Greece: Macro Monitor

Quarterly review

Structural reforms at the heart of the government's agenda

Domestic economy performing well but risks linger

Significant acceleration of EU funds' absorption needed

Tax revenues need a major boost

Fiscal sustainability implies substantial primary surpluses

Greek-EU inflation differential remains a drag on competitiveness

Higher oil prices pose growth and inflation risks

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Contents

Summary

The Greek economy remains relatively resilient in the face of higher oil prices and the weak growth trajectory in the Eurozone, though showing concrete signs of cooling off relative to the 2001-2004 period. Real GDP growth is now expected to come in at around 3.4% this year. This relatively positive growth performance is despite an increasingly adverse external environment as well as sharply lower domestic public investment spending and softer business sentiment post-Olympics, which are partly offset by strong private consumption and higher net exports.

Our forecasts for 2006 remain relatively upbeat, envisioning a slight acceleration of GDP growth to 3.6% on the back of recovering investment activity and a positive contribution from net exports. Yet stubbornly high world oil prices and further fiscal policy tightening to help lower the budget deficit to no more than 3.0% of GDP in 2006 – in line with EU obligations - imply downside risks to our projections.

Downside risks to the growth outlook also stem from the observed difficulties the government appears to be encountering in the implementation of the CSF III program. Recent significant delays in contracting and public financing of new projects leaves little room for complacency as further delays could deprive those projects of the required time for completion before the end of 2008, which represents the final deadline for sending payment requests to the EU. In this respect, the government's decision to proceed with a new restructuring of the CSFIII program (still waiting approval by the European Commission) aiming to boost projects with good performance at the expense of those underperforming, raises the scope for a more satisfactory pace of EU fund absorption ahead.

Despite a significant underperformance of budget revenues and higher than projected interest costs over the first eight months of this year, the government now expects to reduce the 2005 fiscal deficit to 3.6%-3.7%% of GDP, from slightly above 6.1% of GDP last year. The government's prospective securitization of overdue tax receivables worth slightly over 1.0% of GDP both this year and the next are expected to help correct Greece's excessive deficit situation by the end of 2006. While a decision by the European Commission on whether Greece can use tax securitization proceeds to reduce its budget deficit is still pending, we note that such measures are merely one-off, not helping to effectively tackle longer-term structural issues hindering fiscal consolidation and preventing a more satisfactory pace of debt reduction.

The 2006 draft budget is expected to target a 2.8%-of-GDP fiscal deficit and will reportedly contain no unexpected new taxes or special measures besides those already announced (introduction of VAT on real-estate transactions and a gradual increase in "objective" values of properties). The new budget will be framed on a relatively upbeat macroeconomic environment and will contain further significant cutbacks in government consumption and operating expenditures, a slightly more restrictive incomes policy than this year's and tighter budgets and closer expenditure monitoring for most ministries. Yet, significant risks surround next year's deficit target given lingering revenue-collection problems, long-standing difficulties in containing certain significant categories of public spending and rising uncertainty over the economic outlook of major trading partners given recent oil-price developments.

Despite relatively benign price developments in the first half of 2005, inflation risks ahead are to the upside given stubbornly high oil prices and persisting structural rigidities hindering competition and encouraging price-setting behavior in key areas of economic activity. In this respect, the expected moderation of public wage growth next year and the government's increased emphasis on structural reforms leave scope for some reduction in the inflation differential with the rest of the Euro area. However, this differential is expected to remain significant over our forecast horizon, with further adverse implications for Greece's economic competitiveness.

The government has recently placed great emphasis on structural reforms, which so far have included changes in OTE Telecoms' labor practices and banks' pension funds, the tabling of the country's first bill on public-private partnerships, OPAP's and OTE's successful share flotations (which between them exceeded this year's target for privatization revenues), and the recent changes in shopping-hour and overtime rules. For his part, Economy Minister Alogoskoufis says that the threat of new tax measures has faded, and that the Government's new focus will be on accelerating "de-nationalizations" and reforming State-controlled enterprises. A new tax bill aimed at reducing personal tax rates will also be tabled soon, complementing the recent bill on corporate taxation.

Although voters are recorded, in poll after poll, as harboring great unease about the economy's outlook, they nonetheless give the Government consistent leads of about 4 percentage points over main opposition Pasok.

Key macro indicators

Y/Y growth	2003	2004	2005f	2006f
GDP (constant prices)*	4.6	4.7	3.4	3.6
Final consumption*	3.2	4.3	3.3	2.8
Gross fixed capital formation*	13.7	5.7	-2.8	3.7
Domestic demand*	5.6	4.6	1.8	3.0
National CPI (year-average) *	3.5	2.9	3.5	3.3
Budget balance (% of GDP)*	5.2	6.2	3.8	3.0
Public debt (% of GDP)*	109.3	110.5	110.5	109.0
Current account balance (% of GDP)*	-6.4	-4.9	-5.6	-5.4
Unemployment rate**	10.4	11.0	10.5	8.9
Employment growth**	1.3	2.8	1.5	1.5
Labour productivity growth**	3.3	1.3	2.3	2.5
Unit labour cost growth **	0.8	4.4	3.0	2.3

(*) Realisations and EFG Eurobank´s forecasts
(**) NSSG, BOG, FinMin

Part A

Economy and Macroeconomic Policies

- **Political overview**
- **Recent economic developments and outlook**

Politics: structural reforms at the heart of the government's agenda

- **Changes in OTE, bank pension funds, shopping hours and overtime pay, a new PPP bill and more share flotations mark the start of a more active economic policy.**
- **Government promises new focus on "de-nationalizations" and reform of State-controlled enterprises.**
- **Despite voter worries, Government maintains firm lead in opinion polls.**

Emboldened by its recent initiatives launched on several fronts at once (*cf.* OTE's labour and hiring practices, banks' pension funds, the public-private partnership bill, OPAP's and OTE's partial-privatisations, changes in shopping hours and overtime rules), the Government, in its various pronouncements, is increasingly laying claim to the title of "champions of reform". At the very least, it can be said that it is now building up a track record, after a relatively slow start in 2004 and early 2005. Indeed, in his keynote speech at the Thessaloniki Trade Fair (10.9.2005) the PM asserted that his party's elevation to power did not merely reflect voters' desire for a change of government, but revealed the people's readiness to embark on an entirely new "path of reforms". This "shared vision", the PM said, which included an undertaking to "re-invent the state", aspired to a "human-centred type of economic development", to an "economy of opportunities" and to a society characterised by "cohesion and trust".

Both the Prime Minister and the Economy Minister speak with considerable optimism about the economy's prospects. In his Thessaloniki speech, the PM expressed "cautious optimism", foreseeing a "taking off" of the economy a year from now based on his government's policies (which, in the name of fiscal rigour, did not include any hand-outs). For his part, Minister Alogoskoufis says that the threat of new tax measures has faded, and that the Government's new focus will be on accelerating "de-nationalisations" and reforming State-controlled entreprises. A draft reforms programme for 2005-2008 was unveiled on 14.9.2005 by Mr Alogoskoufis – essentially, a classification of on-going policies combined with a catalogue of long-term goals. It contains five main areas, all aimed ultimately at boosting competitiveness: (i) restoring balance to government finances, (ii) increasing productivity by addressing structural problems that currently impede the smooth functioning of markets, by investing in human capital and promoting the Knowledge Society, (iii) improving the business climate, increasing market liberalisation, intensifying competition and increasing the outward-looking nature of the economy, (iv) raising the level of employment, reducing unemployment and raising the efficiency of educational, training and re-training methods and systems, and (v) strengthening social cohesion via a series of actions targeted, *e.g.*, at strengthening the family unit, at better monitoring on-going measures, at providing financial support to the neediest social groups and at improving the efficiency of the labour market (including measures to increase flexibility but also to protect workers' rights).

Also in the works is a new tax bill – to be tabled in Parliament in October at the same time as the draft 2006 budget – which will include cuts in the top two income-tax rates – now at 40% (for incomes exceeding €23,000 per annum) and 30%, respectively – beginning on 1 January 2007. In that year, both the top rate and the second-highest rate will be reduced, but by how much is not yet known. The alleged goal is for those two rates to merge at some point, perhaps at 25% by 2010. (It is not clear whether a single band will be established then, or whether the lowest rate – 15% – will be kept.). The tax bill is likely also to raise tax-exempt income from €11,000 presently, perhaps to €12,000. The Government continues to maintain its leads in the **opinion polls**. A recent survey, by "Opinion" (5.9.2005), put New Democracy ahead of Pasok by 4.1 percentage points, 30.4% *vs.* 26.3%. At the same time, 33% of interviewees said they considered Costas Karamanlis as more competent to be PM, *vs.* 18% for George Papandreou (with 42% rejecting both). However, 83% described the state of the economy as "very bad" or "rather bad", *vs*. 15% who described it as "rather good" or "very good".[1] In the longer term, this could prove a crucial factor (to date, however, it does not seem to have benefited Pasok in any material way).

Notwithstanding the above findings, New Democracy officials claim that initial polls carried out for the Government at the end of August suggest that voters back the reforms currently being introduced by the Government (in contrast to trade unions, which have often responded with strike action). If true, this will help the Government in its efforts to forge a "reformist" image, reinforced also by a perception among voters that opposition Pasok has yet to fashion a clear economic-policy agenda of its own.

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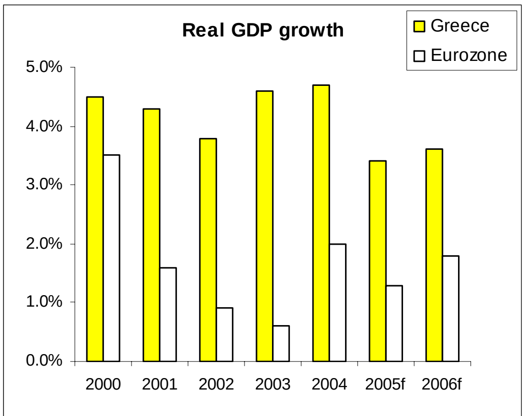
[1] An opinion poll by "Kappa Research", published in the Sunday *To Vima* on 21.8.2005, put New Democracy's lead over Pasok at 2.7 percentage points, 36.8% *vs.* 34.1%, while 52% of interviewees said they considered Costas Karamanlis as more competent to be PM, *vs.* 37.4% for George Papandreou. (In May 2005, ND's lead stood at 2.4 points, and in September 2004 at 7.6 points, according to Kappa Research.)

