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Greece and Southeastern Europe Economic and Financial Outlook

Economic Research Division

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1. GREECE

- Investment-led rapid GDP expansion of around 4.0% continues unabated in 2007, despite net exports acting as a drag on economic growth.

- Maintaining competitiveness and fiscal consolidation through structural reforms so as to keep the current account deficit in check are key prerequisites for preserving growth.

Table 1. Basic Conjunctural Indicators
(change from previous period)

	2005*	2006*	2007*	
Retail Sales				
Turnover Index	6,0%	10,8%	6,4%	Jan-May
Volume Index	3,0%	8,0%	2,9%	Jan-May
Automobile sales	-3.0%	0.5%	4.9%	Jan-June
Tax on Mobile telephony	10,8%	11,8%	114,9%	Jan-May
VAT Receipts	2.8%	12.0%	13,0%	Jan-May
Total Consumption	3,0%	3,3%	2.8%	Jan-June
Building activity (Permits)	35.2%	-19,5%	-4,5%	Jan-May
Cement Production	2.4%	3.1%	-6,7%	Jan-May
Public Investment	-21.0%	8.8%	31.9%	Jan-June
Total Investments	0.0%	12.7%	10,5%	Jan-June
Industrial Production				
Composite Index	-0.9%	0.5%	1,8%	Jan-June
Manufacturing Production	-0.8%	0.8%	1,7%	Jan-June
PMI (manufacturing)	51.5	52.4	54,0	July
Capacity Utilization in Industry	72,3%	76,2%	76,4%	June
Exports goods & services	3.7%	5,4%	9.8%	Jan-June
Imports goods & services	-2.1%	9.8%	9,7%	Jan-June
GDP (growth)	3.7%	4.2%	4,4%	Jan-June

* Growth rates are calculated on a cumulative basis

ECONOMIC DEVELOPMENTS: Maintaining its dynamic eleven year growth trend, the Greek economy grew by 4.4% yoy in H1 2007 (first flash estimate for Q2 2007: 4.2% yoy), compared with a 4.2% yoy growth in H1 2006 and a 4.3% growth in 2006. The main growth drivers remain total investment and exports of goods and services, while the deceleration of imports in Q2 2007 provided an additional boost to growth. Total investment grew by 10.5% yoy in H1 2007 (13.3% H1 2006) and exports by 9.8% (2.6% H1 2006), with imports grew by 9.7% (9.3% H1 2006). On the other hand, private consumption growth decelerated to a healthy 2.8% (3.6% H1 2006) and is expected to remain above this rate in the coming quarters. Finally, in line with the process of fiscal adjustment, government consumption slowed down with growth of 2.8% (4.2% H1 2006). The high growth of imports recorded in H1 2007 offset the beneficial impact from the high growth of exports, leading to a higher deficit on the Trade and Services account which subtracted 1.1 pps from GDP growth in H1 2007.

On the basis of the above developments and economic indicators published until the end of July 2007, we expect GDP growth to once again exceed 4.1% in 2007, following 4.3% growth rate in 2006. Private consumption moderated in H1 2007 in line with slower growth of retail sales volumes, but the sustained high growth of both consumer lending and disposable incomes is expected to facilitate private consumption growth in the following two quarters. On the investment front, public investment is set to remain one of the main drivers of growth in 2007-2008 as the government accelerates absorption of EU funds in the final two years of the CSF III implementation period. A number of important infrastructure projects (budgeted at € 3.6 billion) have already been awarded by the state to consortia of construction companies (domestic and foreign) via public-private partnership arrangements (PPPs). Moreover, the business investment outlook remains positive supported by grants under the investment incentives law. Finally, despite the negative growth in the volume of building permits issued in Jan-May 2007, residential investment is expected to register positive growth in 2007, following the 32% surge in 2006. This is due to the ever-present-high demand for housing which is supported by the continued high growth of mortgage lending and the high stock of building permits issued in both 2005 and 2006. Finally, robust export growth is set to continue in 2007 and the following years based mainly due to the improving domestic production capacity of exporting firms and the rapid development of public infrastructure, as well as on favourable demand conditions for Greek tourism and other products in Greece's main exporting markets. Overall business sentiment is still upbeat with the manufacturing PMI remaining strong until July 2007 indicative of both the buoyant manufacturing production recorded in H1 2007 and favourable the full year outlook.

Looking at high-frequency economic indicators, **Retail sales volume** in Jan-May 2007 posted a solid 2.9% increase (5.9% in Jan-May 2006, 8.0% in 2006). Registrations of **private new passenger vehicles** grew briskly, up 4.9% for H1 2007 (0.9% H1 2006). **Retail business confidence** picked up once more as the index rose to 123.8 in July 2007, after reaching a seven year high of 124.3 in May 2007.

Residential construction activity - as measured by the volume (m^3) of building permits - registered negative growth of 4.5% in Jan-May 2007, compared with the 11.9% increase in Jan-May 2006. However, growth in residential investment is expected to be

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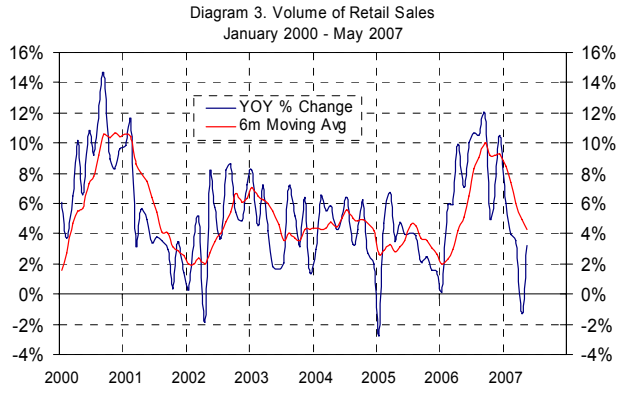
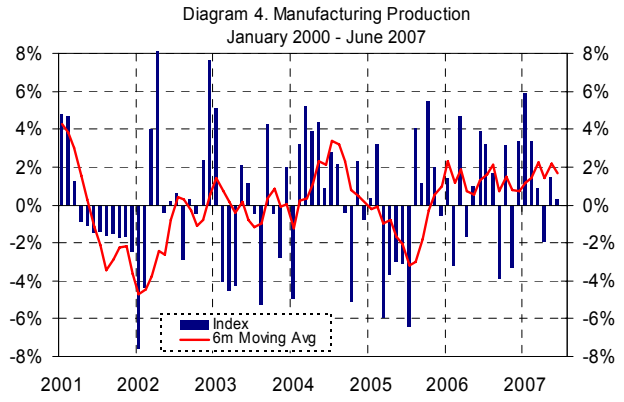
positive in 2007, following a 32.3% rise in 2006. Demand for new housing investment has been boosted by high growth of mortgage lending (25.0% end-May 2007). **The construction business confidence** index receded to 87.7 in July 2007, from 106.2 in May 2007 and 90.7 in February 2007.



Manufacturing production recorded solid 1.7% growth in H1 2007, following the 0.8% growth in 2006 and the -0.8% decline in 2005. This positive development is due: a) to the stabilization of textile production and to the marked improvement in clothing output and tobacco production, b) to robust growth of production in the food and beverage industry, in machinery & equipment and in chemical products and transportation vehicle production. On the other hand, the production of basic metals and non-metallic minerals remained in negative territory. The prospects ahead are encouraging as seen by the level of the **PMI index** which was maintained at 54.0 in July 2007, while **business confidence in manufacturing** has receded to 101.6 in July, falling from 106.6 in May 2007, 113.1 in April 2007 and 101.5 for 2006 as whole.



Finally, the **general index of industrial production** rose by 1.8% in Jan-Apr 2007, following a 0.9% increase in 2006 and the 0.9% decline in 2005. **Mining and quarrying production** increased by 0.4%, compared with the fall of 2.5% in H1 2006. **The production of electricity** was stable to 0.0% in H1 2007, following the fall of -0.5% in 2006. **Natural gas production** rose by 43.3% for the period, from 5.7% in H1 2006. **Water production** was down by 1.3% (2.6% in 2006).

FISCAL POLICY: On the fiscal adjustment front, the favourable implementation of the Budget during Jan-Jul 2007 is still on target to meet the 2.4% of GDP general government deficit expected for 2007, while forecasts by the European Commission and the OECD put the deficit at less than 3.0% of GDP in both 2008 and 2009. In fact, the substantial shortening of the pre-election period, with general elections now scheduled for September 16th 2007, should enable the new government to undertake the necessary measures to ensure fiscal discipline in view of the negative budgetary impact stemming from the relief efforts for the victims of the pervasive fires which hit Greece during the summer of 2007. Continued fiscal adjustment, aiming at a general government surplus from 2010, will require, inter alia, the substantial reform of the country's social security and health care systems. With respect to the **implementation of the 2007 Budget,** data for H1 2007 reflect the following:

(a) Net current revenues reached € 22 billion, up 2.3% yoy compared to the budgeted increase of 6.2%. This outcome is considered to be satisfactory given the high base-effect, with net current revenues having increased by 11.4% in H1 2006. Furthermore, tax rebates surged by 31.5% in H1 2007, with a budgeted decline of 8.0%. **A greater effort for improving tax collection and combating tax evasion is needed for the budgeted 6.2% current revenue growth for 2007 to be reached**, following the sub-par growth of 5.8% in 2002-2006.

