Athens, July 5, 2010

Focus-Greece

BoG cash-basis data shows government on target to meet 2010 fiscal target

Key points

- **BoG cash-basis data shows 41.8% YoY reduction in central government budget deficit**
- **Progress in cutting budgetary expenditure quite impressive so far**
- **Growth in tax revenue likely to accelerate in the following months, as the bulk of revenue-side measures *(e.g. the 2nd installment of hikes in VAT and a range of special consumption tax rates)* will only start being implemented from July 1, 2010**
- **We continue to expect fulfillment, *if not outperformance,* of the 8.1%-of-GDP fiscal deficit target this year**

Bank of Greece (BoG) released earlier today *cash-basis* data on the net borrowing requirement of the central government for the period January-June 2010. The data showed a 41.8% YoY reduction in the central government budget deficit to €11.45bn or ca 4.15% of projected GDP. The breakdown of the report revealed a 15.8% YoY decline in primary expenditure of the ordinary budget. The latter is considered to be the *biggest* and *most inelastic* component of government spending. *(Note that public expenditure on wages, pensions and social transfers in Greece typically account for as much as 75% of total government expenditure)*. Overall ordinary budget expenditure *(including interest costs)* dropped by 15.3% YoY in H1, compared with a full-year target of -4.3% YoY [1]. On the revenue side, progress towards meeting the official budgetary targets has been somewhat less impressive. Ordinary budget revenue --*which typically accounts for more than 90% of total central government revenue* -- rose by 6.7% YoY in H1, underperforming a +10.1%YoY annual target. Elsewhere, the deficit of the public investment budget (PIB) decline by 40.5% YoY in the first six months of the year, mainly as a result of a sharp contraction in PIB outlays.

All in all, the BoG cash-basis statistics reveal broadly similar trends with those reflected in the most recent (January-May 2010) budget execution data released by General Accounting Office (GAO). First, the sharp reduction in the central government budget deficit over the first six months of 2010 appears to be consistent with a fulfillment, *if not outperformance,* of the EU/IMF-agreed target of reducing the overall *(i.e., general government)* fiscal deficit by 5.5ppts to 8.1%-of-GDP this year. Secondly, significant progress has been made so far in cutting public expenditure, with the pace of reducing central government outlays in H1 outperforming, by a large margin, the corresponding full-year official targets. To a certain extent, this was to be expected as the stabilization program agreed with the EU partners and the IMF envisions further significant cuts, in addition to those included in the government´s fiscal plan announced earlier this year *(Stability and Growth Programme 2010 + March 2010 auxiliary budget).* Yet, the process in cutting expenditure has indeed been quite impressive, constituting the primary driver of fiscal adjustment since the beginning of the year.

On the revenue side, certain concerns remain with respect to the strength of tax revenue *(primarily VAT receipts)* in an environment of declining domestic economic activity. According to the most recent data released by the GAO, VAT receipts grew by only 0.7%YoY in January-May 2010, compared with a full-year target of +9.7% YoY. However, it needs to be noted that: a) VAT revenue growth in January-May was much stronger than in the same period a year earlier (ca -8.0% YoY) and b) they have been on an improving trajectory since the beginning of the year (+7.5% YoY in April vs. -9.1%YoY in January 2010). We expect higher growth in tax revenue in the period ahead as the bulk of revenue-side

[1] Full year target calculated by the cost cutting budgetary measures included in the Stability and Growth Programme and the March 2010 auxiliary budget

measures *(e.g. the 2nd installment of hikes in VAT and a range of special consumption tax rates)* will only start being implemented from July 2010 onwards.

Bottom-line

We look for positive surprises on the budget-execution front in the period ahead and continue to expect the government to fulfill its deficit reduction target this year. Besides the (broadly strong) budget execution data in H1: 2010, other factors providing additional support to the latter view include: **a)** nominal GDP growth this year is likely to prove higher (i.e., by at least 2ppts) than that envisioned under the IMF baseline projections, mainly as a result of higher inflation, *given sizeable base effects and the one-off impact of indirect tax hikes,* and **b)** as we have emphasized earlier, the EU/IMF program incorporates significant buffers to address program implementation and domestic growth risks. Note for instance that the 2010 consolidation program outstrips the respective full-year deficit target (~8.1%-of-GDP) by 2.2ppts-of-GDP, with at least 3ppts-of-GDP of fiscal adjustment having been implemented already *(i.e., in the form in wage cuts and one-off measures).* [2]

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[2] See Eurobannk EFG Research, *The Greek Economy and its Stability Programme,* June 2010

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