Domestic Economy: Performing well but risks linger

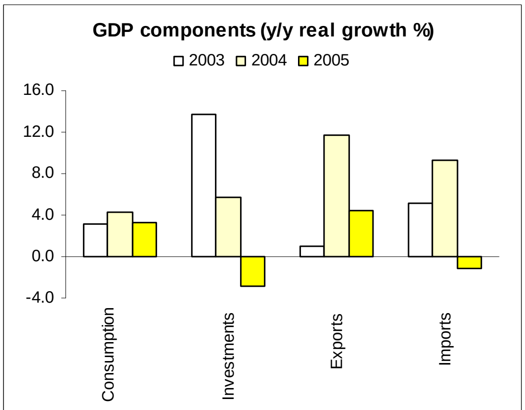
- **Economic growth remains strong, driven mainly by buoyant consumer spending and rising net exports.**
- **Our forecasts for 2006 remain relatively upbeat, envisioning a slight acceleration of GDP growth to 3.6%, from 3.4% this year in line with recovering investment activity.**
- **Risks to our projections lie to the downside due to stubbornly high world oil prices and further fiscal policy tightening next year.**

Economic growth remains buoyant, driven mainly by strong consumer spending and rising net exports, though having decelerated somewhat from the 2004 Olympic Games year. **Real GDP growth** is expected to reach 3.4% this year (EFG Eurobank´s upwardly revised forecast from +3.1% expected previously) after rising by 4.7% in 2004, with the latest quarterly national accounts data showing that the economy maintained a strong momentum in H1 2005. Looking further ahead, we see a slight acceleration in real GDP growth to around 3.6% next year with improving investment activity and a positive contribution from net exports taking the slack from decelerating household spending as real wage growth eases and the consumer gradually embarks upon a de-leveraging effort to improve his finances. Main downside risks to our growth projections include a failure of investments to recover following a significant slowdown in the first half of this year and a less benign external environment due to sharply higher oil prices and persistent global economic imbalances.

Private consumption continued to grow robustly in the first half of 2005 helped by the rapid growth of consumer credit, continuing strong real wage growth and positive wealth effects from firmer equities and recovering housing prices. **Net exports** bounced strongly, with declining imports due to softening domestic demand pointing to a positive contribution to growth this year of around 0.3 percentage points (pp). Last year, net exports subtracted some 0.5pp off real GDP growth. In contrast to the above positive trend, **gross capital formation growth** disappointed (down 2.7% y/y in H1 2005 compared with +6.2% y/y in H1 2004), weighed down by significant cutbacks in public-investment budget outlays and increased business hesitancy to undertake new investments due to post-Olympic economic uncertainties.



Source: Ministry of National Economy, ECB, EFG Eurobank



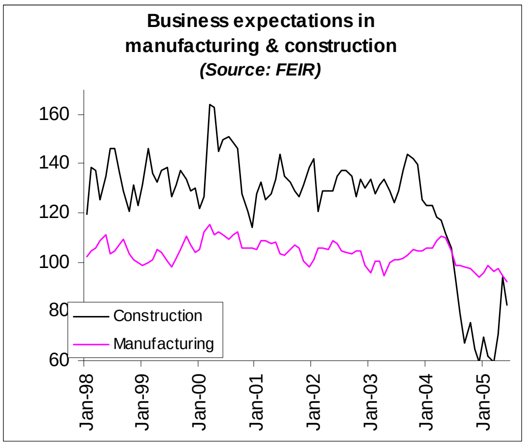
Source: NSSG, EFG Eurobank

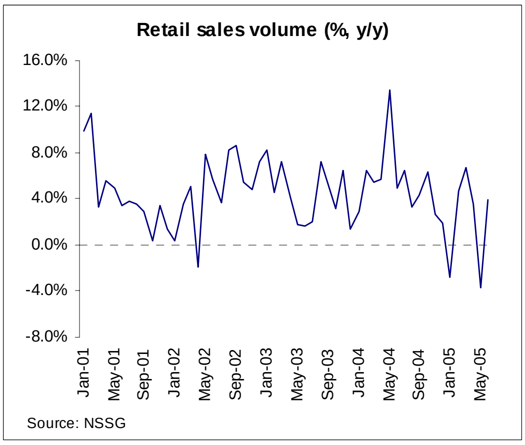
Although we now forecast gross fixed capital formation to contract in 2005 as a whole after recording annual average growth of 8.0% over the previous five years, we look for gradual recovery in investment activity from H2 2005 onwards as the government accelerates the absorption of EU structural funds and its new business-friendly initiatives start to yield tangible results. Our expectation for a better domestic investment environment ahead is further supported by the continuation of double-digit growth rates in mortgage lending and the recent strong bounce in residential construction activity.

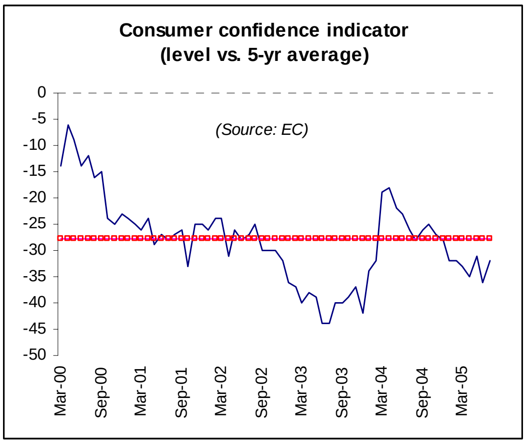
Private consumption (66% of GDP in 2004) remains the main engine of growth and although eroding disposable incomes due to higher oil prices and slower real wage growth in 2005 point to a mild deceleration in consumer spending next year, recent survey data and conjunctural indicators show no significant abatement of consumer vigour yet. Following some transitory weakness earlier this year, real retail sales growth has lately been on a recovering path, growing by a cumulative 3.6% y/y in January-May 2005 on the back of strong gains in the furniture, household equipment, food, beverages and tobacco sectors.

Sales of new private passenger cars rose by just 0.7% y/y in January-May 2005, but this followed annual growth in excess of 15% last year. The strong expansion of consumer credit continued in the January-May period (+28.3% y/y) and, although the gradual elimination of pent-up demand and lower disposable incomes next year might induce a drive by Greek households to restore over-extended balance sheets, total outstanding household credit in Greece remains well below the EU average, pointing to the continuation of strong credit growth in the quarters and years ahead[2]. Furthermore, although the EC's consumer confidence index for Greece has moved sharply lower after reaching a 4-year high in April 2004, the index appears to have stabilised lately, and at -32 in July 2005 was not far off its 5-year average level.

The unemployment rate came in at 10.4% in Q1 2005 (latest available quarterly data), unchanged from a quarter earlier and down from 10.1% in Q3 and 11.3% in Q1 2004. Since Q1 2004, the NSSG´s labour market data are based on a more recent 2001 census conducted in accordance with Eurostat rules[3].







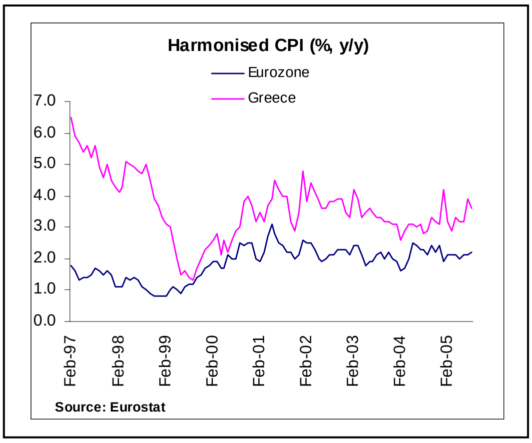
[2] The total outstanding balance of domestic MFIs to the Greek private sector stood at €124.23bn in May 2005, or about 69.8% of this year's officially projected GDP, with households accounting for around 32% of the GDP ratio and enterprises for the remaining 37.8%. Eurozone average household debt to GDP currently stands at slightly over 55%.

3 Previous data based on an older 1991 census – and, thus, not directly comparable with the most recent figures – had shown a drop in the unemployment rate to 9.5% in the fourth quarter of 2003.

Looking ahead, cooling domestic economic activity should inflict a mild slowdown in the pace of job creation this year and the next, with the latter expected to remain positive but not fast enough to prevent a small rise in the unemployment rate over the corresponding period.

Abating domestic demand pressures and sharply lower fresh produce prices prevented a significant acceleration in **headline CPI** in the first half of the year due to higher oil prices[4]. Inflation spiked to 3.9% y/y in July 2005 from 3.3% y/y in the prior month but some 0.4pps of that increase was mostly technical in nature as the comparatively late start of summer sales this year added 0.3-0.4pps to the headline index. Looking ahead, heightened underline cost-push pressures due to rallying oil and commodity prices, recent hikes in processed food and electricity prices and the regular re-inclusion of the heating oil component in the CPI basket calculation from mid-October (expected to add half a percentage point to headline CPI) are likely to keep inflation above the 3.5% y/y mark throughout the remainder of 2005. We now expect 2005 CPI to average 3.5% y/y this year compared with 2.9% in 2004.

Following a considerable improvement in the **current account balance** last year, the 28.7% year-on-year (€1.5bn) cumulative rise in the deficit in H1 2005 was primarily the result of a wider trade gap due to a sharply higher oil bill and net payments in the ships balance (as opposed to net receipts recorded in the corresponding period of 2004). Higher general government gross payments to the EU and in net interest, dividends and profits also contributed to the current account deterioration in H1 2005. On a more positive note, the services surplus widened considerably during that period mainly on the back of higher net shipping receipts (despite the continuing fall in freight rates) and higher tourism revenues. Net receipts from transportation (mainly shipping) and travel



services grew by 10.3% y/y and 3.0% y/y, respectively in H1 2005[5].