(b) Current primary expenditure reached € 21.1 billion, up 8.5% yoy (6.7% H1 2006) and remains above the budgeted increase of 7.4%. However, expenditure is expected to grow at a rate below the budgeted 7.4% for rest of 2007. In fact, the surge in current primary expenditure during H1 2007 is mainly due to the payment of an additional € 110 million rebate of the 2nd instalment of accumulated taxes on pensions (LAFKA), and the payment of an additional amount of about € 500 million for the substantial increase in agricultural pensions and the means tested handout EKAS as well as for the payment of allowances to families with more than three children and other new obligations.

Containing the growth of current primary expenditure may prove to be a challenge for the government in the following years due to: a) the observed high rate of growth of employment in the broader public sector in recent years, b) a public sector wage policy which leads to across the board wage increases, independent of productivity developments, and to a higher rate of growth of pensions. In fact, employee compensation in the general government reached 12.3% of GDP in 2005 (Eurozone: 10.4%), from 10.7% of GDP in 1996 (Eurozone: 10.9%), while the average annual growth of budget payments to the finance the social security funds' operational deficit during from 2002 to 2007 reached 17.8%.

In the **Public Investment Budget (PIB), expenditure** reached € 3.23 billion in H1 2007, compared with € 2.45 billion in H1 2006, up 32% yoy compared to the planned 6.9% increase. **PIB revenues** reached € 6.68 billion in H1 2007, compared with € 1.73 billion in H1 2006, up 54.6% yoy. The projected increase for 2007 is 4.7%, which should be easily exceeded.

Assuming that there will be no additional delays in absorbing EU funds in the investment budget, we estimate that it should still be possible to reduce the general government deficit to 2.4% in 2007. However, the long term sustainability of public finances requires additional measures aimed at reducing the size and increasing the efficiency of the central government, state controlled entities and effectively controlling current primary expenditure. Even if the various indirect tax surcharges help to boost net current revenue growth in 2007/8, the required fiscal adjustment will not be possible without a fundamental reform of the country's pension system. Wide-ranging reforms of the pension and health care systems are needed to ensure their long–term sustainability.

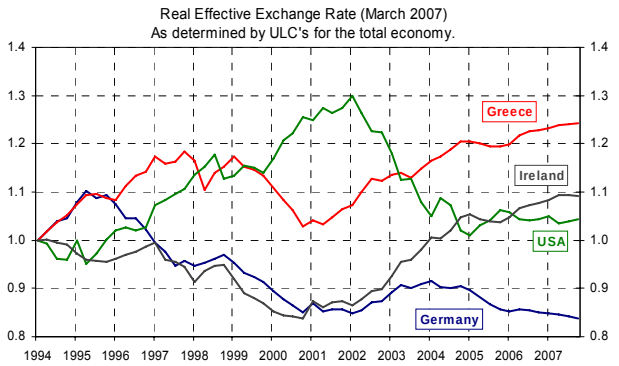
INFLATION: Benefiting from favourable base effects, **CPI inflation** continues to head lower, reaching 2.5% in July 2007. Overall, inflation is expected to average 2.7% in 2007, down from 3.2% in 2006. Core inflation remains higher at 2.9% in July, mainly due to indirect tax increases which compensated for cuts in direct taxation. Greece is still in a period of upward adjustment of administered prices as pertains to various products goods and services, part of the convergence to Eurozone levels.

Table 2. Inflation projections 2007-2008

2007	March	June	July	August	Sept.	December
2,70%	2,60%	2,60%	2,53%	2,55%	2,91%	2,86%
2008	March	June	July	August	Sept.	December
2,70%	2,82%	2,60%	2,50%	2,70%	2,60%	2,70%

Source: NSSG, Projections Economic Research Devision, Alpha Bank

However, the main problem in Greece remains persistently high wage inflation, having reached an average 6.5% in 2002-2006, compared with 2.4% in the Euro area. This implies an average annual increase of unit labour cost of 3.7% in Greece, compared with 1.7% in the Euro area, and the corresponding competitiveness erosion.



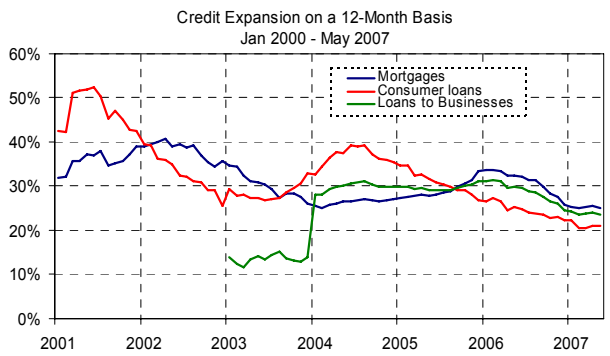
BALANCE OF PAYMENTS: Exports of goods and services remained buoyant during H1 2007, with exports of goods other than oil products and ships, tourism, shipping revenues and other services revenues growing at 6.2%, 3.2%, 10.0% and 15.7% respectively. This is in conjunction with a surge in net capital inflows to € 14.54 billion, as portfolio investment by foreign residents rose to € 21.6 billion for the period (€ 7.29 billion in H1 2006), compared with portfolio investment by domestic residents abroad of € 8.38 billion (€ 5.17 billion in H1 2006). On the other hand, foreign direct investment (FDI) by Greek firms abroad reached € 2.74 billion in H1 2007 (€ 0.34 billion in H1 2006), compared with FDI by foreign firms in the domestic economy of € 0.55 billion (€ 1.35 billion H1 2006). Thus, the current account deficit reached € 14.53 billion in H1 2007 (€ 13.51 billion H1 2006) and is projected to exceed 10.0% of GDP, compared with 10.6% of GDP in 2006.

Table 3. Greek Balance of Payments (€ Billions)

	2004	2005	2006	Jan-June 2006	Jan-June 2007
Trade Balance (TB)	-25,44	-25,56	-35,29	-17,73	-19,03
Exports	12,65	14,20	16,15	8,04	8,24
Imports	38,09	41,76	51,44	25,76	27,27
Services Balance	15,47	15,50	15,36	5,24	5,79
Tourism	10,35	10,84	11,39	3,33	3,43
Shipping	13,31	13,87	14,32	6,99	7,69
Income Balance	-4,38	-5,68	-7,12	-3,54	-4,48
Τόκοι, Μερίσματα, Κέρδη	-4,47	-5,74	-7,16	-3,55	-4,50
Transfers' Balance	6,02	5,15	6,45	3,19	3,35
Current Account (CA)	-8,33	-12,59	-20,60	-12,83	-14,37
CA (% of GDP)	4,95%	6,95%	-10,6%	-	-
Capital Account	8,10	12,61	20,36	13,51	14,54

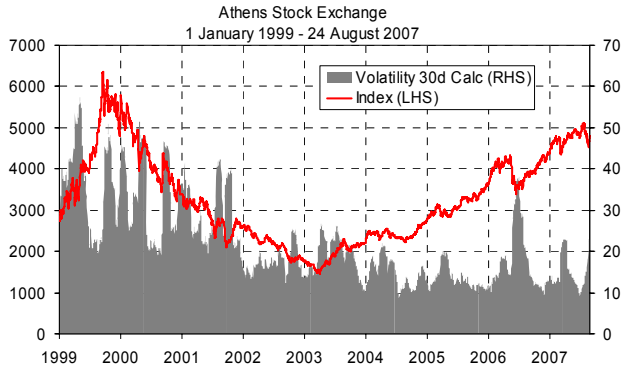
Source: Bank of Greece

MONEY & FINANCIAL MARKETS: Credit expansion to enterprises and households (BoG data) slowed to 19.6% in end-May 2007 from 20.6% in end-2006 and 21.8% in end-2005. In particular, mortgage and consumer lending growth reached 25.0% and 23.4% end-May 2007 (25.6% and 24.4% end- 2006). **Loans to domestic households** reached 36.7% of the revised GDP in end-May 2007 from 31.9% in end-May 2006, compared to 60.2% of GDP in the Euro zone. Overall, credit expansion has moderated towards the end of 2006 and H1 2007, but is expected to remain around 19% for the year.



The **Athens Stock Exchange** saw € 6.2 billion of net inflows from abroad in Jan-Jul 2007, which helped to boost volumes and stock prices. At the end of July 2007 51.73% of the total stock exchange value of listed firms (€ 186.9 billion) was in the hands of foreign institutional investors, up from 36.4% end-2004 and 40.3% end-

2005. The exchange continues to be supported not only by the strong pace of the economy but also the strength of listed firms, evident by the surge in their pre-tax profits by 35% in 2006, while earnings-per-share increased by 31%.



