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Focus Greece:
Latest macro & market developments

Highlights

- **Eurostat postpones revisions to Greece's 2006-09 fiscal data to mid-November; announcement seen unlikely to elicit a pronounced market reaction, provided that final data will not deviate much from what has been suggested by a number of recent media reports**
- **Greece initiates reporting of monthly (cash-basis) data on general government fiscal accounts, in line with respective structural benchmark under the EU/IMF stabilization program. Move is expected to improve transparency and predictability of Greek fiscal accounts**
- **Final budget execution data for January-September show central government deficit down 30.9% YoY vs. 9-month target of -29.0% YoY. Deficit reduction driven, primarily, by steep cuts in primary expenditure and lower investment outlays relative to the same period a year earlier**
- **VAT receipts** *(~33% of total ordinary budget revenue)* **up by 16.9% YoY in September following a10.8% YoY rise in the prior month and broadly flat growth in the first seven months of the year. Acceleration suggests government remains on track to meet this year's 8.1%-of-GDP deficit target**
- **Preliminary signs of revival in Greek interbank lending**
- **Latest auction of 13-week T-bill met with strong market demand**
- **EU finance ministers agree on proposed budgetary reforms**

Eurostat postpones announcement of revised Greek fiscal data to mid-November
A Eurostat spokesman said last week that the EU's statistics agency postponed the announcement of expected revisions to Greece's 2006-2009 budget deficit and public debt figures to mid-November, as it needs more time for thorough checks. Eurostat was expected to publish the revised Greek figures on October 22, in tandem with the new EU-wide government deficit and debt data. A number of recent reports circulated in the local press suggested that Greece's 2009 general government deficit will be revised to 15.5%-of-GDP or slightly higher, from 13.8%-of-GDP estimated earlier, with the corresponding public debt ratio likely to be raised to 128%-of-GDP from 115.4%-of-GDP. These revisions will be mainly due to the reporting of deficits and debts of a number of public organizations and the realization of various other debt items, hidden previously under swap contracts. In an interview on the sidelines of last week's Ecofin meeting, Greek Finance Minister, George Papaconstantinou, said that the upward revision to the country's past fiscal data will not necessitate new austerity measures *i.e.,* additional to those already included in the EU/IMF-agreed stabilization program. Mr. Papaconstantinou added that the impact of revisions to the deficit and debt targets for 2010 will be limited and stressed the government's commitment to the fiscal

targets envisioned by the EU/IMF bailout plan. Along these lines, Eurogroup President, Jean-Claude Juncker, expressed confidence on the Greek government's commitment to fiscal consolidation, but EU's economic affairs commissioner Olli Rehn said that the country might need to take additional austerity measures to ensure fulfillment of the 2011 deficit target.

In our view, the upcoming revisions to Greece's past deficit and debt data are unlikely to elicit a pronounced market reaction, provided that these will not deviate much from what has been suggested by a number of recent local and foreign media reports. Among other reasons, the latter view hinges on the following:

a) *Current sovereign spread levels already price-in sizeable revisions to Greece's past fiscal data.*

b) *According to our calculations, the baseline projections of the EC/ECB/IMF stabilization program already incorporate certain upward revisions to Greece's past fiscal data (by as much as 7ppts in the 2009 debt ratio). As a result, we do not expect any major incipient changes in either the government's or the troika's projections regarding the future evolution of the Greek deficit and debt ratios.*

c) *Reportedly, these will be the last changes to Greece's past fiscal data, meaning that the elimination of asterisks from the respective Eurostat report will help remove market uncertainly regarding the reliability of past deficit and debt figures.*

