Athens, April 27, 2010

Focus
Latest on the Greek sovereign debt crisis

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Part I
Greece submits official request for the activation of the EU/IMF rescue mechanism: Brief assessment and market reaction

The dramatic market developments that followed Eurogroup´s announcements on Greece earlier this month, forced Prime Minister George Papandreou to officially request on April 23, 2010 the activation of the proposed EU/IMF rescue mechanism. Domestic markets initially reacted positively to the news, as the request for aid helped to resolve a part of lingering uncertainty over the country's immense funding problems. However, the initial rally in the Greek equity and sovereign debt markets triggered by the official aid request proved short-lived, with the Athens general stock market index (ASE) finishing the same day marginally in negative territory and the term-structure of the GGB/Bund yield spreads closing little changed from a day earlier ***(17-21bps tighter for the 7-10-year sector; 27 and 35bps wider for the 2-year and 5-year maturities, respectively).***

In our view, the price action of the past 1-2weeks increasingly points to a market that is gradually shifting its focus from near-term liquidity risks to longer-term debt sustainability issues. This is especially so for a number of reasons, including:

a) **The recently-announced upward revisions to Greece's fiscal deficit and debt figures for 2009 render the *(already optimistic)* targets of the country's stability and growth programme (SGP) increasingly difficult to be attained**. Note that Eurostat revised last week the 2009 Greek general government deficit to 13.6%-of-GDP from 12.7%-of-GDP reported initially, while 2009 public debt–to-GDP ratio was re-estimated to 115.1% from 112.6%. To complicate things further, the EU statistics agency expressed reservation over the quality of data reported by the Greek authorities and left the door open for further potential revisions *(of 0.3-0.5ppts-of-GDP for the general government budget deficit and 5-7ppts-of-GDP for the public debt ratio).*

b) **Given a recessionary domestic macro environment, the present extreme sovereign funding costs and the country's high primary deficit, it will take a number of years before Greece manages to stabilize its public debt-to-GDP ratio.** The latter view is, of course, conditional on the successful implementation of a sound program of fiscal consolidation and structural reforms, aiming to reclaim competitiveness losses and put the economy on a sustainable medium-term growth path. Note that in the last quarterly report on the Greek economy we published in late March *(Eurobank EFG Research, Greece: Macro Monitor, March 2010)* we projected that Greece's public debt ratio would peak at levels between 130-133%-of-GDP by the end of 2013, but this forecast was conducted before the more recent revisions to the country's 2009 fiscal data. Moreover, it did not incorporate any potential additions to the debt stock, stemming from *e.g.* existing state guarantees on debts incurred by various entities in the broader public sector. *In view of the above, we believe that the additional requirements and conditionality attached to the upcoming EU/IMF rescue program (likely to become known by May 15) will be crucial in forming market expectations over the medium-term sustainability of the country's fiscal position.*

c) Eurogroup announcements on April 11 helped to resolve a great deal of market uncertainty over to the modalities and cost structure of an aid package for Greece. Of course, current sovereign spreads continue to reflect a certain degree of uncertainty with respect to the timing and conditionalities of the final program, but a great deal of the risks involved are already priced-in, in our view.

Market Update – GGBs

GGB bond yields	Monday's close (April 26)	Change vs. Friday's close (April 23) (in bps)
2-yr yield	13.16%	294
5-yr yield	10.79%	133
7-yr yield	10.08%	99
10-yr yield	9.56%	91
30-yr yield	7.46%	31
GGB/Bund yield spreads (in bps)	**Monday close (April 26)**	**Change vs. Friday's close (April 23)**
2-yr spread	1228	296
5-yr spread	872	181
7-yr spread	755	151
10-yr spread	652	92
30-yr spread	368	33

Source: Bloomberg

Part II
Where we currently stand and what to expect in the days & weeks ahead

News headlines on Greece continue to hit the market with frenetic speed, causing sudden shifts in investor sentiment and immense market volatility. Note, for instance, that the total intraday movement of the 10-year GGB/Bund yield spread on April 23 *(i.e., the day that Greece officially asked for the activation of the EU/IMF aid mechanism)* was ca 150bps! Understandably, under the present circumstances, it is hard for investors to fully keep track of market developments, official announcements, news reports and market gossip about Greece's sovereign debt crisis. In the following lines we will try to summarize some key recent developments and also present a number of milestones and important deadlines for investors to watch in the period ahead.

