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

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Focus notes: Greece

Latest macro & market developments

Written By:

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

Paraskevi Petropoulou
G10 Markets Analyst

Dr. Theodoros Stamatiou
Research Economist

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Highlights

- **Part I: Countdown to the March 24/25 EU Summit: Agenda, risks & market implications**
- **Part II: European Commission on 3rd Review of Greece's Economic Stabilization Programme: Progress cited with respect to fiscal and structural reforms, period ahead to be crucial for programme success**
- **Part III: Latest domestic macro & market developments**

Part I: Countdown to the March 24/25 EU Summit: Agenda, risks & market implications

Market worries that an eagerly-awaited comprehensive package of measures to tackle the EMU sovereign debt crisis might fall short of expectations have been on the rise lately. According to recent press reports, a consensus among EU policymakers on making the **existing EFSF rescue fund** more effective in addressing the current crisis has yet to be reached. Earlier comments by a number of high-level EU officials suggested that a strengthening of the the EFSF could be instrumented by **a)** increasing its *effective* lending capacity; note that at its current from, the EFSF can not lend more than €255bn, *i.e.,* well below its €440bn guarantee pool, as lenders have to set aside cash reserves for securing the fund's top AAA credit rating, **b)** empowering the mechanism to buy government bonds from the market, on an outright basis or through loans to debt-laden governments, and **c)** making emergency loans cheaper. Details of the permanent crisis-resolution mechanism *i.e.,* the so called **European Stability Mechanism** (ESM), and the '**competitiveness pact**' Germany and France jointly proposed at the February EU Summit have also been at the epicenter of recent policy discussions. With respect to the permanent anti-crisis framework that will replace the existing mechanism when it expires in mid-2013, a Eurozone Finance Ministers' decision on February 4 clarified that the ESM will be allowed to lend up to €500bn, the same *nominal* amount the EFSF and EFSM combined have currently at their disposal. Eurogroup Chairman Jean-Claude Junker clarified that the volume of €500bn will not be diminished by capital buffers and will be subject to reviews every two years. In addition, the permanent mechanism could be supplemented by contributions from the IMF and EU countries outside the euro area. EU policymakers purportedly deferred a number of important decisions on the structure and operation modalities of the ESM, to make them

part of a "comprehensive plan" to tackle the debt crisis. The plan is expected to be hammered by the Heads of States at the March 24/25 Council.

EU anti-crisis package: What to expect by the end of March

In our view, the upcoming EU Summit on March 24/25 will likely decide a repayment extension for EU/IMF loans to Greece and, possibly, Ireland. Moreover, an increase in the size of the current rescue mechanism, EFSF, can not be ruled out, in view of the EU Heads of States' agreement in early February to set up the *effective* lending ceiling of the ESM mechanism at the same nominal amount the EFSF and the EFSM combined have currently at their disposal. The above decisions might not by themselves constitute a 'silver bullet' solution to the lingering EMU debt crisis. But, in any case, they would constitute steps in the right direction, reflecting policymakers' willingness to address the crisis. On a less positive note, earlier market hopes for more far-reaching initiatives to tackle the EMU debt crisis, especially with respect to a bond buy-back scheme, may well be disappointed. Yet, in view of the most recent re-widening of EMU-periphery bond spreads -- as a result of a scaling-back in market expectations regarding the outcome of the late March Summit -- it is reasonable to expect any potential disappointment to have a more contained market impact. This holds especially if the EU Heads of States signal that the process towards a comprehensive solution to resolve the crisis will take more time and require a more-step-by-step approach than expected earlier.

Consensus not yet been reached on overhauling EFSF, specifying ESM's modalities

Recent comments by a number of high-level EU officials suggest that a consensus on overhauling the EFSF and deciding on the operational characteristics of the permanent crisis-resolution mechanism has not yet been reached. The following quotes are indicative of the different ideas and attitudes currently prevailing in EU policy cycles with respect to the aforementioned issues.