Greece initiates monthly reporting of <u>general</u> government fiscal accounts

In accordance with the requirements of the EU/IMF support program, the Finance Ministry initiated last week the publication of monthly (cash) data on the *general* government's fiscal accounts. The move is considered to be a major step towards better cost management and fiscal transparency in the broader public sector. Until recently, only data on the execution of the *central* government budget were published on a monthly basis, while information regarding the fiscal accounts of sub-national-level entities *(i.e., local governments, public hospitals and state-controlled enterprises)* was quite limited and subject to sizeable revisions. For the time being, the data are on a preliminary basis and not adjusted according to ESA 95 standards, while only 893 of a total of 1,543 non-central government entities have reported updated accounts. Nevertheless, almost 99 percent of public hospitals (133 out of 135) - which represent a major source of outstanding state obligations to various suppliers - were included in the reported accounts. The quality of data reporting for the broader public sector is expected to improve in the following months, while from January 2011, a new computerized system for registering and auditing public spending will become fully operational. According to the finance ministry's announcement, the year-to- August general government deficit on a cash basis reached €14.2bn. Over the same period, the outstanding obligations of the central government were €0.4bn, while these of the broader public sector amounted to €7.2bn, out of which €5.3bn corresponded to outstanding hospital debts.[1] In line with the EU/IMF-agreed economic program, the practice of outstanding state obligations to various suppliers will need to be abolished. Note that the Greek parliament has already passed a law for the redemption of public hospital debt, part of which has been settled already. The remaining part as well as the rest of outstanding state obligations is expected to be redeemed by the end-of 2010.

[1] Note that outstanding obligations are defined as those that have not been redeemed 90 days after their normal redemption date.

Final budget execution data for January-September period suggests government on target to meet 2010 fiscal target.

According to the (final) budget execution data for the first nine months of the year, the central government deficit declined by 30.9% YoY year-to-September, reaching ca €16.3bn. This was somewhat lower than the *(revised)* full-year official target of -36.9%, but still better than that for the January- September 2010 period (-29.0%).[2] The strong improvement *(i.e., decline)* in the central government budget deficit over the first none months of 2010 reflects, primarily, steep cutbacks in primary spending as well as lower public investment outlays relative to both this year's official projection and the corresponding outlays recorded in the same period a year earlier. In detail, ordinary budget revenue grew by 3.6% YoY year-to-September, continuing to exhibit lower growth relative to the official target for the full-year (+8.7% YoY). Yet, it is quite encouraging that a strong bounce in VAT tax receipts was recorded in both August and September *(up by 10.8% YoY and 16.9% YoY, respectively vs. broadly flat growth in the first seven months of the year).*[3] This reflects primarily: (a) strengthened government efforts to fight tax evasion and (b) the second installment of hikes in VAT and excise tax rates on fuels, cigarettes, alcoholic beverages and a range of various luxury items introduced on July 1, 2010. Elsewhere, ordinary revenue before tax refunds in January-September increased by 2.8% YoY, while tax refunds declined by 5.9% YoY.

Ordinary Budget	January-September 2010 (€bn)	January-September 2010 (%YoY)	Annual target (%YoY)
1. Net Revenues (a-b)	36.50	3.6	8.7
a. Gross revenue	39.76	2.8	8.2
b. Tax returns	3.26	-5.9	3.0
2. Expenditure (α+β+γ)	48.71	-7.0	-7.8
α. Primary expenses	36.76	-11.6	-9.2
β. Transfer to hospitals for the settlement of part of past debt	0.30		
γ. Interest costs	11.65	8.0	7.2
Public Investment Budget (PIB)			
3. Revenue	1.40	-3.3	47.7
4. Expenditure	7.81	-30.3	-6.1
5. Budget deficit (1-2+3-4)	**23.58**	**-30.9**	**-36.9**

Source: Ministry of Economics

On the cost side, ordinary budget outlays decreased by 7.0% YoY year-to-September, compared with an annual target of -7.85%. Primary expenditure fell by 11.6% (or €4.8bn) vs. the same period a year earlier, an annual pace of decline that remains higher than the full-year target for 2010 (-9.2% YoY). Furthermore, interest expenses in the first nine months of the year amounted to €11.65bn, posting an 8.0% YoY rise relative to January-September 2009. We expect the rate of growth of interest costs to converge towards the 7.2% YoY full-year target in the coming months, as ca 88% of projected interest payments for 2010 have

[2] The -36.9% YoY full-year target for the central government budget deficit is in line with the latest (August 2010) baseline projection of the EC/ECB/IMF stabilization program.

