to reports, the government is soon expected to announce additional measures worth around €6bn (ca 2.5ppts-of-GDP) in an effort to facilitate achievements of the 2011 budget target.

Ordinary Budget	Jan-April 2010 (€bn)	Jan-April 2011 (€bn)	Jan-April 2011 (%YoY)	2011 Budget Jan April (€bn)	Annual target (%YoY)
1. Net Revenue (a-b-c)	15.93	14.46	-9.2	16.34	8.5
a. Gross revenue	17.23	16.08	-6.7	17.14	5.6
b. NATO revenue	0.00	0.02		0.01	207.7
c. Tax refunds	1.30	1.64	25.6	0.98	-23.7
2. Expenditure (α+β+γ+δ+ε+στ)	20.29	20.99	3.4	20.84	6.6
α. Primary expenses	16.89	16.74	-0.9	16.27	1.9
β. Transfer to hospitals for the settlement of part of past debt	0.00	0.38		0.27	19.9
γ. NATO expenditures	0.00	0.00		0.00	73.9
δ. Military procurement	0.01	0.05		0.56	57.3
ε. Forfeiture of Government Guarantees	0.05	0.05	-80.4	0.05	0.0
στ. Interest costs	3.34	3.82	14.3	3.71	20.4
Public Investment Budget (PIB)					
3. Revenue	0.30	0.62	108.6	0.03	27.7
4. Expenditure	2.31	1.33	-42.5	2.45	0.6
5. Budget deficit (-) or budget surplus (+) (1-2+3-4)	-6.37	-7.24	13.5	-6.92	-3.9

Source: Ministry of Finance

Table 1: Greece-Key Indicators

	Last	ytd	2009
Macroeconomic indicators			
GDP growth (%YoY)	-4.8 (Q1 11)	-4.5	-2.0
CPI	3.9 (April 11)	1.2	4.7
Unemployment rate	15.9 (Feb 11)	33.1	1.3
Labor Cost (%YoY)	-4.2 (Q4 10)	-4.2	3.6
Economic Sentiment (index level-period average)	74.2 (April 11)	77.0	76.3
Consumer-vigor indicators			
Private consumption in constant prices (% YoY)	-8.6 (Q4 10)	-8.6	-2.2
Retail sales excl. fuels & lubricants volume (% YoY)	-11.5 (Feb 11)	-10.3	-0.9
New private passenger car registrations (% YoY)	-18.1 (April 11)	176.1	22.0
Consumer confidence (index level - period average)	-70.0 (April 11)	-68.1	-45.7
Retail trade expectations (index level - period average)	-30.5 (April 11)	-26.3	-15.4
Industrial-activity indicators			
Industrial production (% YoY)	-8.1 (March 11)	-0.9	-17.4
Capacity utilization in industry (index level -period average rate)	68.0 (Feb 11)	68.4	70.5
Industrial confidence (index level - period average)	-21.1 (April 11)	1.0	-28.1
Manufacturing PMI (index level - period average)	45.4 (March 11)	43.7	45.4
Construction sector & other investment-activity indicators			
Cross fixed capital formation in constant prices (% YoY)	-7.6 (Q4 10)	-7.6	-15.1
Housing investment in constant prices (% YoY)	-18.5 (Q4 10)	-18.5	-23.0
Other construction in constant prices (% YoY)	35.3 (Q4 10)	35.3	-16.7
Private building permits volume (% YoY)	-31.4 (Nov 10)	-39.9	-22.6
Construction confidence (index level - period average)	-71.0 (April 11)	-66.4	-39.5
Balance-of-Payments statistics *(euro-terms)*			
Tourism revenues (% YoY)	-1.9 (Feb 11)	6.2	-10.2
Transportation revenues (% YoY)	--4.1 (Feb 11)	-13.4	-7.9
Customs-based statistics *(€ - terms)*			
Goods exports (% YoY)	23.6 (March 11)	-3.4	-3.2
Goods exports to EU (% YoY)	12.8 (March 11)	7.1	4.2
Goods exports to non-EU countries (% YoY)	42.7 (March 11)	-14.0	-14.4
Goods imports (% YoY)	-37.6 (March 11)	-14.1	1.0
Goods imports from EU (% YoY)	-17.6 (March 11)	4.2	-7.8
Goods imports from non-EU countries (% YoY)	-55.7 (March 11)	-25.8	1.1
Domestic MFI credit to domestic enterprises & households *(oustanding balances)*			
Private sector (% YoY)	1.7 (March 11)	-1.0	1.5
Enterprises (% YoY)	-7.0 (March 11)	-0.9	1.0
Households (% YoY)	-2.4 (March 11)	-1.1	1.9
Housing loans (% YoY)	-1.7 (March 11)	-0.9	3.7
Consumer credit (% YoY)	-2.9 (March 11)	-1.8	-1.6
Private-sector credit outstanding (% GDP) *			
Total domestic enterprices & households	113.0 (March 11)	-	106.6
Domestic households	51.6 (March 11)	-	50.2