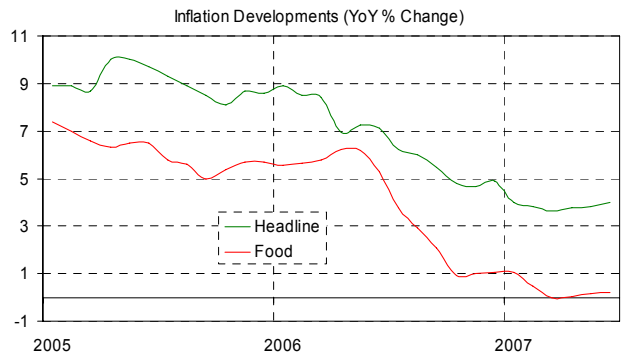
2. ROMANIA

- The economy slowed in Q1 2007 in line with the full year growth forecast of 6.5%. Private consumption remained strong, investment accelerated, while the negative impact of the external sector remained a substantial drag on growth.
- Given an environment characterised by excess domestic demand, pro-cyclical fiscal policy and rampant wage and credit growth - the lack of progress to date in addressing the overheating economy and resultant current account deficit is threatening the country's stability and growth outlook.
- Developments in the external sector remain the clearest indicator of the unsustainability of the current growth of domestic demand, evidenced by the growing current account deficit. Furthermore, financing of the deficit via FDI and Portfolio inflows has begun to slow, requiring increased greenfield investment to compensate.
- Inflation has begun to move higher and is expected to rise in Q3 due to excise tax increases and rising food prices. Upside risks remain due to excess domestic demand, the impact of the drought and high rate of credit expansion. A further impact will be felt via the Leu which, until recently, had a beneficial impact on inflation due to its appreciation. More recently, following the financial market turbulence abroad which commenced around the 2nd July 2007, the Leu has depreciated by over 4.0%.
- In response to the rapid appreciation of the Leu in recent years, the central bank undertook a series of rate cuts, but with the strength of domestic demand, boosted by a further expansion of government expenditure, and the recent Leu depreciation, the central bank is now eyeing the possibility of a rate increase in 2007.

ECONOMIC OVERVIEW: GDP rose 6.0% yoy in Q1 2007 down from growth of 6.9% yoy in Q1 2006. Growth of private consumption remained high at 12.0% yoy receiving continued support from strong wage growth and rapid credit expansion. The outlook for private consumption remains strong with forecast growth of 11.5% for 2007. Investment expanded by 17.2% yoy, up strongly from the 11.2% yoy recorded in Q1 2006 and the 16.1% for FY-2006. The investment outlook remains positive, with moderating FDI inflows being offset by increased public sector infrastructure investment supporting investment growth of over 14.5% in 2007. In the external sector, exports grew by 12.9%, while imports grew by 23.8% (21.8% Q1 2006). These developments support the further expansion of the current account deficit to 12.1% for 2007, with upside risk to the final figure being even higher. Overall, we forecast lower GDP growth of 6.5% for 2007.

FISCAL POLICY: In line with the government's pre-announced intentions, general government expenditure rose 6.4% in Q1 2007, from in 2.2% Q1 2006 and 2.5% in FY-2006. The government is targeting a general government deficit of 2.8% of GDP for 2007 while the European Commission forecast a deficit of 3.2% of GDP. The cause for concern is due to the fact that large portions of this increased expenditure are not being channelled towards infrastructure investment, but rather excessive wage and pension increases. Indicatively, parliament approved a proposal to double state pensions in the coming two years. Furthermore, the main opposition party is said to be looking to block the 2008 budget proposal unless pensioners receive a larger cash payout. The current 2008 budget proposal sees government expenditure increasing to 41.7% of GDP, its highest level in 17 years.

INFLATION: CPI inflation reached 3.8% in June and 4.0% in July, from a low of 3.6% in March. In the first six months of 2007 inflation benefited from the continued currency appreciation, the earlier moderation in energy prices and from various base effects such as the "sin tax" which was introduced in Q2 2006.



However, prices are forecast to accelerate as we move into Q3 driven by (1) rising food prices due to the regional drought (food products account for 40.7% of the overall index), (2) scheduled administered and excise tax price increases and (3) the depreciation of the Leu. The Government has already decided to delay the 3.0% increase in natural gas prices paid by households to later in Q4. Significant upside risk to the 2007 inflation outlook remains due to persistent wage pressure (estimates put wage increases in 2007 at 18-19% yoy) and expansionary fiscal policy. Inline with this view, the central bank has increased its forecast for year end inflation to 3.9% from the previous 3.7%.

BALANCE OF PAYMENTS: The current account deficit increased by 109% yoy in H1 2007, with the trade deficit widening by 77.1%. Exports of goods rose by 11.3% versus growth of 20.0% for the same period of 2006. On the other hand, imports of goods rose a stronger 28.3% versus the 26.0% recorded in H1 2006. Net FDI declined by 26.8% yoy to € 2.14 billion, reducing coverage of the current account continued from 90% in 2006 to 36% during the current period. Currently a large portion of the deficit is being financed by other liabilities and currency deposits. The European commission forecasts a continued decline in net FDI for 2007 and 2008 which poses a problem given the rapidly expanding current account deficit. Politically related delays regarding the privatisation of state-owned enterprises are only making matters worse. Romania will need to look at attracting large inflows of greenfield investment or else resort to extensive debt-financing. For 2007 the current account deficit is forecast to reach 12.1% of GDP.

Balance of Payments developments in Romania

	H1 2007	H1 2006	% change
Current Account	-7.812	-3.744	108,7%
Trade balance	-7.832	-4.423	77,1%
Exports (FOB)	14.105	12.678	11,3%
Imports (FOB)	-21.937	-17.101	28,3%
Services Balance	193	220	-12,3%
Income balance	-2.413	-1.561	54,6%
Current transfers balance	2.240	2.020	10,9%

Source: Reuters

MONEY & FINANCIAL MARKET: In the past year the Romanian Central Bank (NBR) undertook a series of rate cuts, reducing its key monetary policy rate by 125bps to 7.0% as it sought to limit the rapid appreciation of the Leu. To offset the stimulatory effect of these rate cuts given already strong domestic demand, the NBR increased reserve requirements on all durations of foreign exchange deposits to 40% and on all durations of domestic currency deposits to 20%. This has done little to curb the expansion of non-government credit which has seen growth of 37.9%, 45.8% and 54.5% from 2004 to 2006. In April 2007, growth remained elevated at 52.6%, with households expanding by 77.8% and corporates by 37.1%. The recent turbulence in international financial markets resulted in the depreciation of the Leu by over 4% vs. the euro in less than 2 months.

Romanian Lei				
vs.	02 Jul 07 - 22 Aug 07	01 Jan 07 - 02 Jul 07	2006	2005
Euro	4.7%	-8.0%	-8.2%	-7.0%
Dollar	5.9%	-10.9%	-17.6%	6.8%

(-) Appreciation (+) Depreciation

The Romanian government has approved the country's Euro convergence plan and set a target date of 2014 for Euro zone entry.

3. BULGARIA

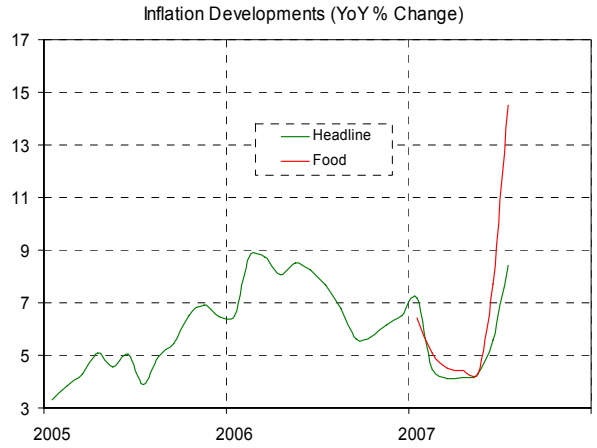
- The economy accelerated faster than anticipated up 6.2% in Q1 2007, with both private consumption and investment posting strong gains of 9.1% and 35.9% respectively. The economy is set to continue its strong performance in 2007 and 2008 (GDP growth of 6.0% and 5.5% respectively).
- The ballooning current account deficit is expected to worsen further in 2007, on the back of sustained domestic demand and weaker exports due to the on going competitiveness erosion and delays in bringing new export related production facilities online.
- Fiscal policy remains expansionary despite the targeted budget surplus. Bulgaria now boasts the lowest corporate tax rate in the region with additional plans to reduce personal income taxes in the coming year.
- Recent food price spikes have sent inflation higher. Further inflationary pressure remains in the form of a tightening labour market, the high rate of credit expansion and additional food price increases due to unfavourable weather conditions.
- Bulgaria's early entry into the ERM-II framework is unlikely, with further convergence and a much lower current account deficit key prerequisites.

ECONOMIC OVERVIEW: GDP expanded by a stronger 6.2% in Q1 2007 (5.5% Q1 2006), driven by the dual forces of private consumption which rose 9.1% for the quarter (5.2% Q1 2006) and investment which rose by a much stronger 35.9% (17.1% Q1 2006). Private consumption will continue to be supported by higher real wage growth (only partially backed by productivity gains) and continued job creation and is forecast to increase by 7.8% in 2007. Investment is expected to remain robust, due to the absorption of EU structural funds commencing this year as well as the continued expansion of production capacity and the upgrading of existing capital stock, leading to a projected growth of 16.0% for the year. Having subtracted 6.2 pps from overall growth in 2006, the net export sector continues to pose a challenge to Bulgaria's economic outlook. Export growth suffered a large Q1 decline up 2.2% (12.7% Q1 2006), which in combination with the growth of imports of 13.2% (20.8% Q1 2006) implies a further deterioration of the external balance.

FISCAL POLICY: Finding a balance between improving living standards and preventing the country's external balance from worsening proves to be a challenge for the ruling government. In 2006, the government recorded a General Government Surplus of 3.25%, up from around 2.0% in 2005 and has announced a 2007 surplus target of over 2.3% for 2007. The European Commission has forecast a surplus of 2.0%. In the 12-months to May 2007 the surplus reached 3.7% of GDP due to a surge in tax revenues. The concern remains however that the proposed surplus will prove insufficient to mitigate the impact of the rapid growth of domestic demand on the deteriorating current account.