[3] VAT receipts accounted for ca 33% of overall ordinary budget revenue in January-September 2010.

already been made by the end of September. Finally, in the Public Investment Budget (PIB), revenues fell by 0.5bn year-to-September vs. the corresponding period a year earlier, a decrease of 3.3% YoY which compares with an annual target for a 47.7% rise. On the expenditure side, PIB outlays fell by 2.4bn or 30.3% YoY, undershooting the -6.1% YoY annual target. *We stick to the view that this year's general government deficit target of 8.1%-of-GDP is attainable, as the government's strong performance in cutting expenditure is likely to more than offset any revenue-side slippages and/or cost overruns in the broader public sector i.e., public hospitals, municipalities and other state-controlled entities[4].*

First signs of revival in Greek interbank lending

EFG Eurobank, one of Greece's largest banks tapped the interbank lending market earlier this month using long-term government bonds as collateral, the first such transaction since the eruption of the country's sovereign debt crisis. The amount of the 2-year repo agreement was €300mn at an interest rate of euribor plus a spread of less than 200bps. The counterparty was an international investment bank. Eurobank's Deputy CEO, Nick Karamouzis, said that the transaction constitutes a "first step in the right direction, but it should not be misconstrued. It marks a better climate, but not an opening of the markets to Greece. That will depend on further progress with implementing fiscal consolidation". The Eurobank official added that the transaction followed several earlier repo deals in which the bank raised €200mn backed by Romanian and Ukrainian government bonds held in its portfolio. Separately, National Bank of Greece (NBG), the country's largest bank, is reportedly planning to tap the interbank market after a successful €1.8bn rights issue was completed on October 11. NBG's chief, Apostolos Tamvakaris, said that Greek lenders are slowly regaining access to wholesale funding markets. Greek banks, seriously hit by the country's sovereign debt crisis, had been shut out from wholesale funding markets over the last few months, being forced to increasingly rely on ECB liquidity. According to the latest data, ECB funding to Greek financial institutions decreased 1.7%mom in September to stand at €94.3bn, the second straight monthly decline, suggesting that deposits probably rose against in September following a meager rise of €70mn in August, the first increase in eight months.

Greek PM expects 2011 to be last year of recession, says no additional measures will be needed to ensure attainability of this year's fiscal target

Addressing a cabinet meeting early last week, Greek Prime Minister, George Papandreou, stressed that, according to his government's assessment, 2011 will be the last year of recession, with a return to positive growth expected from 2012 onwards. Mr. Papandreou also expressed optimism that developments during 2013 should pave the way for the country's final exit from the sovereign crisis and its economic dependence. Yet, the Greek Prime Minister warned that the path to economic stability will be long and painful as a number of serious problems of the past have to be cleared out. Under the EC/ECB/IMF baseline scenario, GDP is seen contracting 4.0% and 2.6% in 2010 and 2011, respectively before posting positive growth of 1.1% in 2013. In a separately conference organized by the Ministry of Regional Development and Competitiveness, Mr. Papandreou said that, in spite of the expected (upward) revisions to the country's deficit and debt figures for 2006-2009, Greece would be able to meet the 2010 fiscal target without additional austerity measures, underlying that wage earners and pensioners have already made "unprecedented sacrifices". In yet another speech to reporters over the course of last week, Greek PM underlined that high unemployment is one of the country's main problems, adding that his government is planning to take a number of initiatives to boost employment rates, especially among young and women. In particular, he announced a detailed plan consisting of 17 programs to be implemented via unemployment agency, OAED. The full plan amounts to €2.6bn and it is expected to address to 670.00 people. Among others, it consists of a mix of subsides to

[4] For more analysis on the attainability of the fiscal targets for this year and the next see Eurobank EFG Research, "2011 budget draft: deficit target attainable", October 5, 2011.

businesses' social security contributions as well as measures to assist the young and women to set up businesses and offer training programs to help the unemployed find jobs. The Greek government expects the unemployment rate to remain in an upward trend over the coming months averaging 14.6% next year from 11.8% in 2010 *(2011 draft budget projection).*

Latest T-bill action met with strong market demand

Greece successfully sold €1.17bn of 13-week T-bills on October 19, 2010, assisted by recent official comments about a possible extension of loans under the EU/IMF bailout package and China's recent pledge to buy Greek government paper once the country returns to primary bond markets. Growing investor confidence over the pace of implementation of the country's fiscal adjustment program provided additional support to market sentiment. The auction produced a yield of 3.75% *i.e.,* 23bps lower than the previous auction of similar maturity paper on September 14. Greece's public debt management agency (PDMA) said that more than 50% of the auctioned T-bills were purchased by foreign investors. Investors bid 5.19 times the bills offered, compared with a bid-to-cover ratio of 6.25 times in the September auction. In an interview on the sidelines of the recent Ecofin meeting, Greek Finance Minister, George Papaconstasntinou, cited that the country is regaining investor confidence and expressed his optimism that it will be able to resume market borrowing at longer maturities some time in 2011. The EU/IMF bailout plan allows Greece to stay away from bond markets until Q1 2012, but the government intends to continue issuing T-bills for rolling-over maturing short-term debt paper.