A trilateral EC/ECB/IMF investigation mission is currently in Athens, holding talks with high-level government officials about the country's fiscal situation and reforms programme. Presumably, the mission will consult with the Greek government on the main parameters and conditionalities attached to the proposed EU/IMF aid mechanism. Earlier this year, the EU Council asked Greece to submit by May 15, 2010 a report providing detailed information on the implementation of the latest austerity measures as well as those that will be taken to reach the 2011 and 2012 budget targets. Separately, following a meeting with Greek Finance Minister in Washington on April 25, IMF Managing Director Dominique Strauss-Kahn expressed his confidence that the Fund would be able to conclude discussions with EU partners on time to meet Greece's financing needs. On the latter, note that the government has already covered its funding needs for the current month. However, next month is particularly demanding, with some €2.28 in coupon payments and €8.09bn for a bond redemption being due on May 10 and May 19, respectively. *Considering the above, we expect: **i)** the full details and quantitative targets of Greece's enhanced stabilization programme (i.e., fiscal and structural measures already announced and any new ones demanded by the euro area partners and the IMF) to become publically known by May 15 and **ii)** the official EU/IMF programme to be announced over the coming few weeks, with financial aid to Greece starting flowing in by May 19. If financial aid from the rescue mechanism cannot be released by the May 19th deadline, then some form of a bridge loan to Greece by euro area member countries can not be ruled out.*

With respect to the total size, cost structure and duration of the EU/IMF aid package, we presently know the following:

a) Up to €30bn in bi-lateral loans will be provided by euro area partners during the first year of the aid programme. The Fund could provide an additional amount equivalent to around one-third of the total financial aid provided by Euro zone member states. Up to this point, we do not yet know the exact IMF contribution, but the 1/3-2/3 share quoted above suggests that the size of the Fund's loan facility could be as high as €15bn *(or slightly more than 1600% times Greece's quota with the IMF).*

b) From what we have heard so far from a number of market reports quoting unnamed EU sources, additional financial aid could be offered to Greece by euro area member states over the following two years. The figures quoted recently in a number of local and foreign media are for a 3-year EU/IMF rescue package worth from €80bn to €100bn, though nothing official has been confirmed yet. These quoted amounts should be contrasted with Greece's total roll over needs for the period 2010-2013 that are currently estimated at ca €150bn.

c) With respect to the cost structure of the proposed aid mechanism, we already now that effective interest rate that will apply to EU bi-lateral loans. The cost structure applied to regular IMF Stand-By Arrangements and other facilities is known as well. Specifically, as we noted in one of our recent special-focus reports on Greece[1], the *effective* annual rate applied to a 3-year *variable-rate* loan offered by a euro zone peer state would be around 3.80%, given current Euribor rates. On the other hand, the effective annual interest rate applied to a three-year *fixed-rate* EU loan would be ca 5.0%. For longer-maturity EU loans, higher interest rates would be charged. For instance, the annual interest rates applied *to* 5-year and 10-year fixed- rate loans would be 5.60% and 6.60%, respectively. An additional annual charge of 100bps will be applied to any loan amounts outstanding beyond 3-years. Separately, for a 3-year IMF loan of, say, €10-15bn, the annual effective interest rate would be around 2.85% (plus an annual 100bps charge for any amount outstanding after 3-years of the programme´s initiation). *All, in all, based on the information we have so far, we believe the proposed EU/IMF rescue mechanism for Greece will have the*