Source: Hellenic Statistical Authority, Bank of Greece, ECOWIN

* IMF's nominal GDP projection for 2011 was used. The respective number is €225.7 bn

Table 2: EC/ECB/IMF Baseline Scenario

	2009	2010	2011	2012	2013	2014	2015	2020
GDP Growth (%)	-2.0	-4.5	-3.0	1.1	2.1	2.1	2.7	3.0
GDP deflator (%)	1.5	2.3	1.6	0.4	0.8	1.2	0.6	1.8
Nominal GDP (€ bn)	235.0	229.0	226.0	229.0	236.0	244.0	252.0	315.0
Current Account (% GDP)	-11.0	-10.5	-8.2	-7.1	-6.6	-5.5	-4.4	----
Interest Rate (%)	4.8	4.9	4.6	5.0	5.4	5.7	5.7	5.9
Bund Rate (bps)	----	225.0	275.0	350.0	350.0	350.0	350.0	350.0
Spread over Bund (bps)	----	550.0	525.0	350.0	300.0	300.0	300.0	250.0
Interest Expense (€ bn)	12.4	14.6	15.1	17.3	19.7	21.2	21.4	23.7
Interest Expense (% GDP)	5.3	6.4	6.7	7.5	8.3	8.7	8.5	7.5
Primary Expenditure (% GDP)	47.9	43.5	44.0	41.7	38.5	33.2	32.2	30.5
General Government Revenue (% GDP)	37.8	40.4	43.1	42.8	42.0	39.3	38.5	36.5
Primary Balance (% GDP)	-10.1	-3.2	-0.9	1.0	3.5	6.0	6.3	5.9
General Government Deficit (% GDP)	-15.4	-10.5*	-7.5	-6.5	-4.8	-2.6	-2.1	-1.6
General Government Deficit (€ bn)	-36.2	-22.0	-16.9	-14.9	-11.3	-6.3	-5.3	-5.0
General Government Debt (% GDP)	127.0	143.0	153.0	159.0	158.0	154.0	151.0	130.0
General Government Debt (€ bn)	298.0	327.0	345.0	364.0	373.0	375.0	381.0	409.0

Note: *Updated after Eurostat's deficit and public debt announcement of April 26th 2011 (EDP procedure)

Source: 3rd Review of the EC/ECB/IMF Adjustment Programme for Greece, Eurostat

Research Team

Editor, Professor **Gikas Hardouvelis**
Ch ief Economist & Director of Research Eurobank EFG Group

Financial Markets Research Division
Platon Monokroussos, *Head of Financial Markets Research Division*
Paraskevi Petropoulou, *G10 Markets Analyst*
Galatia Phoka, *Emerging Markets Analyst*

Sales Team
Nikos Laios, *Head of Sales*
Vassilis Gioulbaxiotis, *Head of International Sales*
Yiannis Seimenis, Ioannis Maggel, *Corporate Sales*
Stogioglou Achilleas, *Private Banking Sales*
Alexandra Papathanasiou, *Institutional Sales*

Economic Research & Forecasting Division
Dimitris Malliaropulos, *Economic Research Advisor*
Tasos Anastasatos, *Senior Economist*
Ioannis Gkionis, *Research Economist*
Stella Kanellopoulou, *Research Economist*
Olga Kosma, *Economic Analyst*
Maria Prandeka, *Economic Analyst*
Theodosios Sampaniotis, *Senior Economic Analyst*
Theodoros Stamatiou, *Research Economist*

Eurobank EFG, 20 Amalias Av & 5 Souri Str, 10557 Athens, tel: +30.210.333 .7365, fax: +30.210.333.7687, contact email: Research@eurobank.gr

Eurobank EFG Economic Research

More research editions available at http://www.eurobank.gr/research

- **New Europe**: Economics & Strategy Monthly edition on the economies and the markets of New Europe
- **Economy & Markets**: Monthly economic research edition
- **Global Economic & Market Outlook**: Quarterly review of the international economy and financial markets

Subscribe electronically at