Comments revealing no urgency to overhaul EFSF

- **German Finance Minister Wolfgang Schauble** told French daily La Tribune early last week that recent stabilization of EMU-periphery bond markets suggests no urgency to overhaul the European Financial Stability Facility and whether this issue will be resolved before the end of March "will have to be seen".

- In a similar vein, **Austrian Finance Minister Josef Proll** said recently that the recent agreement on the permanent support mechanism reduces the need for a strengthening of the current EFSF facility.

- Separately, **outgoing Bundesbank President Axel Weber** argued in an FT article on February 22 that "existing instruments for short-term crisis resolution are adequate and … should not undergo significant adjustment".

- On a more constructive note, **EU Commissioner Olli Rehn** told Reuters y-day that an extension of repayment periods of the bailout loans to both Ireland and Greece and a potential reduction of the interest rates will indeed be issues of discussions at a preparatory EU Summit meeting on March 11.

Opposition to debt buybacks, lower interest rates on EU bailout loans

- In an FT article on February 22, **outgoing Bundesbank President** opposed more favorable interest rates of ESM loans. His objection was on the basis that such an accommodation would entail moral hazard risks and a shifting of financial burden to the taxpayers of other member states. Mr. Weber, who went public last year to criticize ECB's decision to launch its bond buying program, stressed out that debt buy-backs should not be incorporated into the ESM, as they risk to jeopardize financial market stability and cause significant operational governance problems regarding their "volume, timing and conditions".

Legal issues purportedly need to be overcome before a comprehensive anti-crisis framework is decided

- **German European Minister Werner Hoyer** pointed early last week that the German constitutional Court will soon rule whether the Greek bailout package is in line with the German Constitution and until then, it is difficult for the country to agree on any expansion on the EFSF facility (a decision is expected in the coming weeks, but not exact date has been set yet).

- **Meanwhile, German weekly news magazine Der Spiegel** suggested that the German lower house of Parliament, Bundestag, is currently verifying whether the approval of limited Treaty

changes requires a majority of two thirds in Bundestag as well as the Bundesrat *i.e.,* the parliamentary body that represents the sixteen federal states. Note that when EU Heads of States and governments agreed in December 2010 to establish a permanent rescue mechanism to cope with future debt crises, they decided to do so by introducing "limited change" to the Lisbon Treaty, so as to avoid a referendum in Ireland as well as other complex ratification procedures in other member states.

German domestic political developments complicate things further

- Adding to the hurdles on the way to a final agreement on anti-crisis measures, Bundestag is set to approve on March 17 the proposals made by the government's three junior coalition partners. The proposals aim to rule out any European crisis response measures that involve issuing loans to help financially distressed governments or debt buybacks through the ECB or the EFSF/ESM mechanisms. The paper submitted to the lower house of parliament also urged that an increase in the size of the EFSF is not necessary at present and called for the rescue package to include an EU-wide financial market tax to reduce national budget deficits.

- In addition, the three junior coalition partners demanded Chancellor Angela Merkel to ask for the consent of parliament on important upcoming decisions and urged the lower house to vote on any agreements reached at the March 11 EU Summit. Such a move would purportedly aim to strengthen the German government's position by sending a clear signal to other EU member states with respect to the preconditions needed for the approval of financial support. Purportedly, the proposals do not refer to the features of the current rescue mechanism, but Germany is likely to insist that restrictions imposed on the ESM should also apply to the EFSF.

- To add to the aforementioned problems, the February 12 state-election in the German city of Hamburg saw Mrs. Merkel's centre-right Christian Democratic Union suffering a heavy defeat. Vote in favor of the government-backed candidate halved to just 21%, the worst result for more than 50 years. With nearly 70% of the German population opposing a bailing out of other EU member states, the most recent polls suggest that the government is likely to fare poorly in a number of upcoming state elections in the coming months, despite the improved domestic growth outlook. The German Chancellor faces the next state election in Saxony-Anhalt on March 20 and the last one will take place in mid-September in the city-state of Berlin. The most important election, though, will be in Baden-Wuerttemberg on March 27, one of Germany's most populous and prosperous states. The later will take place just two days after the end-March EU Summit that is supposed to hammer a comprehensive anti-crisis package for the euro area.