[1] See Eurobank EFG Research, Eurogroup details sizeable aid mechanism for Greece, April 12, 2010.

following features: i) up to €45bn in bi-lateral loans and IMF financing will be provided during the first year of the programme ii.) the total size of the package could be as high as €80-10bn over a three-year period iii.) the programme could last for at least three years iv.) the effective cost of the package would be well bellow current sovereign market interest rates for Greece.

d) **As for the national contributions of Euro zone member states to the Greek aid mechanism, these will be determined according to the corresponding national central bank's capital weight at the ECB (see table below).** Any EU bi-lateral to Greece will need to get parliamentary approval at a national level. Some recent developments on the latter issue include: **i)** Spanish Economy Minister said last week that Spain's €3.67bn contribution to the Greek lending programme will get parliamentary approval by the coming Friday **ii)** France pledged mid last week €6.3bn in financial aid for Greece. Out of that amount, €3.9bn will be mobilized during the 2010 fiscal year **iii)** The Dutch Finance Ministry said on Monday that the ministry will wait the budget reduction measures the IMF and the European Commission will propose before submitting a bill to parliament for approval. After the ministry informs parliament that the aid is needed, it will have to submit a supplementary budget bill for a vote. A majority in parliament expressed support for an aid package on April 15 **iv)** Chancellor Merkel said yesterday that Germany is ready to take a decision on granting aid to Greece in matter of days, once the IMF and European officials have completed talks with the Greek government. Separately, German Finance Minister Minister Schaeuble said that it may be possible for Germany to finalize a law granting Greece financial aid on May 7 and free up financial support before May 19.

e) **With respect to conditionality attached to the EU/IMF aid mechanism, Greek Finance Minister George Papaconstantinou said yesterday that, although EU authorities and the Fund require specific timetables for the next years, the stabilization program currently under discussion *is not much different* than that laid out in the Stability and Growth Programme.** Yet, according to recent media reports, the government will be asked to take additional measures, ranging from further cuts in civil servant wages *(i.e., on top a 10% effective reduction announced earlier this year) to* additional steps to downside the broader state sector and extend wage reductions to the private sector in order to squeeze production costs and improve competitiveness. Moreover, a strengthening and acceleration of the government´s structural reforms appears to be in the cards, with some areas of particular focus including the social security system and the opening up of a range of closed professions.

Estimated national contributions to an EUR30bn rescue package for Greece

	National CBs' capital weights at ECB (%)	Contribution to a EUR30bn rescue package for Greece (bn)
Austria	1.9417	0.86
Belgium	2.4256	1.07
Cyprus	0.1369	0.06
Finland	1.2539	0.55
France	14.2212	6.29
Germany	18.9373	8.38
Greece	1.9649	
Ireland	1.1107	0.49
Italy	12.4966	5.53
Luxembourg	0.1747	0.08
Malta	0.0632	0.03
Netherlands	3.9882	1.76
Portugal	1.7504	0.77
Slovenia	0.3288	0.15
Slovakia	0.6934	0.31
Spain	8.304	3.67