Qatar drops plans for Greek energy project

Greek Deputy Foreign Minister, Spyros Kouvelis, announced last week that Qatar has dropped its plans to build a €3.5bn energy hub in Astakos Port as the two Qatari companies involved failed to reach an agreement with their Greek partners on the viability of the project. The countries signed in May a non-binding memorandum to explore the possibility of building a complex of LNG terminals and a power station to export electricity to Italy. The government official clarified this setback will not affect Qatar's wider interest in investing in Greece. A $5bn investment memorandum was signed between the two countries last month. Greece has become increasingly reliant on foreign investment as it needs to generate additional revenue to help finance its net external position.

IMF says cost of Greek debt restructuring outweighs benefits

Acting Director of IMF's European Department, Ajai Chopra, told a news conference that the Fund agrees with the Greek government that the cost of debt restructuring "far outweighs the benefits". The IMF official added that Greece's fiscal consolidation remains on track, but more work is needed down the road. In its Regional Economic Outlook released last week, the IMF made particular mention of Greece's accelerating structural reforms efforts. The report also red that the Greek government has already elaborated its fiscal consolidation plan beyond next year and that it remains on track to reduce its deficit by about 5½ percentage points of GDP in 2010, in line with the guidelines agreed with the IMF and the EU.

EU ministers agree on proposed budgetary reforms

In line with the European Commission's recent proposals aiming to improve economic governance in the euro area and to safeguard the common currency, EU ministers agreed last week on a *quasi-automaticity* of the sanctions imposed if a member-state fails to comply with the rules of the Stability and Growth Pact. Specifically, if a country "deviates significantly" from its deficit adjustment path, the European Commission should issue a warning and recommend measures to comply with EU budget rules.[5] Six months later, the Commission should assess whether the country has undertaken the necessary reforms. EU finance ministers

[5] What would constitutes a "significant deviation" in terms of numerical values is to be decided in separate legislation

could either agree or disagree with the Commission through a *qualified majority vote* (weighed by population). Should they agree that required policy changes have not been adopted, an excessive deficit procedure should be initiated, entailing "*near automatic*" sanctions "*in a gradual manner*". Sanctions should begin with an interest-bearing deposit, changing into a non-interest bearing deposit and ultimately into a fine (rates of fines or deposits are not yet specified). Sanctions could also be considered for countries that repeatedly fail to get their statistics validated by Eurostat. However, aiming to make EU budget rules somewhat less strict (and in favor of larger countries with bigger voting power), France proposed that penalties could be blocked by a qualified majority, suggesting that politicians may ultimately be able to prevent a vote on sanctions to take place. According to unnamed official sources, in exchange for accepting sanctions to be subject to negotiations, French President, Nicolas Sarkozy, agreed to negotiate on the establishment of a permanent "crisis resolution mechanism" that would replace the existing European Financial Stability Facility when it expires in May 2013. The proposed fiscal rules will only apply to Eurozone member states, while sanctions for EU countries outside the euro area will be linked to a suspension of EU structural funds. The EU finance ministers' recommendations have to be approved by EU leaders at the next EU summit in Brussels (28-29 October). Amid mounting criticism over a rumored compromise deal between Angela Merkel and Nicolas Sarkozy over the new proposed rules, ECB President Jean-Claude Trichet refused to endorse the full package of proposed EU sanctions. Mr. Trichet demanded a draft of the new rules circulated last week to be withdrawn because it did not explicitly note his objections.

EMU sovereign debt spreads bounce from mid-October lows on profit taking, renewed fiscal jitters

After narrowing sharply earlier this month on easing fiscal worries and receding global double-dip concerns, EMU periphery sovereign debt spreads moved higher over the last few sessions, failing to capitalize on higher German Bunds yields. Greece was among the underperformers, reflecting rising investor uncertainty over whether the upcoming (upward) revisions to the country's 2006-09 fiscal data would have an impact on 2010 and 2011 deficit targets. A Wall Street Journal report suggesting that Greece's fiscal problems are on the rise again as the country might fall short of its 2010 revenues target, added to the bearish note. The 10-yr GGB/Bund yield spread widened to a two-week high of 690bps in late European trade on Monday, some 40bps higher from a four-month trough touched in mid-October. Not surprisingly, the cost of insuring Greek government bonds against default moved higher in recent sessions, with the 5-yr CDS spread coming close to 700bps for the first time over the last couple of weeks.