Upcoming Finland elections suggest incumbent government needs to approve new anti-crisis measures by March 11, at the latest

- Separately, Finland will dissolve its parliament on March 15, as the country is heading for general elections on April 17. As such, the last opportunity for the current government to give its approval to any proposed EMU anti-crisis measures is on March 11 *i.e.,* when the next emergency EU Council meeting takes place (please also see table below). In other words, in order for a comprehensive anti-crisis deal to be reached by the end of March, any new measures will have to be agreed upon by March 11 and then finalized with no changes on March 24/25. That is because any such decision by EU heads of states has to be unanimous. Amid growing pressure to reach a deal by the end of March, Finland is planning to host on March 4 a special meeting of the 14 Eurozone heads of states belonging to the European People's Party (EPP) in Helsinki.

Growing opposition to so-called "competitiveness pact"

- Meanwhile, a number of EU countries continue to voice their opposition to a number of politically-sensitive issues incorporated in the so-called "competitiveness pact". The new pact aims to promote closer economic coordination and enhance fiscal discipline among member states. According to reports, adoption of the competitiveness pact is a precondition Germany has demanded for approving changes to the EFSF framework. Among other measures, the pack envisions changes to member states' wage-setting mechanisms, public pension policy and business taxation. It also proposes the insertion of "debt brakes" in national constitutions to prevent rampant spending. Among the EU officials who voiced their opposition to these proposals, **Spanish Finance Minister Elena Salgado** said last week that a 'constitutional debt break' is difficult to be enshrined into national legislation. Separately, **Eda Keny, the leader of Ireland's main opposition party, Fine Gael,** that achieved a victory at the Feb. 25 snap general election, stressed out that the present 12.5% corporate tax rate is "non-negotiable". Ireland's corporate tax rate is one of the lowest in the EU after Cyprus, Bulgaria and Hungary and a likely abolition would risk damaging the country's appeal to international businesses and curb its

growth potential.

Greece's loan repayment extension at the centre of discussions

Even though the eagerly-awaited comprehensive anti-crisis package runs the risk of underperforming market expectations, an issue that seems to have achieved a semblance of consensus is the extension of repayment periods for loans to Greece under the present bailout package. That is to align its terms with these of the present loan facility for Ireland.

After meeting Greek PM George Papandreou early last week, German chancellor Angela Markel signaled a concession in improving the terms of the EU/IMF bailout package for Greece, noting though that rescheduling of repayment period should be part of a comprehensive package of measures to deal with the EMU sovereign debt crisis. Reportedly, Mrs. Merkel also appeared to be receptive to the idea of lowering the interest rate Ireland pays on its EU/IMF loan (potentially in exchange for Ireland maintaining the sovereign state guarantee for senior bank bond debt, held predominately by German banks). In a similar note, Economic and Monetary Affairs Commissioner Olli Rehn said earlier this week that the EU will discuss reducing the interest rate on emergency loans to Ireland, as part of its comprehensive response to the sovereign debt crisis. In our view, if lower interest rates are provided to the Irish bailout loans, a similar arrangement could also be decided for Greece.

Under the existing EU/IMF loan agreement, Greece will need to repay each loan tranche in eight equal installments over a period of 2 years, following an initial grace period of 3-3 ¼ years. At the November 28, 2010 Eurogroup meeting, EU officials agreed in principle to align the terms of Greece's bailout loans with those to Ireland. If the proposed repayment extension is finally granted, repayment of each loan tranche would take place over a 7-year period, following an initial grace period of 4 years. Such a decision would offer some near-term relief to Greece in the form of more manageable borrowing requirements in the period 2014-15. But, it would probably be inadequate by itself to sustainably change perceptions over the country's longer-term debt dynamics *(for an in-depth analysis on the sustainability of Greek public debt, please see Eurobank EFG Research, Economy & Markets December 2010*).