On the **financial account** side, strong inward portfolio investment to the tune of € 4.94bn in January-June 2005 continued to provide the main source of current account deficit financing, while the FDI balance was broadly flat after recording a small net inflow during the same period a year earlier. All in all, the current account balance-to-GDP ratio should rise to around 5.2% this year from 3.7% in 2004 (EFG Eurobank forecast) on the back of eroding competitiveness due to persistent inflation differentials in comparison with the Euro zone, weakening demand from some key major trading partners and a higher oil import bill.

The Greek **tourism sector** appears to have finally begun reaping the benefits of the Olympics legacy. This has been helped by an intensified promotional effort by the Greek Tourism Development Ministry, which expects a 10% y/y rise in tourist arrivals this year and forecasts the number of foreign tourists visiting the country rising to 20 million within ten years (from around 14 million expected this year). Further initiatives designed both to attract more tourists from the high-income brackets and to expand the tourist season beyond the summer vacations are currently under consideration by the government. Some of the steps proposed to help attain these aims include additional large-scale

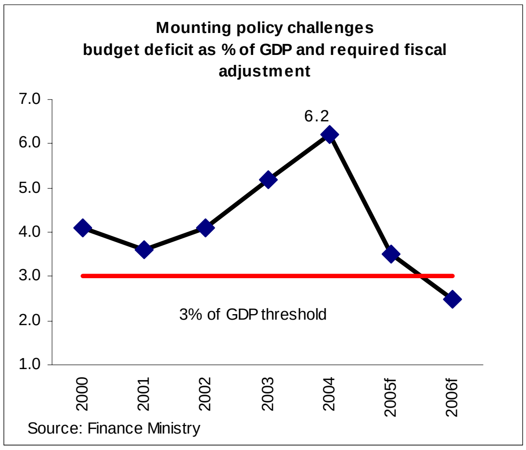
[4] In January-July 2005, the CPI basket's fresh produce component slashed some 0.75pps off the headline index, helping to broadly offset the accelerating impact of domestic fuel prices (+0.87pps) over that period.

5 Gross shipping receipts grew by 38.4% y/y last year to €12.4bn (7.5% of GDP), exceeding gross tourist revenues (6.25% of GDP) for the first time on record.

investments in the sector and the introduction of incentives for the retirement of ageing facilities.

On the **fiscal front,** the baseline scenario of the revised Stability and Growth Programme (SGP 2004-2007) envisions a reduction in the general government deficit from a preliminary 6.1% of GDP[6] last year to 3.5% and 2.8% of GDP in 2005 and 2006, respectively. According to the latest MoF data, ordinary budget revenues increased 4.4% y/y in January-August 2005, falling short of expectations in light of an annual growth target of 11.4% y/y. On the spending side, primary outlays rose by 2.5% y/y in January-July 2005, well within the annual growth target of 4.9%. However, a big rise in interest costs pushed overall expenditure 6% higher in the first seven months of 2005, as against a full-year target of 4.6%. Accordingly, the ordinary budget deficit came to €7.98bn in the first seven months of this year covering already some 94% of the corresponding annual target.

Contrary to prior market expectations for an undershooting of this year's fiscal targets, Greek Finance Minister George Alogoskoufis said recently that the government would manage to bring the deficit down to 3.6% of GDP in 2005. Finance Ministry sources also suggested that the government is planning to proceed before the end of the year with the securitisation of around €1.7bn of overdue tax receivables.[7] Although the above initiative would facilitate the attainment of this year's budget target, we note that such measures are one-off, while the main portion of this significant fiscal adjustment will come from the sharp cutback in the public investment budget's (PIB) outlays. The latter are now expected to drop to € 7.5bn in 2005, down from an initially-budgeted target of €8.0bn this year[8] (and down from ca € 9.5bn in 2004), on the back of non-recurring Olympics-related expenditure and recorded delays in the absorption of EU investment subsidies through the CSF III.



The **2006 draft budget** will target a sub-3.0%-of-GDP general-government budget deficit and will reportedly contain no unexpected new taxes or special measures besides those already announced (introduction of VAT on real-estate transactions and a gradual increase in "objective" values). Instead, the new budget is likely to contain further significant cutbacks in consumption and operating expenditures, a slightly more restrictive incomes policy than this year's (public-sector wage growth not to exceed expected inflation) and tighter budgets and closer expenditure monitoring for most

[6] The 2004 budget deficit is likely to be revised to 6.2% of GDP after the settlement of certain pending issues with the Eurostat regarding inconsistencies in the recording between the Greek and EU budgets as well as the finalization of healthcare and Olympics-related expenditures for past years.

[7] The total debt owed by taxpayers to the State is estimated at about €17bn, or 10% of annual GDP.

[8] Overall PIP outlays have declined to €2.89bn in January-July 2005, from €4.88bn in the same period a year earlier.

ministries[9]. The 2006 budget will be framed on a relatively upbeat macroeconomic environment, envisioning economic growth of around 3.5%[10]. It will target expenditure growth of no more than 5% and revenue growth of about 7.5-8.5% (depending on oil-price developments). Taking into consideration the above and assuming a sub-4.0%-of-GDP budget deficit outcome this year, we deem the 3.0%-or-lower deficit target attainable in 2006. Yet, significant risks surround this target given lingering revenue-collection problems, long-standing difficulties in containing certain significant categories of public spending and rising uncertainty over the domestic/major trading partner economic growth outlook given recent oil-price developments.

Mounting worries that a further watering down of the Stability and Growth Pact could relax fiscal consolidation efforts in the EU forced peripheral **bond markets** such as Greece, Portugal and Italy to outperform their core Eurozone counterparts, with the 10-yr benchmark GGB/Bund yield spread hitting a multi-month high of ca 31bp after the announcement of the French EU constitution vote results in early June. The above spread was trading at around 22-23bps at the time of writing having been on a declining trajectory over the previous two months, helped by lessening political jitters in the EU and abating global risk aversion. At their current levels, GGB yield spreads appear to be relatively fairly-priced and, although we do not currently expect them to undergo any sharp re-widening, we do not see much room for further spread compression either given Greece's continuing fiscal strains.

[9] The Ministries of the Interior, Education and Health are reportedly the only ones to enjoy increases in their allocated funds.

[10] Note that the revised SGP foresaw 2006 real GDP growth of 4.0%.

Part B

Special Focus Topics

- **Long-term sustainability of public finances**
- **2006 budget**
- **Recent fiscal developments and outlook**
- **Public Investment and CSF III**
- **Inflation, wages and competitiveness**
- **Oil prices and macroeconomic implications**
- **Structural issues and market reforms**

Long-term Sustainability of Public Finances

- **Attainment of the 60% debt-to-GDP ratio threshold is feasible in 20 years under favorable macroeconomic conditions.**

The following table presents the main results of a simulation exercise performed by our economic analysis team. It shows the primary surpluses as the percentage of GDP needed to attain sustainability of public finances in 10 or 20 years, under various combinations of nominal GDP growth rates and interest rates on outstanding government debt. Sustainability of public finances is defined here as the target of 60% public debt-to-GDP ratio imposed by the Maastricht treaty. For our simulations we assume zero stock-flow adjustments (i.e., no discretionary items affecting the debt without going through the deficit).

Our key findings are as follows:

- Attaining the target of 60% debt-to-GDP ratio by 2025 is feasible under favorable macroeconomic conditions: The simulation shows that with a 3.5% nominal interest rate on debt and a 7% nominal GDP growth rate, only a small primary surplus of 0.1% is needed to reach the target, assuming zero stock-flow adjustments.

- However, it would require a 3.5% primary surplus to reach the target by 2015, even under the most favorable conditions for interest rates and nominal GDP growth.

- In the worst case scenario with high interest rates of 6% and pessimistic nominal GDP growth rates at 3%, a huge primary surplus is needed: 9.5% to attain the 60% target in 10 years and 8.5% to achieve it in 20 years.

Required primary surpluses as a % of GDP for attaining a 60% debt-to-GDP ratio

Time horizon: 10 years (i.e., by 2015)

		Pessimistic Nominal GDP Growth = 3%	Intermediate Nominal GDP Growth = 5%	Optimistic Nominal GDP Growth =7%
Nominal Interest Rate on Debt	3,50 %	**7.6**	**5.5**	**3.5**☑
	4,50 %	**8.3**	**6.1**	**4.1**
	6.00 %	**9.5**☒	**7.2**	**5.0**

Time horizon: 20 years (i.e., by 2025)

		Pessimistic Nominal GDP Growth = 3%	Intermediate Nominal GDP Growth = 5%	Optimistic Nominal GDP Growth =7%
Nominal Interest Rate on Debt	3,50 %	**4.7**	**2.3**	**0.1**☑
	4,50 %	**6.1**	**3.4**	**1.0**
	6.00 %	**8.5**☒	**5.3**	**2.5**

Note: The calculations take into account the residual maturities of government debt and assume zero stock-flow adjustments.

☒ Worst-case scenario
☑ Best case scenario

Fiscal Position: medium-term sustainability is a key policy priority

- **Sustainable fiscal consolidation is a key medium-term challenge for Greek policy makers to help attain a faster pace of debt reduction and generate the required funds for addressing the expected explosion of social security costs after 2010.**
- **A sub-4%-of-GDP deficit outcome is expected in 2005 but structural handicaps hindering fiscal consolidation remain.**
- **Lower public-investment expenditure is the main driver of deficit reduction this year but further cutbacks in such spending are probably neither feasible nor desirable.**

Restoration of fiscal discipline is a key medium-term policy challenge…

In view of the steep deterioration in the country's fiscal position since the late 1990s[11], a return to fiscal discipline represents a key policy challenge to the authorities in light of their obligation to comply with the EU Council's decisions, but also in view of the need for a sharp reduction in the debt-to-GDP ratio. The necessity of that objective is indisputable given the heavy burden the current sizeable debt-servicing costs place on public finances. Indeed, the ordinary budget's annual interest payments currently stand at 5-6% of GDP, representing some 65% of the total bill for public wages and pensions[12]. If amortization costs are also taken into account, the total annual bill for interest and amortisation is currently around 17-18% of GDP, an amount equivalent to slightly more than 80% of total primary expenditure.