The ruling coalition announced a proposal which would see the introduction of a flat personal income tax, which would reduce the current graduated rate of 10-24% to a flat 10% bringing it inline with the corporate tax rate which was reduced at the start of 2007. As a result, the minimum wage will be increased by 22% to offset the impact on low income workers, due to the removal of the non-taxable bracket under the new tax proposal. Following the 10% pension payments increase in July 2006, an additional 10% increase was approved in October 2006 followed by the reduction in social security contributions by 3pps to 32.6 percent. The government also approved a 10% increase in government wages. While strong growth of government revenues and improved tax collection offset the decline in pension fund contributions, concerns have been raised regarding the long-term sustainability of current (pro-cyclical) fiscal policies, especially given the magnitude of the current external imbalance. Based on the strong economic growth outlook and the forecast fiscal surplus, General Government Debt is expected to decline to 20.9% of GDP in 2007 from 22.8% in 2006 and 45.9% in 2003.

LABOUR MARKET: The private sector has shown strong job growth, aided by reduced pension contributions and increased participation rates. Growth in employment reached 2.5% in 2006. With participation rates increasing once more in 2007, employment growth is expected to once again exceed 1.4%, despite the decline in working-age population due to emigration and negative demographic trends. Unemployment declined to 7.4% in June 2007 leading to a further tightening of the labour market. As this tightening continues there will be increased upward pressure on nominal wages. Already, real wages increased by 10.9% yoy in Q1 2007, 7.5% yoy in the public sector and 14.2% yoy in the private sector. This implies a 4.2% increase in unit labour costs in 2007, compared with 1.2% in the euro area and 2.2% in Greece. Labour productivity growth, which is projected to rise from roughly 3.5% in 2005 to 3.6%, 4.6% and 4.9% respectively in 2006, 2007 and 2008, boosted by continued investment and economic restructuring, is insufficient to prevent a sizable deterioration of competitiveness in the same period.



INFLATION: CPI inflation raced to 8.4% in July, from 5.6% in June (4.3% May and 4.2% April), with food prices contributing in excess of 5.2 pps to the headline figure. The government has announced that it is looking into the possibility of importing maize in the hopes of tackling the domestic shortage which prompted the spike in food prices. Given the trading range of oil around $70-75 a barrel, further expected increases in food prices and persistent wage demands being driven by expansionary fiscal policy, there remains significant upside risk to the year-end inflation target, with December inflation now expected at 6.5%.

BALANCE OF PAYMENTS: The magnitude of the external imbalance continues to pose a challenge to both monetary and fiscal authorities. After reaching a high of 15.9% of GDP in 2006, the current account deficit is now forecast to exceed 18.0% in 2007. During H1 2007, the deficit has already increased by 54.1% yoy (see table below) to 10.6% of GDP (7.3% of GDP H1 2006). The deficit on the trade account increased by 45.2% yoy, as export growth slowed to 7.6% (30.2% H1 2006) while import growth slowed to 18.0% (26.9% H1 2006). The weak export performance is partly due to developments in the copper sector where completion of investment projects which were planned for this year are now only expected in 2008. The surplus on the financial account also in increased H1 2007 to € 3.62 billion, from € 2.69 billion in H1 2006. Net Foreign Direct Investment (FDI) reached € 2.02 billion up 1.8% yoy in H1 2007 with coverage of the current account falling to 71.3% (coverage for H1 2006 was 108.0%).

Balance of Payments developments in Bulgaria

	H1 2007	H1 2006	% change
Current Account	-2.836	-1.840	54,1%
Trade balance	-3.201	-2.205	45,2%
Exports (FOB)	6.142	5.711	7,6%
Imports (FOB)	-9.344	-7.915	18,0%
Services Balance	205	33	530,5%
Income balance	-20	61	-132,1%
Current transfers balance	181	272	-33,5%

Source: Bulgarian National Bank (BNB)

MONEY & FINANCIAL MARKETS: Non-government credit expansion (in Leva) increased to 48.0% in June 2007 from 45.4% and 39.4% in May and April. Credit expansion to households rose by 38.6% and to corporates by 54.0%. In response to this acceleration, the Bulgarian Central Bank (BNB) has increased minimum reserve requirements to 12% from 7% effective from 1st September 2007. This should result in the slowing of credit growth to 40% by year end, with credit penetration reaching 60% of GDP. Given the Lev's peg to the euro, Bulgaria's high inflation rate and

Bulgarian Lev

vs.	02 Jul 07 - 22 Aug 07	01 Jan 07 - 02 Jul 07	2006	2005
Euro	-	-	-	-
Dollar	1.1%	-3.2%	-10.6%	15.3%

(-) Appreciation (+) Depreciation

the broad appreciation of the euro, the real exchange rate will continue to appreciate in 2007 and 2008,

eroding competitiveness. While announcements were made regarding the possible entry into ERM-II this summer, such a scenario seems highly improbable. The ECB has made it clear that further progress needs to be made concerning euro-convergence before such entry would be possible. The government is targeting euro currency adoption around 2012.

4. Cyprus

- GDP Q1 growth was in line with the full year growth forecast of 3.8%. Positive contributions were recorded once again by private consumption and investment, while the impact of the external sector worsened due to a slow down in export of goods and services.
- Determined fiscal policy has facilitated declines in both the budget deficit and government debt ratios. However, the aging population and the impact on the country's fiscal outlook are posing challenges for the government.
- Inflation increased in recent months due to largely technical factors such as VAT harmonisation and energy prices. Nonetheless, inflation remains contained, below Maastricht requirements.
- Having participated in the ERM II framework since 2005, Cyprus has received the green-light to adopt the Euro in 2008.

Economic Overview: GDP expanded by 3.8% in Q1 2007 (3.8% Q1 2006), with private consumption growing 5.1% (4.0% Q1 2006) as robust credit growth drove retail sales, car purchases and construction higher, helping to offset the continued decline in the tourism sector. Investment saw a significant pickup with 14.1% growth and will continue to be a key driver of economic growth in 2007 due to a combination of strong foreign demand for both housing and larger infrastructure projects which will drive construction growth as well as higher investment in machinery and equipment due to the positive sentiment based on the pending euro adoption. Exports declined 3.9% in Q1 (7.5% Q1 2006) but are expected to recover in the following quarters, with 4.0% growth forecast for 2007 as a whole while imports rose 2.1% (2.8% Q1 2006). The export sector continues to feel the impact of declining tourism, with tourist arrivals having declined by 3.4% in H1 2007. The outlook for 2007 is for full year GDP growth of 3.8% (3.8% 2006)

Fiscal Policy: The government's stringent fiscal policy has seen the general government deficit declining to 1.5% in 2006 from 2.3% in 2005. Fiscal consolidation was supported by increased revenues, predominantly via one-off measures such as the tax amnesty (generating tax revenue equal to ¾ percent of GDP in 2004 and almost 1 percent of GDP in 2005). Meanwhile fiscal expenditure has remained tight, with moderate public sector wage increases and ceilings on the growth of public consumption and investment expenditures, implying a surplus of 0.5% of GDP in Q1 2007. Pressure to increase spending is likely to emerge with elections scheduled for February 2008 the impact though is expected to be nominal, with the deficit increasing from the initial forecast of 1.4% of GDP to between 1.5-1.6% for 2007.

Labour Market: Eurostat forecasts employment growth of 1.5% per year until 2008. Unemployment remains at roughly 4.75%. Wage pressure should remain fairly contained, alleviated by higher participation rates and increased inflows of foreign workers.

Inflation: There has been a pickup in CPI inflation in July to 2.43%, from the low of 1.45% in February. Significant base effects due to lower energy prices in H1 2007 did not apply in July when energy prices reached new highs. Looking forward, a combination of factors ranging from the acceleration in credit expansion, planned increases in VAT rates and the base effect of H2 2006 and H1 2007 inflation should see inflation higher, remaining around 2.0% by end-2007 with a modest acceleration in 2008.

Balance of Payments: The current account deficit increased by 27% in Q1 2007 as the trade deficit grew by 9.8% (12.9% Q1 2006). Exports of goods declined by 12.2%, while imports of goods rose 3.8%. Tourism revenue registered a 0.2% fall in Q1 2007, with net negative tourist flows of -€ 8.2 million from positive net balance of € 7.6 million in Q1 2006. The surplus of services balance was 0.5% higher in Q1 2007, with receipts 6.7% higher and payments 12.4% higher. A decline in competitiveness, via the appreciation in the real exchange rate has contributed to the weakness in exports of goods and services and the sharp increase in current account deficit. Full year forecasts see the current account deficit remaining essentially flat at 5.6% of GDP. Foreign Direct Investment (FDI) of foreign residents in Cyprus reached € 280 million, up from € 237 million in Q1 2006. FDI of residents of Cyprus abroad reached € 150 million, from € 88 million in Q1 2006.

Money & Financial Markets: Fuelled by declining interest rates and strong capital inflows, private sector credit growth continues to accelerate, to 26.6% in June 2007 (12.5% June 2006) from the 17.5% growth recorded in January 2007.