Yield premiums of other EMU periphery sovereign bonds vs. their German peers also widened over the last few sessions. Indicatively, the 10-yr Portuguese/German Bund yield spread was hovering around 326bps at the time of writing, some 16bps wider from one-month lows touched a week earlier. Uncertainty surrounding a parliamentary vote on Portugal's 2011 budget is currently weighing on market sentiment. Portugal's opposition party has announced a number of terms for providing support to the minority government's budget plan for next year. These terms include: a) a temporary (i.e., for 2011 only) VAT rate hike of 1ppt (instead of a permanent 2ppt increase), with the resulting shortfall being offset by further spending cuts b) a freeze of all public infrastructure programs in 2011 and c) independent monitoring of public finances. However, a budget approval is far from certain. Portugal's Finance Minister said that he does see any scope for future spending cuts, adding that if the budget does not receive approval, Portugal will resort to the Eurozone Financial Stability Facility. In a similar vein, the corresponding 10-yr Irish yield spread to Bund hit earlier today a two-week high above 400bps, after the government-funded Economic and Social Research Institute announced that the goal of cutting the country's budget deficit to 3% by 2014 (from an estimated 32% this year) seems "worryingly ambitious" and would require additional savings of €15bn, twice the current official target.

The technical picture for the 10yr-Greek government bond (GGB)/German Bund yield spread suggests scope for some further widening in the sessions ahead with the 750-800bps region capping the upside ahead of the mid-November revisions to Greece's 2006-2009 fiscal data.

Written by

Dr. Platon Monokroussos
Assistant General Manager
Head of Financial Markets Research
pmonokrousos@eurobank.gr

Paraskevi Petropoulou
G10 Markets Analyst
ppetropoulou@eurobank.gr

Dr. Theodoros Stamatiou
Research Economist
Tstamatiou@eurobank.gr

Table: EMU periphery yield and spread levels

10-yr Government bond yields	Today, October 25 (16:30 local time)	Change vs. mid-October multi-session/week closing lows (in bps)	Change vs. all-time closing highs recorded earlier this year (in bps)
Greece	9.32%	54.0	-313.0
Portugal	5.70%	16.7	-81.3
Spain	4.08%	8.8	-80.2
Ireland	6.48%	47.8	-26.2
10-yr Periphery/Bund yield spread (in bps)	**Today, October 25 (16:30 local time)**	**Change vs. mid-October multi-session/week closing lows (in bps)**	**Change vs. all-time closing highs recorded earlier this year (in bps)**
Greece	687.88	37.72	-277.38
Portugal	325.10	10.68	-101.60
Spain	163.20	1.55	-57.97
Ireland	402.70	41.05	-46.70
5-yr CDS	**Today, October 25 (16:30 local time)**	**Change vs. mid-October multi-session/week closing lows (in bps)**	**Change vs. all-time closing highs recorded earlier this year (in bps)**
Greece	689.34	13.87	-319.01
Portugal	345.72	5.13	-97.34
Spain	202.41	3.71	-64.66
Ireland	419.14	24.57	-65.96

Source: Bloomberg

Research Team:
Gikas Hardouvelis, *Chief Economist and Director of Research*
Platon Monokroussos, *Head of Financial Markets Research*
Paraskevi Petropoulou, *Economist*
Galatia Phoka, *Economist*

Sales Team:
Fokion Karavias, *Treasurer*
Nikos Laios, *Head of Sales*
Yiannis Seimenis, Ioannis Maggel, *Corporate Sales*
Stogioglou Achilleas, *Private Banking Sales*
Petropoulos Theodore, *Institutional Sales*
Karanastasis Kostas, *Retail Sales*

EFG Eurobank Ergasias, 8 Othonos Str,GR 105 57, Athens,Tel:(30210) 3718 906, 3718 999, Fax:(30210) 3337 190, Reuters Page: EMBA,Internet Address: http://www.eurobank.gr