.. to help attain a faster pace of debt deduction…

According to the latest fiscal revisions, government gross debt stood at 110.5% of GDP at the end of 2004[13], having declined only marginally in recent years despite strong nominal GDP growth, sizeable privatization proceeds and lower interest rates since the adoption of the euro. Besides being a consequence of the significant loss of fiscal discipline post-EMU entry, the slow pace of decline in the debt ratio was also due to sizeable stock-flow adjustments (around 11% of GDP between 2001 and 2004). These adjustments have been inflating the debt stock without being accounted for as expenditure in the budget accounts. Although the recent fiscal inventory resulted in the proper recording of a great deal of such bellow-the-line items, the revised SGP still includes a sizeable stock-flow adjustment this year (1.9% of GDP, mainly due to hospital debt settlements), while a more drastic reduction is expected to take place in 2006 and 2007. These suggest that a close monitoring of such off-balance sheet items as debt assumptions and capital injections to public enterprises is required if authorities are to attain a more adequate pace of debt deduction in the period ahead. The latter is particularly true in the current trajectory since our analysis suggests that even without such adjustments it would take primary surpluses in excess of 4.0% of GDP annually for a period of up to 10 years to help bring down the debt ratio approximately to the 60%-of-GDP threshold.

…and enhance macroeconomic stability.

Besides facilitating a faster pace of debt reduction, the restoration of a sound fiscal position would also help to enhance macroeconomic stability by reducing inflation, restoring competitiveness, reversing the crowding-out of the private sector and generating the required reserves for addressing the expected explosion of social security costs after 2010. Regarding the latter, we refer to a recent OECD study[14], which found that the Greek pension system remains one of the most generous, and

11 A recent fiscal audit performed by the current government has showed that the fiscal deficit-GDP ratio has been understated by around 2pp and the debt ratio by 6-8 points annually since 1997.

12 Estimates based on the 2005 budget figures.

13 Revised SGP (2004-2007)

14 Economic Survey of Greece, 2005

inequitable, in the OECD. Without further changes, age-related expenditures will rise by as much as 12pp to over 22% of GDP between now and 2050, according to the study. In view of the above, we derive some encouragement from the government's stated willingness to initiate a public debate on the issue, aiming to build a minimum consensus on the parameters of, and the potential solutions to, the social security problems. That said, the government has ruled out any concrete policy action to reform the social-security system in the remainder of the current government's term.

A sub-4%-of-GDP deficit outcome is expected this year…

The government now expects the fiscal deficit to shrink to 3.6-3.7% of GDP this year, from 6.1% of GDP in 2004 (likely to be revised to 6.2% of GDP)[15], with a prospective securitization of overdue tax receivables worth around 1.0% of GDP helping to attain that aim. A decision by the European Commission on whether Greece can use such securitization proceeds to reduce its budget deficit is still pending. If the EU authorities give Greece the green light, the government is likely to tap another 1.0% of GDP or more in proceeds from an estimated outstanding pool of €17bn (10% of annual GDP) of recoverable past tax liabilities next year. Although these initiatives could facilitate the attainment of a sub-4.0%-of-GDP deficit in 2005 (and also help compress the 2006 budget gap towards the 3.0% EU threshold), we note that they merely represent one-off measures, which do not help to effectively tackle longer-term structural issues hindering fiscal consolidation.

…but structural handicaps hindering fiscal consolidation remain

One such important structural problem has been awkwardly revealed by the Finance Ministry's latest (January-August 2005) budget data, which show a significant underperformance of tax-revenue growth relative to the full-year target despite higher VAT and excise-tax rates since April 1, 2005. Recent government efforts to locate the potential causes of disappointing revenue growth have uncovered extensive tax evasion among non-wage earners and small-, medium- and large-sized businesses. This phenomenon appears to have been on the rise in recent years, as suggested by the constant decline in the ordinary budget revenue-to-GDP ratio since 2000[16]. Indeed, recent official data suggest that the current government has recently been facing mounting tax-collection problems. In a move to counter such problems, the government has recently intensified its revenue-generating efforts via upgraded electronic means and the formation of a special tax police squad targeting high-profile incidents of tax evasion.

Lower public-investment expenditure is the main driver of deficit reduction this year…

On the expenditure side, a key area of savings helping to contain this year's budget deficit has been lower public-investment budget (PIB) spending. This is expected to drop to around € 7.5bn in 2005 compared to a budget-targeted €8.0bn (and from ca € 9.6bn in 2004), mainly on the back of lower-than-projected EU co-financed investment outlays due to the recorded delays in the absorption of EU investment subsidies under the CSF III program. The sharp drop in the public investment budget's deficit this year is expected to account for some 1.2 pp of GDP of the overall reduction in the 2005 general government deficit.

…but further cutbacks in such spending are probably neither feasible nor desirable

Arguably, cutbacks in PIB-related expenditure probably constitute the easiest (and politically least-costly) way to achieve one-off reductions in the central government deficit. However, in the case of Greece where the continuation of strong economic growth for many more years to come is a key prerequisite for achieving per capita income convergence with the rest of the Eurozone, further significant reductions in the PIB are probably neither feasible nor desirable. In the

[15] The upward revision to the 2004 deficit figure is likely to be included in the Commission's Autumn 2005 forecasts.

[16] Ordinary budget revenues as percentage of GDP are forecast to close below 25% this year compared to 28.1% of GDP in 2000.

shorter-term, apart from the need to reverse this year's worrying contraction in gross capital formation growth (which seems to have been at least partly due to lower PIB spending), the necessity to accelerate the implementation of approved CSF III projects in order to comply with the so-called n+2 rule points to increasing PIB spending in the years ahead. Indeed, recent press reports suggest that the 2006 budget will provide for an increase of more than 10% in public-investment spending next year with the overall adjustment in the total PIB balance expected to have a broadly neutral contribution to the targeted reduction in the overall budget deficit next year.

Further steps needed to contain primary expenditure

The above points suggest that, apart from aiming to crack down on tax evasion, fiscal policy efforts in the years to come should place particular emphasis on restraining current public spending growth, given also planned reductions in corporate and personal income-tax rates and continued infrastructure investment, both necessary to boost long-term growth. Again, potential areas of focus include public-sector wage restraint, containment of public-sector employment growth, lower defence spending, a better control of health-care costs, multi-year fiscal budgeting at both the central and regional levels, and avoidance of loan guarantees and capital transfers to public enterprises.

Recent developments on the excessive deficit procedure for Greece

Following an earlier EU Council notification to Greece to take decisive measures to remedy its excessive deficit position "as rapidly as possible and the latest by 2006", the Greek authorities submitted to the EU authorities on 21 March a revised Stability and Growth Programme (SGP) covering the 2004-2007 period. The new Programme was structured in such a way as to take into account the budgetary impact of an auxiliary fiscal package[17] which, along with the measures included in the 2005 budget, would facilitate the necessary fiscal adjustment required to comply with the Council's recommendations. In view of the above, the EU Council decided in early April that no further steps in the excessive deficit procedure against Greece were needed at that time, as the measures outlined in the revised SGP were deemed adequate to remedy the country's excessive deficit situation by 2006. Note that in its spring 2005 forecasts, the Commission projected a Greek fiscal deficit of 4.5% of GDP for 2005 and 4.4% for 2006, but these projections were based on a no-policy-change scenario and, therefore, did not include the budgetary impact of the additional fiscal measures (VAT, and excise tax hikes, etc.) introduced in late March by the Greek government, the latter having been made public after the forecast cut-off date. However, even after taking into account the estimated impact of these measures, the Commission still projected higher deficit outcomes for both this year and the next than those in the revised SGP[18]. According to the Commission, these divergences were due to overly optimistic projections for social-security contributions, public-consumption expenditures and EU grants and to the fact that the revised programme did not provide for further measures to compensate for any upward revision in the deficit figure of 2004. Although such slippages in 2005 would not affect compliance with the Council's requirements, their occurrence in 2006 would require additional measures next year, the Commission noted in its assessment of the revised Greek SGP issued in early April. A new assessment of Greece's compliance with the Council's recommendation will be provided by the Commission in late October 2005.

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[17] The auxiliary fiscal package introduced earlier this year included "permanent measures" involving an increase in the average VAT rate by 1 percentage point, higher excise duties on alcoholic beverages, tobacco and heating oil, lower travel expenses for civil servants and reduced subsidies to urban-transport companies. According to the government's initial estimate, the package was expected to lead to a deficit reduction of 0.5% of GDP in 2005 and 0.9% of GDP in 2006. Should these measures be deemed inadequate to reduce the deficit to below 3.0% of GDP, the 2006 draft budget would also include further measures to ensure the desirable outcome, such as expenditure reductions in the areas of military spending, state contributions to social-security funds, local administrations and public investment.

18 Communication from the Commission to the Council, SEC (2005) 443 final, 6 April 2005.

2006 Budget: targeting the 3% of GDP deficit threshold

- **The 2006 budget targets a deficit of no more that 3% of GDP in line with EU Treaty obligations.**
- **The new budget will target a more restrictive incomes policy and further significant cutbacks in public consumption and operating expenditures.**

The 2006 budget will reportedly target further significant cutbacks in public consumption and operating expenditures, a more restrictive incomes policy than that implemented this year (public sector wage growth not to exceed expected inflation) and tighter budgets and closer expenditure monitoring for most ministries. These seem to be in the right direction towards attaining a 3.0%-of-GDP or lower budget deficit next year. However, we would not entirely rule out the introduction of additional deficit-reducing measures besides those already announced[19] should some of the 2006 budget's likely assumptions (i.e., 3.5% real GDP growth, 7-8% revenue growth, etc.) prove overly optimistic. The table below has been recently circulated in the local press and reportedly represents one of the most prevalent scenarios for the 2006 budget figures and we present it here for indicative purposes only (the first budget draft will be submitted to Parliament in early October). A quick look at the table shows that the envisioned reduction in the general government budget deficit to 2.8% of GDP next year will mainly come via higher ordinary budget revenues (up 1.5% of GDP compared to this year), lower primary spending (down 0.8% of GDP) as well as a continued sizeable public utility surplus. Note that the larger than previously expected decline in the general government debt ratio this year is mainly due to recent sizeable upward revisions to past (2002-2004) nominal GDP estimates.