Cypriot Pound				
vs.	02 Jul 07 - 22 Aug 07	01 Jan 07 - 02 Jul 07	2006	2005
Euro	0.2%	0.6%	0.5%	-0.9%
Dollar	1.3%	-2.6%	-9.9%	13.7%

(-) Appreciation (+) Depreciation

Despite strong capital inflows, the Cypriot Pound has depreciated against the euro, moving towards its central parity rate with the euro. This most likely represents intervention on the part of the Central Bank as it prepares for euro adoption. Cyprus has been cleared for euro adoption in 2008 with the conversion rate set at € 1 = CYP £ 0.585274.

5. SERBIA

- Despite the formation of a new government, political risk continues to define the economic landscape as witnessed by the recent downward revision to Serbia's economic outlook by S&P.
- The economy recorded solid growth in Q1 2007, benefiting from the delayed effects of developments in 2006: (1) large wage increases which are supporting private consumption (2) substantial FDI inflows in Q4 2006 spurring Q1 2007 investment.
- Political developments in 2007 have led to further privatisation delays reducing FDI inflows and further constraining economic growth. The new government needs to ensure that rapid structural reforms are undertaken, privatisation accelerated and corruption attacked head-on.
- Unemployment remains high, elevated in the short-run by the privatisation of inefficient state and public enterprises.
- The easing of fiscal policy by the new government is a concern, fuelling further domestic demand and adding to current account imbalances.
- The appreciation of the Dinar and reigning in of credit expansion via significant reserve requirements facilitated the rapid decline in inflation from double-digits in 2005 to below 4% in May 2007. This development faces the risk of a sudden reversal with rampant wage growth and loose fiscal policy fuelling domestic demand.

POLITICAL OVERVIEW: The resolution of political impasse in May 2007, with the formation of a new coalition government has lead to a renewed air of stability. First, the World Trade Organization (WTO) has indicated that Serbia could become a WTO member by the end of 2008, pending the completion of a list of required regulatory changes. These changes include the improvement of hygiene standards at border crossings as products exit the country, the strengthening of food safety regulations, the lifting of non-customs protection practices and the reduction of customs protection from the current average of 6.5%. The government has announced that WTO membership is "one of the main priorities of Serbia's foreign trade and economic policies". Joining the WTO is a key condition for EU membership. Serbia's government is aiming at signing a Stabilization and Association Agreement (SAA) by the end of 2007 and looking to secure official candidate status to the EU by the end of 2008. Achieving the above, government officials believe that Serbia may be ready to join the EU in 2012.

In July of this year Standard & Poors, the rating agency, revised Serbia's outlook downwards to "stable" from "positive", while keeping the country's long term rating at "BB-". Fitch kept their rating at "BB-", with a stable outlook. Despite the formation of a new government, political risk remains a material constraint on the country's development. According to an S&P statement, "a material diminution of political risk, coupled with renewed focus on fiscal consolidation and broader structural reforms in the context of eventual EU accession, will be central to enhancing sovereign creditworthiness" .

ECONOMIC DEVELOPMENTS: GDP grew 8.7% yoy in Q1 2007 (7.0% Q1 2006, 5.0% Q4 2006, 5.7% 2006). Growth in Q1 was fuelled primarily by last year's record € 3.2 billion FDI inflows, while private consumption was driven by the substantial wage increases of between 20-30% in 2006. On a sector by sector basis, the trade sector registered the strongest growth, up 24.1%, while the transport sector was up 19.4%, financial intermediation sector 18.7% and the construction sector 16.2%. On the other hand, the electricity, gas and water sector registered an output decline of 5.6%, while the real estate sector declined by 1.4%. The strength of domestic demand has resulted in the surge of imports, leading to a further increase of the trade deficit pushing the current account deficit to a forecast 14.0% of GDP in 2007 from 13.3% 2006. Growth is forecast at around 6.0% in 2007.

FISCAL POLICY: In 2006 fiscal policy slipped as the General Government Balance shifted to a deficit of 1.6% of GDP from a surplus of 0.7% in 2005. Fiscal prudence and constraint are desperately needed with developments in 2007 depending on the success of the newly elected government in containing current expenditure and on the extent to which it will execute plans aimed at increasing capital spending, as set under the National Investment Plan of 2006. A clearer indication of where the current fiscal policy is heading can be seen via the increase in real salaries and wages which have risen roughly 18% yoy during Jan-Mar of this year and are projected to increase by as much as 22% by December 2007. Failure to contain wage growth will continue to drive the external imbalance and further erode Serbia's competitiveness. The Serbian parliament approved the 2007 budget this June, with a planned budget deficit of 0.6% of GDP. A budget deficit would most certainly lead to an increase in external debt which is now forecast to increase to around 23% of GDP (20% of GDP in 2006) as the government looks to finance its spending. IMF forecasts see the deficit rising as high as 2.7% of GDP in 2007.

INFLATION: CPI Inflation accelerated to 5.1% in June and 5.9% in July, fuelled by higher crude oil prices and public transport costs. It had slowed to 3.1% in May, from 6.0% in December 2006 due mainly to favourable base effects in the first months of 2007. For 2007 the NBS forecasts that core inflation will decline to 3.0% by year-end while headline will increase to around 6.0% due primarily to unfavourable base effects in H2 2007. The government is targeting 6.5% year end inflation.

BALANCE OF PAYMENTS: During H1 2007, the Current Account deficit increased by 99.0% reaching € 2.05 billion. The deficit on the Trade Balance increased by 33.3% to € 2.9 billion as exports increased by 41.4% and imports increased by 37.3%. The Services Account

recorded a surplus in March, with the three month deficit shrinking by 65% or € -9.4 million. Finally the Transfers Account saw its surplus shrink by 28.6% to € 1.1 billion as transfer receipts slowed by 10.3% and transfer payments increased by 31.2%. FDI inflows slowed by 8.4% to € 620 million in H1 2007 (or € 1.02 billion if portfolio investments are included). Politically related privatisation delays have played a significant role in this H1 slow down. Unless privatisation and restructuring are able to get back on track, it is very possible that FDI inflows will be even slower in H2 2007.

MONEY & FINANCIAL MARKETS: In 2006, following large increases in reserve requirements, non-government credit expansion slowed significantly, having expanded by 17.5% vs. 51.3% at end-2005 and by 44.3% at end-2004. This year, credit growth has accelerated once more, reaching 22.0% in May from 15.1% in January. Credit to households has remained high at 49.3% in May while credit to corporates has accelerated from 2.1% in January to 10.3% in May. In response, the central bank announced a series of measures, effective from the 27th August 2007, aimed at curbing credit growth. These measures include a 2yr ceiling which will be imposed on the maturity of the cash credits extended to households (the measures will not be applied retroactively). In addition, banks will be obligated to reconcile their gross household lending so as not to exceed 150% of the value of their share capital (currently at 200%). Moreover, the central bank assured, that additional steps will be taken, if current measures do not serve to curb credit growth.

However, citing the governments fiscal expansion, rising wages fuelling domestic demand, supported further by higher credit growth rates, the central bank is considering reversing its nine month easing cycle and is now looking at increasing its two-week repo rate from the current level of 9.5%. This stands in stark contrast to the government who favours further rate cuts in order to boost growth and reduce unemployment. As a result of this divergence in views, the government is now planning to submit a new central bank law in the following two months that would allow the parliament to elect the governor of the Central bank and appoint the board of directors. This is seen as a possible window of government intervention in the conduct of monetary policy and the supervision of the financial sector.

Serbian Dinar				
vs.	02 Jul 07 - 22 Aug 07	01 Jan 07 - 02 Jul 07	2006	2005
Euro	0.6%	-0.1%	-7.0%	8.6%
Dollar	1.6%	-3.3%	-16.6%	24.3%

(-) Appreciation (+) Depreciation

6. ALBANIA

- The economic growth outlook is contingent on further privatisation especially within the energy sector which played a substantial role in constraining economic growth in 2005 and 2006, coming to the fore once more in 2007.
- Inflation has been heavily influenced by the combination of the domestic energy crisis and global rise in energy prices. The inflation outlook for 2007 remains positive 2006 – remaining within the central banks target range – given (1) the establishment of the new government which will lead to a resumption of electricity imports (2) base effects due to oil price increases in

(We would like to point out the continued lack of official national accounts data for Albania for 2006 and 2007. Preliminary national accounts data has been released for 2005 while data for 1996-2004 has recently been revised.)

ECONOMIC OUTLOOK: Albania's economy, driven by strong domestic demand, recorded average growth of 5.75% during 2000-05. Based on IMF estimates, real GDP growth is expected to have slowed to 5.0% in 2006, from 5.5% in 2005 and 5.9% in 2004. This is partly due to the slowdown in the construction sector and to postponements in public investment programs, both due to the establishment of new procedures and rigorous permits and procurement policies on the part of the new government. The forecast 2007 economic expansion is being put in jeopardy by a renewed energy crisis. Domestic generation of electricity has declined by close to 50% yoy in H1 2007 while energy imports are 4.7 times higher as the government attempts to offset the energy supply shortfall. In all, power supply (domestic and imported) has declined by 16.3% yoy in H1 causing widespread power outages of up to 6hrs in city centres and 20hrs in outlying rural areas.