On a more positive note, a combination of lower interest rates on EU/IMF loans and a bolder "re-profiling" of repayment periods could cause a more lastingly improvement in investor perceptions over Greece's debt sustainability. On the latter issue (and echoing ECB Weber's comments in early February), Eurogroup Chairman Jean-Claude Junker said recently that he would not oppose to a 30-year extension in the repayment schedule of Greece's bailout loan if Germany would consider this idea.

A very important issue is though the lowering of the interest rate cost of the EU/IMF loans to EMU countries receiving bailout funding. According to unnamed EU sources, a number of Eurozone governments are leaning towards reducing the annual effective lending rate for both Ireland and Greece to about 3.2%-3.5% *i.e.,* the rate EU currently charges to non-Eurozone states for balance-of-payment support loans (Greece and Ireland currently pay between 5.5% and 5.8%).

EMU crisis: Key Events in March

Date	Event
3 March	ECB meeting & press conference
4 March	Preparatory Meeting of 14 EU Leaders (EPP European People's Party members) in Helsinki
10 March	No-Confidence Vote against Portugal's government raised by small opposition party
11 March	EU Heads hold Extraordinary Sumit in Brussels
14/15 Marcl	Regular Eurogroup/ECOFIN Meetings in Brussels
20 March	State election in Germany (Saxony-Anhalt)
21 March	Extraordinarly Eurogroup Meeting in Brussels
24/25 Marcl	EU Heads hold Summit in Brussels
27 March	State election in Germany (Baden Wuerttemberg and Rhineland-Palatinate)

Upcoming EU Summits/ ECOFIN meetings: Key issues under debate		
Increase of EFSF's effective lending capacity	In its current form, EFSF can not lend more than €225bn, lower than €440bn guarantees	Uncertain, subject to strict conditionality (German-French proposed 'competitiveness pact')
Sovereign debt buybacks via EFSF	Suggested recently by a couple of high-level EU officials	Uncertain, subject to strict conditionality (German-French proposed 'competitiveness pact')
Align terms of EU/IMF bailout package for Greece with that of Ireland	-Extend loan repayment schedule from 5-5 ¼ year to 11 years -Increase annual effective interest rate to ca 5.8% from current 5.5%	High probability outcome, likely to be part of a comorehensive anti-crisis package but not sufficient by itself to substantially ease debt-sustainability worries
Reduce interest rate costs of EU/IMF loans to Greece & Ireland	Recent official suggestions to reduce effective interest rates to 3.2%-3.5% i.e in line with loans to CE countries for BoP support	Uncertain, subject to strict conditionality (German-French proposed 'competitiveness pact')
Extend loan repayment schedule of EU loans to Greece & Ireland by 30 years	Suggested recently by a couple of high-level EU officials (Eurogroup Chairman Jean-Claude Juncker, ECB's Alex Weber)	Low probability outcome
German/French proposed 'competitiveness pact'	-Abolision of wage/salary indexation schemes -Adjustment of pension systems to -'Debt alert mechanisms' in national constitutions	A precondition Chancellor Angela Merkel demands for supporting overhaul EFSF, adoption of a number of proposals likely
More details about ESM operational features	EU Heads of States agreed in early February to set up the effective lending facility of ESM at €500bn	Uncertain, subject to strict conditionality (German-French proposed 'competitiveness pact')

Part II: European Commission on 3rd Review of Greece's Economic Stabilization Programme: Progress cited with respect to fiscal and structural reforms, period ahead to be crucial for programme success

The joint EC/ECB/IMF mission that visited Athens between January 27 and February 11 assessed compliance with the terms and conditions of the 3rd programme review and updated the conditionalities of the next reviews. Note that approval of 3rd programme review by the IMF Board and the EU sovereign lenders will allow disbursement of the fourth tranche of funds (€15bn), under the present €110bn bailout program. According to the joint mission's assessment, programme implementation has so far been satisfactory, even though important risks in the period ahead remain. These relate to, among others, **a)** the final 2010 budget deficit outcome and the achievement of the 2011 fiscal targets, **b)** the medium-term fiscal plan for the period 2010-2015, **c)** the creation of a credible plan aiming to reduce public debt to more sustainable levels and **d)** the pace of implementation of the EU/IMF-backed program of structural reforms.