% of GDP	2003	2004	2005 (SGP)	2005 (f)*	2006 (B)**	2006 (SGP)	2007 (SGP)
1. Ordinary Budget							
a. Revenue	25.9%	25.2%	25.8%	24.5%	26.0%	24.7%	25.9%
a1. Tax returns	1.5%	1.7%	1.7%	1.5%	1.7%	1.5%	1.7%
a2. Advance tax collection				1.1%		1.0%	
a3. Net revenue (a-a1+a2)	24.3%	23.5%	24.1%	24.1%	24.3%	24.3%	24.3%
b. Expenditute	26.4%	27.2%	26.7%	26.7%	26.1%	25.8%	25.5%
b1. interest	6.1%	5.7%	5.5%	5.4%	5.6%	5.0%	5.5%
b2. Primary expenditure (b-b1)	20.3%	21.6%	21.2%	21.3%	20.5%	20.8%	20.0%
2. Ordinary budget balance (1a3-b)	-2.1%	-3.7%	-2.6%	-2.6%	-1.8%	-1.6%	-1.2%
3. Public Investment Budget							
a. Revenue	1.2%	1.8%	1.9%	1.7%	2.1%	1.8%	2.1%
b. Expenditure	5.5%	5.7%	4.5%	4.3%	4.6%	4.5%	4.5%
4. PIB balance (3a-3b)	-4.3%	-3.8%	-2.6%	-2.6%	-2.5%	-2.7%	-2.4%
5. Central government balance (2+4)	-6.4%	-7.7%	-5.1%	-5.1%	-4.3%	-4.3%	-3.7%
5a. Primary balance (5+1b1)	-0.3%	-2.0%	0.4%	0.3%	1.3%	0.7%	1.8%
6. Public utility & other adj.	0.7%	1.4%	1.7%	1.5%	1.5%	1.4%	1.5%
6a. Public utility sector surpluses	3.3%	3.5%	2.6%	2.4%	2.5%	2.4%	2.5%
6b. Transfers to social security	-1.3%	-1.1%	-0.3%	-0.2%	-0.2%	-0.2%	-0.2%
6c. Diffence expenditure	-1.4%	-1.1%	-0.9%	-0.8%	-0.8%	-0.8%	-0.8%
6d. Adjustments	0.0%	0.1%	0.2%	0.2%	0.0%	0.0%	0.0%
7. General government balance (5+6)	-5.7%	-6.0%	-3.5%	-3.6%	-2.8%	-2.8%	-2.2%
8. Central government debt	119.0%	120.7%	119.7%	119.1%	116.4%		113.1%
9. Intragovernmental debt	10.2%	11.4%	11.7%	11.6%	12.5%		13.2%
10. General government debt (8-9)	108.8%	109.3%	108.0%	107.4%	103.9%		99.9%

(f)* = forecast (B)**= budget

[19] i.e. introduction of VAT on real estate transactions and gradual increase in objective values.

Public Investment and the 3rd CSF

A significant acceleration of funds absorption is required to meet the December 2008 deadline

As we pointed out in our previous Macro Monitor (April 2005), nearly all risks to the execution of the budget's public-investment component lie with the Government's ability to successfully develop projects that qualify for EU funding. Data on the execution of the public investment budget (PIB) over the first seven months of 2005 suggest certain delays: Only 36% or €2.9bn out of the budgeted €8bn (for the year as a whole) was spent, compared with 51% during the same period last year and out of a much larger budget. Note that the investment component of the 2005 budget was curtailed to €8bn from €9.6bn in 2004 (i.e., a decrease of 16%) and €8.4bn in 2003. Specifically, the part of PIB that is co-financed by the EU was raised by a meagre 6.2% to €5.1bn in 2005, while the part that is purely nationally-funded was reduced by a vast 39%, to €2.9bn, as the latter national component was unusually high during the Olympic year 2004.

The observed delays in the execution of the PIB during the January-July 2005 period (latest available data) occurred primarily in the budget's co-financed part, as the national program represents highly inelastic expenses such as projects for schools and country roads, some of which were held back significantly in the last few years due to elevated spending for Olympics-related preparations. One proposed explanation for the recent delays in the execution of the (co-financed) PIB is that these are due to the intensifying efforts by the Greek Ministry of Economy and Finance to curb spending, presumably in order to achieve its 2005 deficit target of 3.5% of GDP. We would assign a relatively low probability to such a course of action, however, as it could risk undermining economic growth in 2005 and the next two-three years. A more plausible reason for those delays is probably the increased difficulties encountered in completing projects eligible for EU financing, as a result of more stringent EU regulations and certain domestic policy decisions in year 2004, which prevented the maturity of a significant flow of new projects. Whichever the cause of the delays, however, it is probably fair to say that the risks in successfully absorbing the promised EU funds have increased substantially.

To gain a deeper understanding of such risks, it is important to examine separately the three major phases of implementation of a CSF project. The first phase ends when a project is signed by the counterparties through a binding contract. The signing represents the end of a lengthy process that begins with initiating a new CSF activity. The second phase, the expenditure stage, is when public funds are disbursed as payments for the on-going execution of a project. The third phase ends when the EU goes ahead and credits the Greek government with its share of the cost, contingent, of course, on the co-funded projects' compliance with the relevant EU regulations. This latter phase takes place after a project is completed, audited internally by the Greek authorities, and the corresponding bills are sent to the EU for reimbursement.

New Contracts for CSF projects are lagging behind

At the end of August 2005, 53% of the CSF III program had reached and/or passed the stage of a signed contract. This leaves a gap of 47% to be closed in only 16 months, as the deadline for reaching a level of 100% in signed contracts is the end of 2006. Time is clearly running out and recent signs that the EU Commission may be lenient on the end-2006 deadline leave little room for complacency. Indeed, further significant delays in signing new projects would deprive those projects of the required time for completion before the end of 2008, which represents the final deadline for sending payment requests to the EU.

As the table below illustrates, the flow of signed contracts over the first 8 months of this year is lower than in corresponding periods of previous years.

The Flow of New CSF III Projects with a Signed Contract (% of total CSF III public funds)				
	Jan. – Aug. 2002	Jan. – Aug. 2003	Jan. – Aug. 2004	Jan. – Aug. 2005
% of public funds	7.3	7.6	5.3	4.0

The slowdown in contracting can be attributed to the cancellation of many calls for bids during 2004 due to the changes in legislation (abolition of the so-called “mathematical formula” in public procurements) and delays caused by rising frictions with the Commission over the “Major Shareholder in Mass-Media” Law, which Parliament suspended in June until 31 October, pending some kind of compromise solution with the Commission. Delays were also caused by legal obstructions lodged by companies that lost out in the bidding process.

Note that the programs with the lowest percentage of signed contracts are the Information Society, the Environment and the Railways programs, as well as the majority of the Regional programs. In August, it was announced that the European Regional Development Fund approved two modernization projects for the railway axis Athens – Thessalonica at a total cost of €840 million. The future signing of these contracts will give a major boost to the railways program.

New public expenditure growth on CSF projects is also short of the required rate

Turning attention to the next phase of CSF projects, which is the execution and disbursement of public funds (i.e., EU plus national public funds), the latest data – provided by the 7th Monitoring Committee of CSF III – show that by June 15, 2005, €11 bn out of a total amount of €34.3bn, or 32% of the program, had been spent. (This portion is by definition smaller than the percentage of projects with a signed contract (53%) discussed earlier). The deadline for reaching the level of 100% in public expenditure is December 2008, hence two-thirds of the public expenditure has to be disbursed in the next 40 months. An acceleration in public expenditure on CSF projects is thus clearly required but recent data do not provide any comfort that such an acceleration is under way. Indeed, the flow of new public expenditure during 2004 and in the first half of 2005 is the same or even less than before:

The Flow of Public Expenditure on CSF III projects (% of total)				
Full Year	2002	2003	2004	2005
% of public funds	6.7	9.3	8.7	
1st half	Jan. – June 2002	Jan. – June 2003	Jan. – June 2004	Jan. – June 15, 2005
% of public funds	2.9	3.5	2.9	2.3

Looking forward, the risk of delays in public spending on EU co-financed projects appears to have risen lately, following the imposition of stricter rules by the Commission on the ability of a project manager to alter a contract’s details once it is signed. A ceiling of 10% of a project’s total value was established on the amount of funds that can be reallocated within the project. This would potentially make it harder to complete projects in a timely and smooth manner, risking substantial penalties at the later inspection stage or causing some projects to come to a standstill.

Facing those risks, the government has not stayed idle. In an effort to boost the pace of public investment expenditure, it set out to restructure the CSF programs for a second time within one year. Note that the first restructuring of the 3rd CSF programs was completed at the end of 2004 in accordance with the corresponding EU regulation. Currently, the government is designing a second restructuring, which is to be completed by the end of 2005. This restructuring was deemed necessary in order to boost programs with good performance at the expense of those programs that underperform, thus increasing the probability of a successful absorption of funds.

The absorption rates of EU funds represent an ex-post indicator of past performance

Turning attention now to the final stage of the absorption of EU funds, the most recent data come from the 7th Monitoring Committee in June 2005. The data show that by June 15, 2005, 35% of the total EU funds were cashed out. It is important to note that these absorption figures are not directly comparable to the expenditure figures that we discussed earlier. First, the percentages now reflect the pool of EU funds only, not public funds, which are defined as EU plus national funds. Second, the absorption figures are boosted by an original EU pre-payment in 2001, the first year of the CSF III program, which was equivalent to 7% of the total amount of EU funds. This pre-payment was disbursed at the very beginning to help the country begin the process and it does not reflect the value of completed projects.

The table below provides a picture of the inflow of EU funds, as a percentage of their total amount.

The Absorption Rates of EU CSF III Funds
(% of EU funds)

	2001	2002	2003	2004	1st half of 2005
Annual Rates	9.2	5.8	6.1	9.6	4.4
Cumulative Rates		15.0	21.1	30.7	35.1

The above data suggest that absorption accelerated in 2004, but this could partly be due to some approved but inadvertently delayed 2003 payments by the Commission. Moreover, one should be cautious not to overinterpret those figures. The inflow of EU funds in a given period is not necessarily an indicator of how well the process is being managed in that particular period, neither does it reflect future risks. It is an ex-post rather than ex-ante measure. For example, the absorption rates of 2004 and 2005 reflect, for the most part, projects which were initiated, signed and partly executed during earlier times.