INFLATION: Despite rampant credit expansion, the domestic energy crisis and higher international oil prices, CPI inflation remains benign, rising by 2.1% yoy in July from 2.0% in June and a year low of 1.4% in May. The major inflation drivers in July continued to be alcohol and tobacco products, up 13.0% as well as rent and utilities up 6.8%. Tobacco prices increased by an average of 17.1% in the first seven months of the year, while the annual prices of power and fuel surged by some 12.4%. The central bank is targeting CPI inflation of between 2-4% by year-end 2007 inflation with an end year forecast of 3.0%.

FISCAL POLICY: The general government budget posted a surplus of ALL 10.2 billion (€ 84 million) in the first six months of the year. The positive result was based on overall revenues of ALL 115 billion and total expenditures of ALL 105 billion. On a yoy basis, the surplus increased only marginally in the six month period. However, both revenues and expenditures of the government rose by 9.6% and 10.5% respectively. Tax revenues amounted to ALL 105.5 billion in Jan-Jun, growing by almost 9% yoy. These developments supported the adoption of the new supplementary budget.

The supplementary budget amounts to ALL 27.7 billion (€ 227 million). From this total, ALL 13.5 billion arose from the improved fiscal performance in the first half of the year, while the remaining ALL 14.2 billion will be

generated via the privatisation of the landline operator Albtelecom. The additional revenue will finance key road infrastructure projects, public debt reduction as well as subsidies the state power utility KESH. The IMF which only recently completed its third economic review, has given its support for the governments overall fiscal programme including the supplementary budget.

The government has embarked on a programme aimed at reducing the corporate and personal income tax rates while raising indirect taxes such as excise taxes on alcohol and tobacco. The flat personal income tax rate of 10%, replacing the current 5-bracket personal income tax system, came into effect from the 1st August 2007. Low incomes of up to ALL 10,000 will be exempt from the tax. Incomes of ALL 10-30,000 will be charged 10% of the amount exceeding ALL 10,000. While incomes higher that ALL 30,000 will be taxed 10% of the total amount. The new flat corporate income tax rate of 10% will come into effect from the 1st January 2008. The amended tax system will.

Balance of Payments: The current account deficit reached 5.9% of GDP in 2006 (2005: 6.5%, 2004: 3.9%). In Q1 2007 the current account deficit increased by 42.2% reaching € 183 million. The trade balance increased 20.7% as export growth improved to 26.0% (18.8% Q1 2006) while imports grew 22.2% (29.4% Q1 2006). The balance of the Services account worsened by 17.0% to € -29.8 million as service exports declined decline by 0.9% (+35.8% in Q1 2006). It is important to note that the deficit on goods and services account reached 23.4% of GDP in 2006 and was financed primarily by private transfers equal to 14.3% of GDP and official transfers equal to 1.3% of GDP in 2006. In Q1 2007, net FDI increased by 51.8% to € 86.2 million covering 47% of the deficit on the current account. Adding in remittances of € 233 million for the period brings coverage of the current account to 174%.

Money & Financial Markets: Private Sector Credit Expansion remains strong, having increased by 55.6% in May 2007 from 50.4% by the end-December 2006, (73.6% December-2005 and 36.9% December-2004). Credit to households expanded by 68.3%, up from 67.7% in 2006. The high rates of credit expansion have been driven by the growth in foreign currency deposits, the result of the divergence in spreads between domestic and foreign deposits which saw foreign currency deposits increasing by 35% in 2005 vs. 7.3% in domestic currency deposits. Credit growth in the corporate sector increased by 49.6% in May 2007 but is expected to stabilise slightly as companies reach their desired leverage levels. However, despite this surge in credit expansion, on a regional basis Albania still has one of the lowest credit penetration levels equal to 20.8% of GDP at end-2006, from 14.9% of GDP at end-2005. According to the IMF, credit penetration is expected to reach 25.5% by end-2007, 28.9% by end-2008 and 34.9% by end-2010.

Albanian Lek				
vs.	02 Jul 07 - 22 Aug 07	01 Jan 07 - 02 Jul 07	2006	2005
Euro	-0.7%	-1.2%	0.4%	-1.4%
Dollar	0.4%	-4.3%	-9.9%	13.0%

(-) Appreciation (+) Depreciation

7. Frmr Yugoslav Republic of Macedonia

- GDP growth surprised to the upside in Q1 2007. Economic growth remains driven by private consumption and investment, with the prior benefiting from improved confidence in the economy and the rise in disposable income. Slower GDP growth is expected in the coming quarters, bringing full year growth to around 4.5% for 2007.
- The government is aiming at a slight expansion of fiscal policy in 2007 as it looks to promote economic expansion. Further declines in general government debt are expected following the rapid decline in 2006 due to the early repayment of its Paris Club debt.

Economic Outlook: Preliminary data for Q1 indicate that GDP expanded by an unexpected 7.0% yoy following a series of rapid increases in industrial production. Moreover, strong growth was recorded in investment, particularly in machinery and equipment, rising by over 10% in the quarter. However, the slow down in industrial production in Q2 augur a slow down in Q2 GDP. However, the coming quarters might see a boost to GDP from improved construction activity and investment in capital equipment. This is dependent on planned projects in both the real estate and energy sectors being realised. Government forecasts see GDP expanding by 6-7% in 2007, while the more likely consensus estimates see growth of around 4-4.5%.

As with other countries in the region, domestic demand will be the primary driver of the economy. Specifically, investment, which increased by 9% in 2006 is expected to increase by 12% in 2007, brining the investment-to-GDP ratio inline with other economies in the region. Private consumption is the other key factor, benefiting from improved consumer confidence as employment growth continues while low inflation will help boost real incomes. However, the combination on strong domestic demand and limited domestic supply potential will sustain the negative contribution from net exports, leading to deterioration in the trade balance. For the foreseeable future, this will be financed by increased workers remittances and FDI.

Labour Market: As economic activity increases, this will help sustain employment growth forecast at 3.3% and 3.6% in 2007 and 2008 respectively. However, as the labour supply increases in tandem the growth in job opportunities, unemployment is expected to decrease only marginally to around 35% in 2008 from 36% in 2007. Eurostat estimates that wage growth will remain inline with productivity growth.

Inflation: CPI inflation has averaged only 0.9% yoy during Jan-Jun 2007 from an average of 3.2% in 2006

due largely to a substantial base effect which saw a 23.9% increase in alcohol and tobacco prices in Jan-Jun 2006. For the rest of 2007 the inflation outcome will continue to benefit from base effects relating to both the surge in energy prices and excise taxes in 2006. Additional support will come via the absence of any excessive demand and the relatively stable exchange rate vis-à-vis the euro. Inflationary pressure will arise from the acceleration in economic growth in the following two years, the increase in electricity prices to international levels as well as adjustment of excise tax duties to EU levels.

Fiscal Policy: Fiscal discipline has underpinned the country's continued strong economic performance. The expected budget deficit increase this year will finance reductions in both taxes and import tariffs, and more importantly, will allow an increase in public investment. The government balance as a percent of GDP increased to -0.6% in 2006 from the 0.2% surplus recorded in 2005. The aforementioned plans are likely to lead to a further increase in the government deficit to -1.2% this year. The risk to the planned investment and reform expenditure increase via a concomitant increase in wage demands, which can be ill-afforded and if not contained, could further impede relative competitiveness. To this end the government has agreed to a wage ceiling by keeping the government wage bill from rising faster than total tax revenues. On the revenue side, active steps have been taken to improve tax administration through improvements in procedures relating to registrations, collections, and the equal treatment for taxpayers. In a related move, steps are being taken to consolidate and rationalise the collection of social insurance contributions and personal income taxes. Following the increase in General Government Debt to 46.9% of GDP in 2005, early repayment of Paris Club Debt in 2006 permitted a reduction in the debt to 39.5% in 2006 with a further decline to 23.9% expected in 2007.

Balance of Payments: External balances continue to improve, with the current account deficit declining to 0.7% of GDP in 2006 from 1.4% in 2005. The large inflow of workers remittances and cash exchanges reduced the deficit in 2006 by almost a full percentage point. The current account balance recorded a jump in Q1 2007, recording a cumulative surplus of € 39.7 million vs. a deficit of € 36.7 million during the same period of 2005. For the quarter, the trade deficit increased by 11.6% to € 196 million while goods exports rose by 42.8% and goods imports rose 22.5%. The ratio of exports to imports increased to 71.1% from 62% in 2005. The deficit on the services account increased by 69.4% while the surplus on the incomes balance increased by 172% to € 13.8 million. The surplus on the current transfers account increased by 20.6% to € 223.5 million of which 97% was private transfers. Meanwhile, net FDI slowed to € 16.9 million from € 239.4 in Q1 2006.

Money & Financial Markets: Private sector credit growth accelerated in 2006, increasing by 23% in 2006 and is forecast to increase by 20% in 2007. In 2007, the rate of credit expansion has accelerated once more, increasing by 29.2% in May, with credit to households increasing by 44.9% and credit to corporates increasing by 21.7%.