Regarding the performance of the macro economy, the programme's estimate for 2010 GDP growth was lowered to -4.5%, from -4.2% expected earlier (2nd programme review, Dec 2010). The baseline growth forecast for this year remains at -3.0%. Notably, it is expected that positive quarter-on-quarter GDP growth will resume in the second half of 2011, mainly as a result higher growth of exports and lower imports. Balance-of-payments trends are expected improve in the following years, with the current account deficit seen falling to 7.9%-of-GDP and to 6.3%-of-GDP in 2011 and 2012, respectively, from levels around 10.5%-of-GDP last year. The forecast for average annual inflation in 2011 was revised upwards to 2.4% from 2.0% seen previously, due to more elevated expectations for commodity and oil prices. The respective figure for 2012 is 0.5%.

2010 fiscal deficit target deemed achievable; 2011 target remains challenging

The 2010 general government budget deficit (ESA-95 definition) is estimated at ca 9.5%-of-GDP even though some upward risks to that figure remain due to the lack of complete data for the balances and arrears of public organizations, hospitals, social security funds and local authorities. According to the European Commission, the 2011 fiscal deficit target of 7.4%-of-GDP remains challenging and the government may need to take additional

measures to achieve it. Note here that the initial memorandum of understanding (MoU) with official lenders envisioned a 0.4ppts-of-GDP reduction in this year's general government budget deficit. However, following the latest (November 2010) revisions to Greece's past deficit and public debt figures the deficit reduction target for 2011 has been revised to 2ppts-of-GDP. In order to achieve the latter target the government plans to, among others, **a)** continue rationalizing public sector expenditure and **b)** intensify the fight against tax evasion. Note that the achievement of the 2011 deficit target depends crucially on a €1.5bn increase of tax receipts stemming from the fight against tax evasion.

Medium-term fiscal plan deemed critical for macroeconomic stabilization

The government's medium-term fiscal plan for the period 2012-2015 is currently under preparation. A first draft for public consultation is expected by late March 2011. The plan is expected to be finalizes and pass Parliament by May 2011. The plan envisions a reduction in the general government budget deficit to just €3bn by 2015, from ca €17bn expected this year. According to Minister of Finance George Papaconstantinou, around two-thirds of the targeted deficit reduction in 2012-2015 will come from spending cuts, while the medium-term program will not include further reductions in salaries and wages or new tax hikes. The budget deficit targets for the coming years are as follows: 6.4%-of-GDP in 2012; 4.8%-of-GDP for 2013 and 2.6%-of-GDP in 2014. In addition, the government committed itself to further reduce the 2015 budget deficit to levels below 1%-of-GDP.

Government urged to focus on implementation of reforms agenda

The 3rd review of the Economic Adjustment Programme for Greece also stressed the importance of a vigilant implementation of the reforms completed so far as well as those to be completed in the immediate period. Special attention was given to the effectiveness of the labor reform that was voted in Parliament in December 2010. That is especially with respect to the following issues: **a)** the prevalence of firm-level agreements over industry- and country-level ones and **b)** the symmetry in central arbitration. According with the 3rd review, the implementation of these reforms has not been entirely satisfactory so far. Nevertheless, it is recognize that time is needed for the reform's full impact to materialize.

In addition, the government was urged to accelerate its remaining reforms agenda, which among other items includes the opening up of a number of "closed professions"; the health care reform; a bill aiming to reform the tax collection system; the strengthening of the role of the Hellenic Competitiveness Authority; the licensing of new firms etc. Again, emphasis should be given on the quality and the ambition of the respective reforms as well as to their actual implementation.

Finally, the competitiveness of the Greek economy is expected to be boosted by the further liberilization of the energy markets. Note here that according to the 3rd review liberalization of the energy market for corporate users should be completed by the end of 2011. The energy market will remain centralized for residential customers.