One development that could negatively affect the pace of future EU fund absorption is the recent imposition of penalties on Greece by the EU Commission due to past irregularities in project implementation. In July, after lengthy negotiations, a penalty of €518 million payable in 4 years was imposed on Greece due to irregularities mainly concerning the reallocation of funds within a project during the period 2000–2004. Furthermore, a flat-rate correction of 10% on EU funds was imposed in public works contracts that were tendered before 1 March 2005 and concerned all expenditures declared to the EU after 31.12.2004. There is no official estimate of the total amount, since it will be imposed on future declarations of expenditures. (On 22 July, the European Commission issued a positive assessment on the management and control systems put in place by Athens for European Regional Development Fund (ERDF) payments under Greece's CSF III. This follows a lengthy verification procedure which began in 2001 and which culminated recently in an order to Greece to pay back over €500m due to irregularities in many of the structural expenditures declared by the Greek authorities to the European Commission in the period 2000-2004. The question is unrelated to the current entanglement caused by the Government's "main shareholder" law, which still awaits resolution.)

No news on CSF IV

Finally, regarding the 4th CSF package for the period 2007-2013, its size is still under negotiation. It will certainly be less than that of the 3rd CSF, not only as a percentage of Greek GDP, but also in absolute nominal terms. After the failed negotiations at the June European Council meeting, the matter was passed on to the British presidency, but it is still unclear if a compromise will be reached before the end of 2005.

Inflation: Rising risks ahead

- **Despite relatively benign price developments in the first half of 2005, inflation risks ahead are to the upside given stubbornly high oil prices.**
- **The expected moderation of public wage growth next year and the government's increased emphasis on structural reforms provide scope for some reduction in the inflation differential with the rest of the Euro area.**
- **However, this differential is expected to remain significant over our forecast horizon, with further adverse implications for Greece's economic competitiveness.**

Rising inflation risks ahead…

Following a transitory spike to a 22-month high of 4.0% y/y in January 2005, Greek inflation has been on a decelerating path in February-June 2005 despite rallying oil and commodity prices, a softer euro and the hikes in domestic VAT and excise rates in April. Sharply lower fresh produce prices compared to the same period a year earlier due to generally favourable weather conditions have been a key driver of the above favourable development, helping to broadly offset the accelerating impact of higher domestic fuel costs[20]. Abating domestic demand pressures and somewhat lower nominal wage increases compared to last year also contributed to a relative moderation of domestic inflationary pressures over that period.

Notwithstanding relatively subdued inflation developments in the first half of this year, inflation spiked to 3.9% y/y in July 2005 from 3.3% y/y in the prior month, with some 0.4pps of the increase being mostly technical in nature due to the late start of summer sales this year (18 July instead of 12 July in 2004). Looking ahead, heightened cost-push pressures due to rallying oil and commodity prices, recent hikes in processed food and electricity prices and the regular re-inclusion of heating oil in the CPI basket calculation from mid-October (expected to add up to half a percentage point to the headline CPI) are likely to keep inflation above the 3.5% y/y mark throughout the remainder of 2005. We now expect average inflation to rise to 3.5% this year, from 2.9% in 2004.

…as underlying pressures intensify

The CPI basket's heavyweights in the first eight months of this year were housing and, to a lesser extent, the clothing-footwear and transportation components[21], which accounted for around 63.5 percent of the 3.5% y/y average rise of the overall index over that period. Presumably, higher heating (housing) and motor fuel (transportation) prices played a role in the above developments. On the other hand, communications and food and-non-alcoholic beverages were the two sole sub-indices with a decelerating impact on both the headline and core inflation rates, slashing slightly less than 0.1pp off the average inflation rise over that period. In fact, communication prices have been a consistent dis-inflationary contributor to CPI growth since 2001 following the liberalization of the telecoms sector.

Core CPI (i.e., national index excluding the volatile fresh produce and energy components) averaged 3.2% y/y in the first eight months of 2005, down from 3.4% y/y in the same period of last year, with risks in the months and quarters ahead lying to the upside due to second round effects from higher oil prices. An intensification of underlying inflationary pressures is also manifested by higher producer prices[22], with

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[20] In January-July 2005, the CPI basket's fresh produce component slashed some 0.75pps off the headline index, helping to broadly offset the accelerating impact of domestic fuel prices (+0.87pps) over that period.

[21] To total weight of these components in the national CPI basket is 31.3%.

[22] PPI up 5.1% y/y in July 2005; average PPI in Aug. 04 – Jul. 05 up 4.3% y/y vs. 2.7% y/y in the same period a year earlier.

recent strong price gains in domestically produced intermediate and consumer durable goods for domestic consumption pointing to increased efforts by local manufacturers to pass higher input costs further down the pipeline.

Greek-Eurozone inflation differential widening…

In EU-harmonized terms, Greek consumer inflation grew 3.4 % year-on-year in January-August 2005, bringing the average Greek/EU differential to 1.3pps, from 0.9pps in the same period a year earlier. Greece's higher dependency on oil relative to other EU members[23] may be one reason for this unfavourable development, but other more significant influences can explain this persistent differential as suggested by the fact that domestic consumer prices of goods and services excluding fuels and processed food have cumulatively been 6 percent higher than the EU-12 average over the last 4 ½ years. As we have noted in the past, the persistence of the Greek/Eurozone inflation differential can be explained by cyclical forces (positive output gap in Greece vs. negative in the Eurozone) and convergence influences[24]. However, it can also be attributed to a multitude of structural rigidities hindering competition and encouraging price-setting behaviour in key areas of economic activity (energy, coastal navigation, fresh produce and other markets).

…inflicting further competitiveness losses

The persistent and significant inflation differential features among the main reasons for Greece's deteriorating economic competitiveness in recent years with various relevant indicators showing that domestically produced goods and services find it increasingly difficult to compete in both domestic and international markets. While the recent rebound in tourist arrivals (arguably, as a result of the Olympic legacy, more aggressive marketing efforts by the Ministry of Tourism, rising geo-political tensions in some important competing destinations and the softer euro) raises hopes for a sustainable recovery of the tourism sector, other domestic markets face increasing competition from lower cost/higher value-added foreign producers. Indeed, the rather disappointing performance of the Greek manufacturing sector in the 2001-2004 period alongside strong import growth, points to increasing import substitution, while other relevant statistics show that Greek exports continue to lose share in foreign markets. In this respect, various indicators of Greek economic competitiveness, ranging from the sizeable current account deficit to the appreciating euro-real effective exchange rate weighted by Greece's trade shares, continue to tell a worrying story and render imperative the implementation of domestic policies aimed at promoting flexibility in domestic product and labour markets. Regarding the latter, we note that wage and non-wage labour costs in Greece have been growing at a much faster rate than in most Eurozone countries in recent years[25], giving rise to significant unit labour cost growth differentials with the rest of the euro area. Official suggestions that public sector nominal wage increases will not exceed expected inflation in 2006 offer scope for more favourable labour cost developments next year. However, recent signs of elevated wage demands by trade unions ahead of negotiations for reaching early next year a new 2-year collective wage agreement in the private sector raise considerable uncertainty over future wage developments.

[23] According to IEA data, Greece's total energy bill as % of GDP is the highest among (EU) members.

[24] Balassa-Samuelson effect.

[25] According to European Commission's spring 2005 forecasts, employee compensation growth in Greece averaged 6.1% in the period 2000-2004 compared with 2.6% in EU-12, mainly as a result of generous domestic wage increases in the public sector. For the current year, the Commission forecasts compensation of employees per head to grow by 5.9% in Greece vs. 2.2% in EU-12.

Oil: Higher prices and uncertainty can hurt the Greek economy

- **The direct contribution of dearer oil to the cumulative year-on-year rise in the Greek CPI between January and August 2005 has been around 0.76pps.**
- **We expect this contribution to increase considerably following the regular re-inclusion of heating oil in the CPI basket calculation from mid-October.**
- **While inflation is expected to rise, higher oil prices could slash up to half a percentage point off real GDP growth in 2005.**

The global picture

The recent jump in oil prices is attributed to an array of demand and supply-side factors. Population growth, urbanisation and the industrialization of the developing world are the key driving factors of world energy demand. Demand is expected to grow at a minimum pace of 1.8% a year in the foreseeable future. This amounts roughly to half the projected global real GDP growth rate and is about 0.9 percentage points above the annual estimated world population growth rate. With the latter reaching 8 billion people by 2025, oil will retain the largest share of primary energy consumption (more than 40% according to IEA's statistics), even if economies become less energy-intensive.

On the supply side, limited reserve capacity from oil producing countries and supply rigidities for refined products appear to be the strongest forces driving oil prices up. The past decade's low oil prices have deterred investments in new refineries. No new major refineries have been built in the USA (the biggest refiner worldwide) in the last thirty years. On top of this, the oil price collapse of 1997 has led to a significant decline of funds for oil exploration and investments in refineries. It is now a common belief that producers will not be able to meet demand at reasonable prices even in 2010. On top of existing supply constrictions, speculators realising the reduced margins in production and refining capacities buy oil now to sell later at higher prices. Speculative activity inflates prices even more.

According to our analysis and given the current dynamics of the world economy, average crude oil prices are expected to fluctuate between $55 and $65 per barrel over our forecasting horizon (Oct 2005-Dec 2006). We anticipate, however, frequent episodes of higher price spikes, such as the ones experienced this summer. We attribute such market dynamics to speculation, seasonal factors and significant supply rigidities in both crude oil and refined products. A more "optimistic" analysis suggests a medium-long term average of $45 per barrel. However, if oil markets continue to operate above their supply capacities, we should anticipate even higher and more frequent price spikes and significant volatility. This should also be the case even if prices manage to retract gradually to their pre-2003 lows, which currently seems as an unlikely scenario.