FYROM Denar				
vs.	02 Jul 07 - 22 Aug 07	01 Jan 07 - 02 Jul 07	2006	2005
Euro	-0.8%	0.7%	0.1%	-3.1%
Dollar	0.3%	-2.5%	-10.2%	11.4%

(-) Appreciation (+) Depreciation

8. Turkey

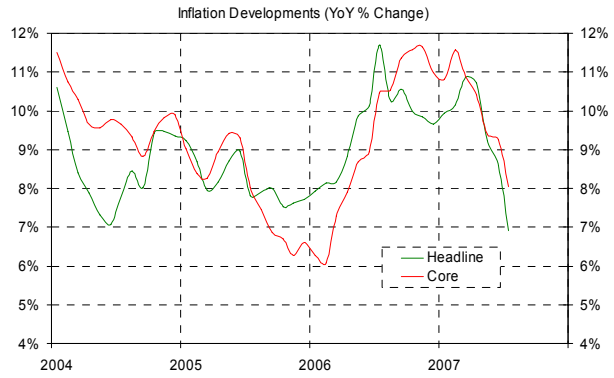
- Solid external demand offset still weak private consumption and investment leading to a jump in Q1 growth.
- Election related spending slippage is no cause for concern. The government continues to maintain tight control over its budget and has renewed its commitment to the IMF target of a Primary Surplus of 6.5% of GDP for 2007.
- Inflation has continued to moderate, dropping to a 3yr low, but will remain highly volatile and will most likely exceed the central banks target range in 2007.
- The decline in domestic demand will have a positive impact on the trade account leading to a decline in the current account deficit. The deficit continues to be financed by large FDI and portfolio inflows which surged in Q1.

Economic Overview: Driven largely by external demand, Q1 GDP accelerated with growth of 6.8% (6.7% Q1 '06). Private consumption remained soft, rising 1.6% (8.1% Q1 '06) while investment continued to show signs of weakness, rising by 3.0% (32.0% Q1 '06). With interest rates set to remain at their current level for the remainder of 2007, private consumption is forecast to post only modest growth of 3.8% with investment growth of 11.2%. The driver of Q1 growth was stronger external demand, as exports of goods and services rose 14.2% (6.8% Q1 '06) while imports of goods and services continued to slow inline with the slower domestic demand, recording growth of 4.2% (9.9% Q1 '06). These developments are having a positive knock-on effect for the current account deficit, which is seen declining to 7.2% of GDP from 7.7% in 2006. Full year GDP growth is forecast at 5.2%.

Fiscal Policy: Turkey's Primary Surplus shrank to TRL 9.4 billion for Jan-Apr 2007, from TRL 11.6 billion for Jan-Apr 2006. This is illustrative of the relaxation of fiscal policy (non-interest government expenditures increased by 49.9% during Jan-May 2007) in the run-up to the recent elections. Despite this, the government has committed itself to meeting the IMF agreed upon target of a Primary Surplus 6.5% of GDP for 2007, having just missed the target in 2005 and 2006. A combination of the rise in interest rates leading to increased interest expenses (having increased by 18% yoy Jan-May 2007) and reduced tax revenue (7.9% yoy

higher, but below the rate of inflation) due to the slow-down in domestic demand will contribute to the widening of the government general deficit to higher than 2.2% of GDP in 2007, from the 0.6% recorded in 2006. Central Government Gross Debt remained relatively unchanged from 2006 at TRL 341 billion due to the repayment of IMF debt and the appreciation of the Lira. General Government Gross debt has been steadily declining since 2003 and is forecast to fall to 56.6% of GDP in 2007.

INFLATION: The combination of tight monetary policy, weaker domestic demand, the appreciation of the Lira and a modest base effect have led to the third monthly decline in inflation. CPI inflation rose 6.9% yoy in July from 8.6% and 9.2% in June and May respectively. The single largest contributor was Food accounting for 27% of the index having contributed 2.5pps to headline inflation in July. Assuming fiscal policy remains contained and the currency does not depreciate significantly, the forecast is for year-end inflation of 7-7.5%, well above the official target of 4.0% for 2007.



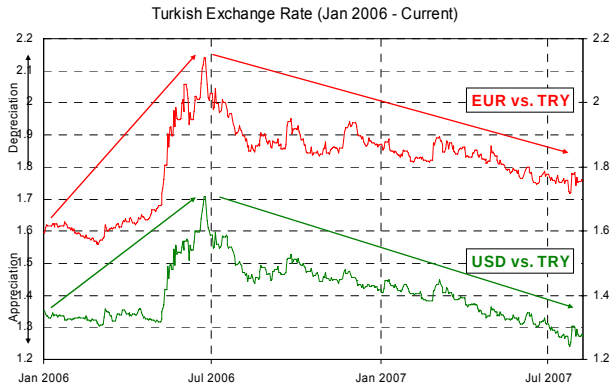
BALANCE OF PAYMENTS: Benefiting from stronger foreign demand and weaker domestic demand, Turkey's current account deficit remained essentially flat, rising by 0.1% during the first six months of 2007 compared to the 52.1% rise in H1 2006. The trade deficit shrunk 0.7% (up 41.6% H1 2006) as exports benefited from the stronger external demand, rising 24.1% (14.2% H1 2006) while imports, responding to weaker private consumption and investment, recorded slower growth of 15.8% (22.1% H1 2006). Net Foreign Direct Investment increased by 13.4% reaching a cumulative € 7.5 billion, with coverage of the current account remaining strong at 52.5%. Including net Portfolio Inflows which have recovered strongly following last May's market turbulence, reaching € 4.5 billion for the first six months (€ -695 million for H1 2006), coverage increases to 83.7%. The current account deficit, while remaining high, is expected to decline to 7.2% of GDP from the 7.7% recorded in 2006.

MONEY & FINANCIAL MARKETS: After the cumulative 425bps increase, the Central Bank has kept its overnight borrowing rate at 17.5% since June 2006, with a possible cut expected only late in Q4 2007. The cost of domestic borrowing has begun to decline, with the Turkish Treasury borrowing at between 19-20% in recent months. This follows the surge to 21-22% in mid-2006 from 14% earlier that year. Credit expansion has continued to slow with growth at end Q1 2007 of 34.6% vs. 51% a year earlier, with corporate and household credit rising by 33.7% and 36.2% respectively.

Turkish Lira				
vs.	02 Jul 07 - 22 Aug 07	01 Jan 07 - 02 Jul 07	2006	2005
Euro	2.5%	-5.5%	17.1%	-13.1%
Dollar	3.5%	-8.5%	5.0%	0.3%

(-) Appreciation (+) Depreciation

Foreign capital inflows attracted by higher domestic interest rates have driven the recovery in the Turkish Lira, having appreciated until July versus both the euro and the dollar following the massive sell-off the currency experience in 2006. Renew market volatility has however lead to a renew depreciation of the Lira.



9. Economic Data – Greece

Selected Economic Indicators
(% change or as otherwise noted)

Yearly Data	2002	2003	2004	2005	2006	2007
Real GDP Growth	3.8	4.8	4.7	3.7	4.3	4,1
Gross Fixed Total Investments	5.7	13.7	5.7	-1.4	12.7	10,5
- Construction	3.7	10.9	3.6	-4.4	21.6	10,0
- Equipment	6.9	18.3	8.0	0.5	3.5	11,0
Manufacturing production	-0.1	-0.4	1.2	-0.8	1.4	1,8
Unemployment (percent)	10.9	10.4	11.0	10.4	9.3	8.3
Employment	0.1	1.3	2.9	1.3	2.4	1.8
Consumer Price Index (year average)	3.6	3.5	2.9	3.5	3.2	2,7
Producer Price Index (year average)	2.3	2.3	3.5	5.9	6.9	2.0
Unit Labor Cost	6.0	1.2	4.0	4.1	3,1	3,0
Credit Expansion (Private Sector)*	16.9	19.5	19.5	21.8	20.6	18.0
Deficit (as % of GDP)	-5.2	-6.2	-7.9	-5.5	-2.6	-2.4
Current Account (as % of GDP)	-9.7	-10.0	-9.5	-9.2	-10.9	-9.9