Domestic banks' liquidity should be enhanced; reliance to the Eurosystem should be reduced

The risk of deteriorating liquidity conditions for Greek banks due to the economic recession and the expected changes in ECB's collateral framework led to the enhancement of the government guarantee scheme by an additional €30 bn. Access of the Greek banks to that scheme should be permitted only if the respective banks provide a medium term funding plan that reduces the dependence to Eurosystem liquidity. In addition the 3rd Review encourages the efforts of Greek banks to reduce their operational cost.

Part III: Latest domestic macro & market developments

Budget execution data for January 2011 broadly in line with official target

Final data for the state budget execution in January 2011 showed a surplus of €165mn compared with a surplus of €578mn in the same month a year earlier. According to the General Accounting Office, the data were broadly in line with the revenue and expenditure projection included in the 2011 budget. Note also that it is rather customary for the state budget to generate a surplus in the first month of the year, as a result of seasonal factors related to the timing profile of revenue and expenditure realizations. Specifically, net ordinary budget revenue declined by 9.2% YoY, but this was the result of a) lower receipts (by €393mn) from car circulation fees relative to the first month of 2010, because the due payment data was not extended to January as happened last year and b) lower revenues (by €140mn) from an extraordinary tax on the profits of large companies. On the spending side, ordinary budget expenditure was down by 2.5% YoY, with primary outlays declining by 2.6% YoY and interest costs by 2.3% YoY. In the Public Investment Budget, both expenditures and revenues declined relative to the same month a year earlier (down 14.7 YoY and 63.3% YoY, respectively). In addition, VAT revenues increased by ca 12.3% YoY despite the downturn of the economy. Part of this increase is due to base effects (i.e. the increase in VAT rates during 2010) but the remaining could be attributed in the fight against tax evasion.

Note that the above data correspond only to the execution of the state budget deficit and thus, do not coincide with the ESA95-defined general government deficit, which includes a number of sub-national entities (e.g. public hospitals, local governments and state-control corporations) and represents the benchmark for the assessing the country's economic policy program.

Ordinary Budget	January 2011 (€bn)	January 2011 (%YoY)	Annual target (%YoY)
1. Net Revenues (a-b-c)	5.09	-9.0	8.5
a. Gross revenue	5.49	-8.8	5.6
b. NATO revenues	0.00		207.7
c. Tax returns	0.40	-6.6	-23.7
2. Expenditure (α+β+γ+δ+ε+στ)	4.85	-2.5	6.6
α. Primary expenses	4.25	-2.6	1.9
β. Transfer to hospitals for the settlement of part of past debt	0.00		19.9
γ. NATO expenditures	0.00		73.9
δ. Military equipment expenditure	0.00		57.3
ε. Forfeiture of Government Guarantees	0.00		0.0
στ. Interest costs	0.59	-2.2	20.4
Public Investment Budget (PIB)			
3. Revenue	0.03	-63.3	27.7
4. Expenditure	0.11	-14.7	0.6
5. Budget deficit (-) or budget surplus (+) (1-2+3-4)	-0.17	-71.4	-3.9

Greek CPI edged down in January; still at elevated levels

Greece's headline CPI came in at 5.2%yoy in January, unchanged compared to the prior month and not far from a 13-year peak of 5.6%yoy hit in September, as higher energy prices and VAT taxes continued having an impact. In EU-harmonized terms, HICP inflation slowed to 4.9%yoy from 5.2%yoy in December 2010. For the whole of 2010, average consumer price inflation was 4.7%yoy compared to 1.2%yoy in 2009. According to the European Commission's third review of the country's economic adjustment programme, average HICP inflation is projected to moderate to 2.4%yoy this year, despite recent VAT rate hikes in January 2011, plans to increase excises on heating oil in autumn and the cost recovery in the tariff policy of state-owned enterprises. The forecast was revised upwards from 2.2%yoy expected previously, mainly as a result of revisions to the outlook of commodities and oil prices for the remainder of the year.