Given the current state of the oil market, the European economy has demonstrated resilience so far, as core inflation appears to be contained by stable monetary policy. Consumption has dropped slightly while price levels are still being maintained by cheap imports and good profit margins for the private sector. The Eurozone's annual inflation was up 0.3% in August to 2.2% from July's level.

Taking into consideration the current circumstances, our view is that the real GDP growth rate for EU15 will be less than last year's 2.3%. We estimate the growth rate being around 1.3% and 1.8% for 2005 and 2006 respectively, if oil prices continue to soar. According to our estimations, the recently revised 2% IMF growth target for 2006 (or the one above 2% that the ECB suggests) may prove unattainable. The projections by the OECD, IMF, ECB and other international organisations over the last few years have often underestimated today's high oil prices. We find that estimations of up to a 0.5% cut in annual GDP growth rates, based on the ECB's model, to be too optimistic for Europe under the provision that prices continue to rise in the near future. At the time of writing this report, oil prices have receded towards the lower 60s. However, such corrections were observed in the August-September periods of past years and were followed by episodes of even higher prices. It remains to be seen whether we have witnessed a turning point in oil price trends.

Oil prices and uncertainty can hurt the Greek economy

Greece has not managed to control its energy intensity over the last decades. It takes today about 260 tonnes of oil to produce a million €-worth of Greek GDP, while in Germany this number is about 160 tonnes, in Spain it is 230, in Japan 120 and in the EU25 on average 210. Energy intensity for Greece is expected to rise in years to come. In other words, the running of the growing Greek economy is expected to become more "expensive" in energy terms.

As oil prices rallied during the summer, their full effect on economic indicators has not been experienced yet. At the moment, it seems unlikely that they will lead to an inflationary spiral. However, we estimate that it will take 4 to 6 quarters to appreciate their full effect on the Greek economy. The direct contribution of dearer oil to the cumulative year-on-year rise in the Greek CPI in January-August 2005 has been around 0.76 percentage points but we expect this contribution to increase considerably following the regular re-inclusion of heating oil in the CPI basket calculation from mid-October. As we have already noted, we expect the latter effect to add up to half a percentage point to the headline figure. Furthermore, we estimate that inflation can rise another full percentage point cumulatively from today's levels over the next 12-month period, if oil prices do not retreat in the immediate future.

While inflation is expected to rise, higher oil prices could slash up to half a percentage point off real GDP growth in 2005, according to our estimates. The effect of high energy prices will also be amplified by taxation, as V.A.T. is a regressive tax to the extent that is an indirect tax, and their negative impact on disposable income and spending should not be underestimated. Note that the revised SGP´s worst-case-scenario forecasts a full 1% drop of real GDP growth to 2.9% this year (relative to the base-line scenario) in case of a less benign than previously envisioned external environment[26].

Concluding, uncertainty can be as harmful as higher energy prices in the oil markets. Preliminary analysis results indicate that high oil price volatility goes hand-in-hand with the slowdown of the Greek as well as other European economies. Given this rather downbeat outlook, it is imperative that the Greek economy seeks immediately to diversify its "portfolio" of energy products and sources. Moreover, its allocation of energy resources should be rethought and incentives should be given for their more effective use. Consumers should also be informed about energy-saving practices and new technologies. There is no room for delay or complacency, given that the environmental impact of continuing economic growth and increased energy use in Greece has not been fully appreciated yet. In a nutshell, less oil dependency will make the Greek economy less prone to the negative effects of oil price uncertainty and alleviate growth-related environmental costs. The times of "cheap oil" appear to be over, and we should brace ourselves for a rough ride.[27]

[26] The revised SGP´s base-line scenario assumes a $44.8/barel average oil price in 2005.

[27] The Electricity Directive 2003/55/EC is the key piece of European legislation establishing the Internal Market for Electricity. The Directive had to be implemented by Member States by 1 July 2004. Thus, from July 2004 the market in all EU countries has been opened up for all non-domestic users. In July 2007, this will extend to domestic users too: all consumers will be free to shop around for gas and electricity supplies. In Greece, however, the market continues to be entirely dominated by State monopolies (DEH for electricity and DEPA for gas).

Structural and market reforms

- **State enterprises set to undergo organizational overhaul along private-sector lines**
- **Government plans more share flotations, long-term leases but no outright privatizations**
- **No result yet from designs to develop State real-estate assets and Olympic venues. Delays in energy-market liberalization**

Structural and market reforms

The Government announced that the **OTE voluntary-retirement scheme** decided last May, affecting some 5,200 workers and putting an end to lifelong tenure for all newly-hired employees, at an estimated cost of approximately €1.0bn (which apparently is to be wholly booked in this year’s financial results), would form the model for further reforms in State-controlled entities.[28] Economy Minister George Alogoskoufis is confident that the scheme does not fall foul of EU competition rules (although the question will not be definitively settled until mid-October, when the number of employees taking advantage of the new provisions will be made known[29]). At issue is a State-owned 4%-equity stake that the Government wants to transfer to OTE employees’ fund TAP-OTE (intended to cover a portion of the total cost of the early-retirement plan, the greater part being covered directly by OTE[30]). Commission objections could yet create complications in the light also of the yet-to-be-resolved “main shareholder” entanglement with the Commission. As a result of the latter, the **awarding of public contracts** is currently in limbo, with visible adverse effects on the rate of absorption of CSF funds. Meanwhile, the Government is said to be preparing a draft bill whose aim is to rationalise the triple functions of financial control, reforms oversight, and day-to-day management in **public entreprises**, which today are splintered, thereby impeding reform. The bill will introduce the principles of corporate governance and international accounting standards to these entreprises, and bestow co-responsibility for their supervision on the Economy and Finance Ministry, which will henceforth have a greater say in the way their resources are managed in light of a new obligation facing them to submit business plans.

Parliament on 30 June approved a bill settling the issue of **bank employees’ social-security funds**. From a technical point of view, the problems brought up by the need to

[28] It may be interesting to note that, although it is the current government that put a formal end to life-long jobs for workers hired from now on, and to this extent must take credit for abolishing an entirely out-of-date system, the previous government in practice had essentially placed the option of new permanent jobs in abeyance. Thus, OTE’s labour force was reduced from 22,000 to 16,000 in the period 1998-2004 with the help of various early-retirement schemes, a development linked to OTE’s listing on the New York Stock Exchange in November 1998. In addition, in that period only about 100 people were hired, on indefinite-term contracts through ASEP, the State’s “Supreme Council for Personnel Selection”. The present government proclaims that it will not abolish this method of hiring in relation to OTE. In theory at least this will impose constraints on OTE’s ability to freely and rapidly select personnel on the open market, in the way that a private-sector firms would.

28 At the time of writing, 1,832 applications have been submitted, but management expects that number to rise further.

[29] At the time of writing, 1,832 applications have been submitted, but management expects that number to rise further.

[30] Even if OTE does not end up assuming the whole €1bn burden from own resources, it is expected to register losses in 2005 (despite profits in the first half, thanks to mobile operator Cosmote’s good results). However, management expect these to be overturned next year, as the benefits from the early-retirement scheme start to come in. CEO Panayis Vourloumis has said he would be satisfied if 70% of those eligible for early retirement took up the offer.

conform with IFRS rules have thus been resolved (essentially thanks to the transition from a régime of guaranteed benefits to one of fixed contributions). However, implementation may yet run into legal difficulties if up to 10,000 employees carry out a threat to seek judicial redress. Meanwhile, OTOE refuses to send a representative to the newly-established bank employees' fund ETAT. **Emporiki Bank**'s General Meeting approved on 16 August a decision to denounce the previous agreement with the employees' union, and to join the new, State-managed, auxiliary fund designed to cover all bank workers. (By end-September, Emporiki Bank should have completed a new share issue to raise up to €400m to help address a €1.1bn actuarial deficit which reduced its equity by €712m. This rights issue is in addition to the sale of a 5.2%-tranche to foreign institutionals at the end of July, which brought in €140m.). Bank of Attica is also poised to take a similar decision to join the new bank employees' fund, despite opposition from employees. Other potential candidates include ATE (Agricultural Bank), Piraeus Bank, Alpha Bank and National Bank.

Meanwhile, on 25 August the management of ATEbank's employees' pension fund decided to merge the bank's main fund into IKA, according to the modalities of the new law governing the social insurance of bank employees adopted on 30 June 2005, and as originally provided for by Law 3029/2002. (Until now, the only two banks possessing their own main funds – and therefore remaining outside IKA – were the National Bank of Greece and ATE.)

The **public-private partnership bill**, tabled in Parliament on 4 August, aims to give a boost to investment at a time when the Government is struggling to bring the budget deficit to under 3% of GDP by end-2006, from (an estimated) 6.1+% in 2004. The 2005 budget has placed the brunt of spending cuts on public investment (16% lower in 2005 compared with 2004, or €8bn *vs*. €9.5bn last year), while actual public spending in this area so far this year is already about 30% lower than the originally-planned levels. The bill applies to projects with a budget of up to €200m, though the ceiling is not limitative. The new legal framework will not apply to State-controlled utilities listed on the ASE, such as OTE or DEH. (Parliamentary debate began on 6.9.2005 and a vote is expected some time thereafter.) The Technical Chamber of Greece (TEE) has pronounced the provisions of the bill "inadequate", citing among other things the need for a more precise definition of the role of engineers and technical consultants such as to provide greater oversight of the private sector's role in the projects. Pasok fears the new legislation may pave the way for "corruption" and "lack of transparency", claiming that it lacks in political-oversight mechanisms, and as such has asked for any new deals to be cleared by a parliamentary committee (which, of course, would largely defeat the purpose of the new, streamlined, framework). The current bill removes responsibility for such deals from the Public Works Ministry and hands it over to a new Secretariat-General at the Economy Ministry.

At the same time, the Government pronounces itself pleased with the results, so far, of the new **incentives law** adopted at the end of last March: by 18 August, 425 project proposals had been submitted worth €986.7m, of which 134 have been approved worth €232.5m, set to create 1,247 new jobs.

The Government, in July, raised €1.27bn in the sale of 16.44% of **OPAP**'s share capital to foreign and local investors, the highest amount ever from a Greek privatisation equity deal. After the fourth sell-off of its kind, the State now controls a 35%-stake. OPAP, said to be Europe's largest gambling and lottery company, will maintain its monopoly of the Greek betting market, which runs until 2020 – if the Government has its way. However, foreign potential competitors have already challenged this monopoly position in Greece's highest Administrative Court (*Symvoulio Epikrateias*).