Source: ECB

Key Dates to watch ahead

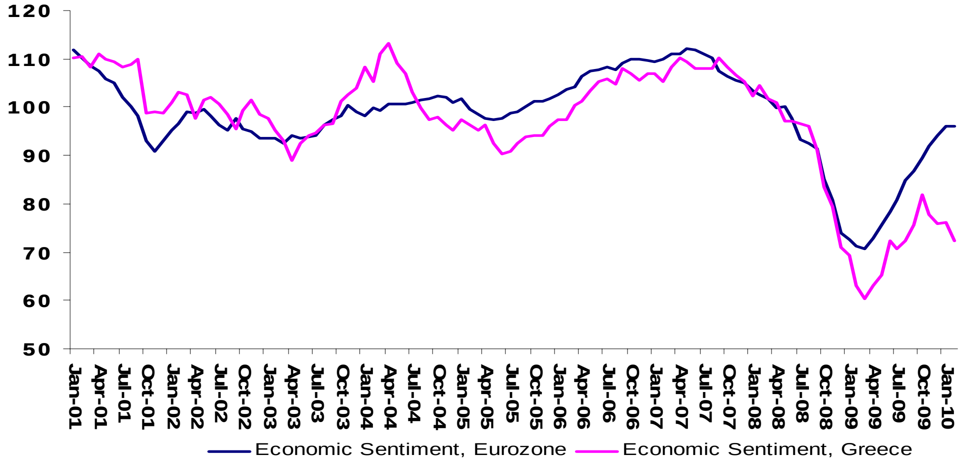
* May 5: European Commission (EC) issues Eurozone spring economic forecasts (pay attention to the relevant figures for Greece)
* May 9: German regional elections
* May 10: EUR2.28bn coupon payments
* May 15: Greece to submit to the EC an official report on the budget execution y-t-d and the time line for the implementation of the structural reforms
* May 17: Eurogroup meeting
* May 18: Ecofin meeting
* May 19: EUR8.1bn bond redemption

Part III
Recent domestic macro developments

Recent readings in a number of high-frequency indicators confirm a further worsening in the domestic macro outlook.

Graph 1 below shows the recent developments on the **Economic Sentiment Indicators** for Eurozone and Greece respectively. The divergence path that started in November 2009 continued throughout the first two months of 2010. The Greek Economic Sentiment indicator declined further in the first two months of 2010. At the same time, the respective Eurozone indicator continued its rising trend, though at a slower pace than in recent months.

Graph 1:



Source: ECOWIN

The most recent **CPI data** showed a rise of 3.1%/3.9% MoM/YoY in March 2010, which compares with a 2.0%/1.3% MoM/YoY reading in the same month a year earlier. Among the main culprits of the March CPI rise were:

- Higher domestic retail prices of fuels
- Higher consumption taxes on gas, alcohol and tobacco
- Increases in the utility taxes

However, a major part of that increase was due to the seasonal effect related to the February sales period and their consequent adjustment of prices to pre-sales level. Note that only a small part of the March CPI increase was due to the new VAT announced by the Government on March 3rd and applied from March 15.

The turnover Index in **Retail Trade, excluding fuel,** increased by 5.4% YoY in January 2010. This increase was due to the early start of the sales period in 2010 compared with previous years (mid January instead of early February).

The most recent data on **unemployment** (January 2010) show an increase in the jobless rate to 11.3%. This compares with 9.4% in January 2009 and 10.2% in December 2009. Developments in unemployment fit well with the most recent readings in the construction and industry sectors of the Greek economy.

Total **Building Activity index** (volume) decreased by 22.4% during the February 2009-January 2010 period as a result of weakening economic activity as well as uncertainty ahead of certain changes in the Building Code passed by the Government.

Elsewhere, the **Production Index in industry** fell by 9.2% YoY in February 2010. This was due mainly to the downturn of the Greek economy and the low competitiveness of the Greek exports.

According to Bank of Greece's data, **the current account deficit** more than doubled in February 2010, from the same month a year earlier**.** The respective deficits were €3.25bn for February 2010 and €1.2bn for February 2009. But these figures are partially affected by the delay of payments of EU agricultural subsidies funds (0.09 bn in February 2010 compared with 1.76 bn in February 2009). These payments are made throughout the year on a non-periodic basis.

In addition, the declining trend in the **trade deficit** observed in the previous months continued in the first two months of 2010. In February 2010, exports of goods (excluding ships and oil) decreased 10.1% YoY and at the same time imports of goods (excluding ships and oil) decreased even more by 15.2% YoY and thus led to a further improvement in the trade deficit (excluding ships and oil) by 17.1% YoY.

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