Prolonged domestic recession weighs heavily on consumer spending; manufacturing activity continues to contract

Greek **retail sales** continued to decline in December for the ninth month in a row as wage restraint and higher taxation continue to weigh on disposable income. Sales (including fuels and auto lubricants) in volume terms, plunged by 19.2%yoy, a higher pace of contraction compared to November's 12.0%yoy, pointing to a further significant decline in consumer spending in the fourth quarter of last year. Retail sales by revenue (including of motor fuels and lubricants) declined by a hefty 13.2%yoy following a 6.3%yoy drop in November, weighed down by weak consumer sentiment and anemic credit growth. According to our estimates, private consumption contracted by ca 5% in real terms in 2010. We expect consumer spending to remain in negative territory in the greater part of this year with net exports providing the sole positive contributor to gross domestic product. Adding to the recent string of negative data releases, manufacturing activity remained in contractionary territory in February. The **Markit manufacturing purchasing managers' (PMI) index for Greece** came in at 42.8, unchanged compared to the prior month's eight-month low and firmly below the 50 boom-or-bust level that separates growth from contraction. Incoming new business continued to fall, while the pace of contraction in employment accelerated to its highest in six months. Input price inflation hit a 31-month peak, putting upward pressure on manufacturing charges. Separately, contraction in domestic **housing market** activity continues, reflecting the ongoing recession. The number of **private building permits** (in volume terms) declined by a further 21.7% in November marking a cumulative drop of 11.6%yoy over the first eleven months of the year.

EMU sovereign debt spreads on a widening trend; Greece among the worst performers

Yield premiums of EMU periphery sovereign bonds vs. their German peers widened further early this week amid lingering worries that a comprehensive package of anti-crisis measures expected by the end of this month may fall short of market expectations. The ongoing turmoil in Libya and North Africa, added to market jitters, especially as a heavy government debt issuance in the euro area is expected in the sessions ahead. Meanwhile, Portugal's IGCP debt agency announced that on March 12 it will buy bonds maturing in April and June. This will be the second time it offers to buy government paper ahead of expiry, in a move to reassure investors that the country could avoid an EU/IM bailout.

In the EMU sovereign space, Greece has lately been among the worst performers. After revisiting levels above 800bps in early February, the 10-yr Greek government bond (GGB) yield spread to German Bund resumed its widening trend hovering around 880bps at the time of writing, the widest since mid-January and not far from record highs of 973.6bps marked nearly two months earlier. Buying interest for Greek government paper declined in the last few sessions, with secondary market volume in the HDAT platform moving sharply lower. The daily average turnover stood around €25.6mn last week, down from some €53.8mn a week earlier and €35mn in the first month of the year. Technically, a clear move of the 10-year GGB/Bund spread above recent highs has the potential to open the way for some further widening towards 940bps (Jan. 10 high) in the way to 974bps all-time highs. On the downside, immediate support lies at 830bps (late January trough) ahead of 755bps year-to-date lows set in early February.

Ireland also fared poorly on the back of lingering debt-related worries and renewed domestic political jitters. Irish opposition party Fine Gael won general elections on February 25 and secured 70 seats. That is 13 seats short for securing an absolute majority in the 166-seat lower house of parliament and form a single-party government. A coalition with the Labour party is most likely although Fine Gael might also seek a deal with independent members of parliament (since the country's independence in the 1920s, there have been six occasions when Fine Gael has been in power and on each occasion was with the Labour party). Fine Gael has pledged to call for a renegotiation of the terms and conditions of the EU/IMF bailout, especially for lower interest rates, and more financial support to restructure domestic banks. Fine Gael has threatened that, in the absence of an agreement with the EU, it is prepared to sanction unilateral debt restructuring. That is of course something that the European Commission wishes to avoid due to the potential for contagion effects across the EMU periphery. A new Irish government is expected to be formed by March 9, two days ahead of a special EMU Summit.

Research Team

Editor, Professor **Gikas Hardouvelis**
Chief 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*
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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

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