Moreover, on 7-8 September the Government divested itself of another 10%-tranche of **OTE** equity via an accelerated book-building procedure held in New York and London aimed at institutional investors. The sale raised

€835m[31]. (As this now leaves the State with only a 38.6%-stake, of which another 4% is intended to be transferred to OTE employees' fund, the option to bring in a "strategic partner" is, per force, precluded, given that the Government does not intend to reduce its share to less than 34%.) Between them, therefore, OPAP and OTE have brought privatisation revenues for 2005 to about €2.1bn, considerably higher than the original target of €1.6bn.[32] Other sell-offs being considered this year include a 10%-stake in **ATE Bank**, possibly this winter (this could raise about €250m-300m, according to ATE's deputy governor, or more thanks to the recent rise in ATE's share price – the State currently holds an 85% stake), and a stake in **Emporiki**, following the completion of the rights issue mentioned above. (Crédit Agricole, which holds an 11%-stake in Emporiki, refused to participate in the placement of a 5.2%-stake to institutional investors at end-July, raising concerns in Government circles over whether the French bank will ultimately boost its role in Emporiki, as the Government would like, in the wake of the planned share-capital increase – see above.) Other companies on Greece's State divestments catalogue include the **Postal Savings Bank** (TT) and the **Athens International Airport** (the State owns 55% and Hochtief 39.8%). Both are headed for ASE listings in 2006. The State's (indirect) 38.2%-stake[33] in **Bank of Attica** may also be up for sale in early-2006, with current main shareholder TSMEDE (the engineers' fund, which owns 41.96%) potentially being a prime contender. Further down the road, further initiatives are likely, affecting power utility **DEH**, the two main port authorities, **OLP** and **OLTh**, and water company **EYDAP**. That said, the sale of **DEPA**, the gas utility, seems to have been put on ice, at least for now, pending the formal straightening out of the relevant legislative framework, which has yet to be brought in line with EU energy-market-liberalisation directives. Late reports suggest that the Government may be abandoning the idea of a strategic partnership for DEPA in favour of a share flotation, and a break-up into two companies, a parent company that will deal with the commercial aspects of the business and a wholly-owned subsidiary that will be responsible for control and management of gas transportation and distribution, all of which ostensibly based on the EU-mandated liberalisation model.

Olympic Airlines' fourth privatisation attempt has exceeded the originally-planned deadline for completion, hampering the planning of winter and summer 2006 schedules. Promisingly, a Memorandum of Understanding was signed on 5 August between the Greek State and a foreign-based consortium, York Capital/Olympic Investors, for the sale of the flag carrier. However, a further hurdle – which this time may prove fatal – must be cleared: on 14 September, the European Commission declared illegal a number of measures taken by the Greek state which gave an unfair advantage to Olympic Airways and Olympic Airlines, the new company that took over its flight operations in December 2003. In December 2002, the Commission asked the Government to recover €160m in illegal aid. But this sum was never paid back by OA, which in the meantime re-invented itself as Olympic Airlines, a new company that took over the flight operations of OA and most of its assets (without managing, however, to avoid incurring new losses of its own). In the process, Olympic Airlines left behind almost all of its debts with the rump "Olympic Airways", which has been renamed "Olympic Air Services" and mainly does ground-handling, maintenance and engineering. The European Court of Justice found on 12 May 2005 that the creation of this new company would have had the effect of

[31] The State now controls a 38.6%-stake in OTE. Of this, a 4% slice will be transferred to OTE employees' fund TAP-OTE (though this could yet be deemed a State subsidy contrary to EU competition rules by the Commission). The Economy Minister has precluded the State's share falling under 34%, the statutory majority threshold.

[32] This fact might deter the Government from going ahead with another plan mooted a couple of months ago by the Economy Minister, *viz.*, to sell government real estate, such as ministry buildings, in order to lease them back, thus generating a substantial increase in short-term revenues.

[33] This "indirect" stake derives from a 19.13%-stake controlled by the Consignments and Loans Fund and a 19.098%-stake owned by the Postal Savings Bank (TT), both institutions wholly owned by the State.

circumventing the obligation to recover the aid. The Commission thus decided that Olympic Airlines is a successor company to Olympic Airways, and, indeed, found that since its creation it had received even more aid, as had Olympic Airways (in the latter case, mainly in the form of lenience *vis-à-vis* overdue tax and social-security liabilities). The actual sum to be recovered is in excess of €500m. The Commission, whose latest decision closes an investigation that was started on 16.3.2004, has given Greece two months to inform it of the measures it intends to take to comply with the above decision. The contents of the decision – considered earlier by most observers all but a foregone conclusion – have prompted the Government to say, all at once, that it will appeal to the European Court of Justice (Pasok concurs) regarding the sums to be returned by OA, that it will pursue its on-going privatisation plans, that there will be a successor to the company, albeit very different in form from the present one (the Government now no longer rules out a State-private partnership), and that no-one (from the 8,000-strong work force) will lose his/her job (they will somehow be absorbed within the wider public sector) or see their pension benefits affected in any way.

Meanwhile, very little has been accomplished to date in the area of **State-owned real-estate assets** (including the country's marinas), which would have constituted the second pillar of the Government's privatisation drive. On 6.9.2005, the Inter-ministerial Privatisation Committee approved a plan to lease eight tourist properties (currently managed by the Tourist Development Corporation) to private operators.[34] And on the first anniversary of the Olympic Games, facilities and venues still await development. The Culture Ministry decided at end-July to call two tenders for the maintenance of former Olympic installations, while three tenders are under way for long-term leases, involving part of the International Broadcasting Centre, the badminton arena at Goudi and the canoe/kayak slalom installation at Hellenikon. Tenders for the long-term right of use of the Haghios Cosmas Olympic Sailing Centre and the Galatsi Olympic Indoor Hall also went out recently.

Parliament approved, on 21 July, a bill extending **shopping hours** in principle until 9 p.m. on weekdays and 8 p.m. on Saturdays. The Government is banking on this change to "modernise" the Greek market, stimulate sales and reduce unemployment (despite the fact that the largest impediment to part-time employment in Greece may well be the lack of a legislative framework pertaining to salaried part-time work[35]). Opposition Pasok, which voted against the bill, claims the new schedule will lead to the closure of many smaller firms due to an inability to compete with their larger competitors. The only clear winners will be the consumers (provided diversity and choice-of-goods do not suffer as a result). As for the net total impact, it will probably be smaller than the law's promoters or detractors anticipate because – contrary to original plans, which foresaw the application of a broadly uniform system throughout the country – the additional hours essentially will be optional, decided upon by local authorities in agreement with employers and employees (similar to current practice). This observation may help ease the fears of those sceptics who believe that (i) unemployment cannot be reduced by administrative measures that end up raising costs to private firms, (ii) shopping hours were *not* inefficiently short under the previous arrangements, stifling sales (otherwise the volume of retail trade in recent months would not have grown, in y-o-y terms, 4 to 5 times faster in Greece than in the Eurozone as a whole[36], and employment in non food-and-drinks retail commerce would

[34] The Corfu Casino, the Afantou golf course in Rhodes, the marina at the Peace and Friendship Stadium in Phaleron, the Anavyssos saltworks grounds, and the Xenia hotels at Vytina, Skiathos, Thassos and Tsangarada.

[35] In Greece, declared part-time workers of both sexes amount to 11.9% of all workers, *vs*, 13.7% in the EU25. This may have contributed to the fact that Greece has the second-lowest employment rate in the EU25 (behind Italy), *viz*., 59.4%, *vs.* an EU25 average of 63.3%. This low employment rate is even lower as regards women (45.2%, *vs*. 55.7% in EU25), who in other countries view part-time work as a particularly attractive form of employment. See, Eurostat, *Labour Force Survey – 2004*, STAT/05/112**,** 8 September 2005.

[36] See, Eurostat, *Euro-indicators News Release*, STAT/05/110, 6.9.2005.

not have increased by 2.1% in Q2 in relation to the same quarter in 2004), and (iii) encouraging more spending in the retail sector of the economy will do little to counteract the economy's relatively greater lags in the knowledge-intensive, higher-productivity sectors of the modern economy. In a move that suggests government second thoughts about the effects of the new policy on opening hours, the Government announced (25.8.2005) that it would grant more than €48m to 10,000 small retail entreprises that offer part-time work to unemployed people. The programme – a joint effort by the Ministries of Development and Employment and by the Manpower Organisation (OAED) – seeks to assist the latter entreprises in the wake of the recent extension of opening hours. Be that as it may, the retail sector has chosen largely to ignore the new provisions governing shop opening-hours.

Rounding up last season's batch of reforms, Parliament approved on 28 July a new **labour bill** which seeks to introduce more flexible work-hours and cheaper overtime. Under the new framework, employers will be able to ask staff to work up to ten hours in a single day, rather than the normal eight, in return for fewer hours on another day. Employees will have the right to refuse the request. In companies with less than twenty employees and who are not members of a union, managers will be allowed to introduce flexible working hours, provided they have the consent of all the workers. (According to legislation in force today [Law 2874/2000], firms employing 20 workers or less that wish to introduce some flexibility and/or prolong working hours must first seek the consent of the relevant sectoral associations or federations.) The Opposition is against this provision on the grounds that bosses will be able to intimidate workers, but the Government argues that doing away with the time-consuming intervention of trade unions will enable small firms to move more quickly in the face of changing market conditions.

Overtime pay for the first five hours of extra work a week will also be cut by half, *i.e.* workers will now be paid 25% more than their normal hourly rate, instead of 50%. Any hours of overtime worked above that during the week will be paid double rate (down from the previous 75% extra).

Pasok's George Papandreou said that when his party comes to power, it would repeal the law on opening hours as well as the labour reforms on the grounds that they are not the product of consensus. The country's largest trade union organisation, GSEE, said it will fight the new provisions tooth and nail, and called a general 24-hour strike for 22 July to protest against them, with more action planned for the period ahead.