Source: National Accounts, 2007 Official and Alpha Bank Research

Quarterly Data	2005	2006				2007	Period
	IV	I	II	III	IV	I	(cumulative)
Economic Activity (period average)							
Retail Sales Volume	3.0	4.1	6.6	8.1	8.0	4,4	2,9 (05/07)
Construction Activity	35.2	13.6	13.1	4.6	-19.5	2,2	-4,5 (05/07)
Industrial Production (Manufacturing)	-0.8	0.9	1.0	0.7	0.8	3,4	1,8 (05/07)
Credit Expansion (end of period)							
Private Sector	21.8	22.3	22.1	22.3	20.6	19,9	19.6 (05/07)
Consumer Credit+Other	28.7	28.6	25.9	24.4	23.9	22,0	23,4 (05/07)
Housing	33.5	33.6	32.3	29.9	25.8	25,5	25.0 (05/07)
Business	14.7	15.4	15.9	17.6	16.6	15,9	15.4 (05/07)
Tourism	3.7	4.2	2.9	6.5	3.7	3,3	3.3 (05/07)
Prices (end of period)							
Consumer Price Index	3.7	3.3	3.2	3.4	2.9	2,7	2.5 (07/07)
Core Inflation	3.0	2.5	2.5	2.7	3.0	3,2	2,9 (07/07)
Producer Price Index	7.7	9.2	8.6	6.8	2.2	0,7	1,8 (06/07)
Dwelling Price Index (17 urban areas)	17.8	15.7	14.2	11.8	10,5	7,0	7,0 (03/07)
Interest Rates (period average) (on outstanding amounts)							
Savings	0.87	0.92	0.96	0.99	1.06	1,10	1.13 (05/07)
Short-term Business Loans	6.93	7.02	7.12	7.24	7.32	7,37	7.47 (05/07)
Consumer Loans (up to 1 year)	12.31	12.52	12.62	12.71	12.86	13,06	13.18 (05/07)
Housing Loans (over 5 years)	4.73	4.75	4.81	4.89	5.09	5,14	5.09 (05/07)
12 month Treasury Bill	2.63	2.95	3.31	3.62	3.86	3,93	4.12 (05/07)
10 year Bond Yield	3.56	3.77	4.28	4.19	4.03	4,26	4.80 (06/07)
National Accounts							
Real GDP	3.8	4.2	4.2	4.5	4.4	4.6	4.2 (06/07)
Final Consumption	2.9	3.4	3.9	3.3	2.8	2.8	2.8 (06/07)
Investment	1.7	9.9	17.1	10.7	13.6	15.8	4,9 (06/07)
Exports	2.8	2.1	2.9	7.8	8.3	9.8	9.9 (06/07)
Imports	-0.2	5.7	13.1	8.7	11.8	15.1	4,4 (06/07)
Balance of Payments (in € mn - Cumulative)							
Exports of Goods	14,200.9	3,652.3	8,036.0	12,176.1	16,154.3	3.796,9	8.239,7 (06/07)
Imports of Goods	41,747.8	12,791.4	25,763.8	38,247.2	51,440.6	13.266,2	27.271,0 (06/07)
Trade Balance	-27,546.9	-9,139.0	-17,727.8	-26,071.1	-35,286.3	-9.469,4	-19.031,4 (06/07)
Invisibles Balance	15,548.0	1,876.5	4,959.2	12,099.6	14,687.2	2.375,3	4.659,6 (06/07)
Invisibles Balance / Trade Account (%)	56.4	20.5	30.0	46.4	41.6	30.0	24,5 (06/07)
Current Account	-12,298.9	-7,262.5	-12,768.6	-13,971.5	-20,599.0	-7.094,1	-14.371,7 (06/07)
Direct Investments	-679.0	422.9	1,009.8	888.2	953.8	-2.051,8	-2.192,0 (06/07)
Portfolio Investments	7,323.6	1,009.0	2,113.9	5,646.8	8,115.4	11.051,9	13.210,8 (06/07)
Athens Stock Exchange (end of period)							
Composite Index	3,663.9	4,122.3	3,693.8	3,931.1	4,394.1	4.643,1	4.917,5 (07/07)
% change	31.5	44.4	20.7	16.2	19.9	12,6	31,2 (07/07)
Market Capitalization ASE (% of GDP)	67.9	76.3	70.9	73.6	80.9	85,3	90,7 (07/07)

9. Economic Data – Southeastern Europe

Romania	2003	2004	2005	2006	2007 (f)	2008 (f)
Real Economy						
Real GDP	5.2	8.5	4.1	7.7	6.5	5.8
Private Consumption	8.4	14.6	9.6	13.8	11.5	9.9
Public Consumption	7.7	-4.9	9.0	2.5	4.8	5.1
Gross Fixed Capital Formation	8.6	11.1	12.6	16.1	14.5	13.7
Exports (Goods & Services)	8.4	13.9	8.1	10.6	9.4	8.1
Imports (Goods & Services)	16.0	22.1	16.6	23.0	21.6	17.1
Consumer Prices	15.3	11.9	9.1	6.6	3.7	3.5
Unemployment	7.0	8.1	7.2	7.4	7.2	7.1
General Government (%GDP)						
Revenue	32.1	31.1	32.4	30.1	30.4	31.0
Expenditure	33.6	32.6	33.7	38.8	41.7	40.4
Overall Balance	-1.5	-1.5	-1.4	-1.9	-3.2	-3.2
Gross Debt	21.5	18.8	15.9	12.4	12.8	13.1
Monetary						
Credit to Non-Government	-	37.9	45.8	54.5	47.8	44.0
Short-Term Interest Rate	17.7	19.1	8.4	7.4	-	-
Long-term Interest Rate	-	-	-	7.3	-	-
Balance of Payments (% GDP)						
Current Account Balance	-4.8	-5.0	-8.7	-10.3	-12.1	-12.3
Trade Balance	-7.6	-8.7	-9.8	-12.1	-13.9	-14.8

Source: IMF, Central Bank, Eurostat, Alpha Bank Economic Research

Bulgaria	2003	2004	2005	2006	2007 (f)	2008 (f)
Real Economy						
Real GDP	5.0	6.6	6.2	6.1	6.0	5.5
Private Consumption	5.5	5.9	6.1	7.5	7.8	8.0
Public Consumption	7.7	3.8	2.8	2.4	3.5	4.0
Gross Fixed Capital Formation	13.9	13.5	23.3	17.6	16.0	14.0
Exports (Goods & Services)	10.7	12.7	8.5	9.0	10.0	9.6
Imports (Goods & Services)	16.4	14.5	13.1	15.1	12.1	11.6
Consumer Prices	2.3	6.1	6.0	7.4	4.2	4.3
Unemployment	13.7	12.0	10.1	9.0	8.2	7.4
General Government (%GDP)						
Revenue	40.0	41.4	41.4	39.9	39.3	39.6
Expenditure	40.9	39.3	39.5	36.6	37.3	37.6
Overall Balance	-0.9	2.2	1.9	3.3	2.0	2.0
Gross Debt	45.9	37.9	29.2	22.8	20.9	19.0
Monetary						
Credit to Non-Government	48.3	48.7	32.3	24.6	-	-
Short-Term Interest Rate	3.7	3.7	3.6	3.1	-	-
Long-term Interest Rate	6.4	5.3	3.8	4.4	-	-
Balance of Payments (% GDP)						
Current Account Balance	-5.5	-6.6	-12.0	-15.9	-18.0	-17.2
Trade Balance	-13.7	-14.9	-20.2	-21.5	-22.1	-22.7

Source: IMF, Central Bank, Eurostat, Alpha Bank Economic Research

Turkey	2003	2004	2005	2006	2007 (f)	2008 (f)
Real Economy						
Real GDP	5.8	8.9	7.4	6.1	4.9	5.9
Private Consumption	7.2	10.6	9.1	5.2	3.8	5.0
Public Consumption	-2.4	0.5	2.4	9.6	9.0	3.5
Gross Fixed Capital Formation	10.0	32.4	24.0	14.0	11.2	10.9
Exports (Goods & Services)	16.0	12.5	8.5	8.5	6.7	6.4
Imports (Goods & Services)	27.1	24.7	11.5	7.1	6.0	5.5
Consumer Prices	25.3	10.1	8.1	9.3	8.2	5.8
Unemployment	10.5	10.3	10.2	9.9	9.9	9.6
Monetary						
Credit to Non-Government		54.5	53.9	40.1	31.2	31.4
General Government (%GDP)						
Overall Balance	-11.3	-5.8	-0.3	-0.6	-2.2	-1.8
Gross Debt	85.1	76.9	69.6	60.7	56.6	54.3
Balance of Payments (% GDP)						
Current Account Balance	-3.4	-5.2	-6.3	-7.7	-7.2	-6.6
Trade Balance	-8.1	-10.3	-10.9	-9.9	-9.0	-8.1

Source: IMF, Central Bank, Eurostat, Alpha Bank Economic Research

Cyprus	2003	2004	2005	2006	2007 (f)	2008 (f)
Real Economy						
Real GDP	1.8	4.2	3.9	3.8	3.8	3.9
Private Consumption	2.0	6.3	4.7	4.0	3.5	3.5
Public Consumption	6.0	-5.5	3.4	2.4	3.5	3.9
Gross Fixed Capital Formation	1.2	10.0	2.7	5.2	4.8	4.8
Exports (Goods & Services)	-0.7	5.1	4.7	2.1	4.0	4.0
Imports (Goods & Services)	-1.0	9.6	3.1	2.2	3.6	3.9
Consumer Prices	4.0	1.9	2.0	2.2	2.0	2.1
Unemployment	4.1	4.6	5.2	4.7	4.8	4.8
General Government (%GDP)						
Revenue	38.8	38.8	41.2	42.4	42.6	42.6
Expenditure	45.1	42.9	43.6	43.9	44.0	43.9
Overall Balance	-6.3	-4.1	-2.3	-1.5	-1.4	-1.4
Gross Debt	69.1	70.3	69.2	65.3	61.5	54.8
Balance of Payments (% GDP)						
Current Account Balance	-2.2	-5.0	-5.6	-5.9	-5.6	-5.4
Trade Balance	-23.9	-25.6	-25.0	-27.0	-26.8	-26.6

Source: IMF, Central Bank, Eurostat, Alpha Bank Economic Research

Serbia	2002	2003	2004	2005	2006 (e)	2007 (f)
Real Economy						
Real GDP	4.5	2.3	9.3	6.3	5.5	6.0
Consumer Prices	21.2	11.3	9.5	17.7	12.0	6.0
Unemployment	13.3	14.6	18.5	-	-	-
General Government (%GDP)						
Revenue	42.8	42.7	44.5	44.4	44.6	-
Expenditure	47.3	46.0	44.8	43.5	42.2	-
Overall Balance	-4.5	-3.3	-0.3	0.8	2.6	3.0
Gross Debt	85.4	79.2	60.2	52.1	45.9	41.1
Monetary						
Credit to non-government	49.6	25.1	47.9	62.6	33.7	27.8
Repo rate	9.7	10.6	16.3	15.9	-	-
Balance of Payments (% GDP)						
Current Account Balance	-12.9	-12.3	-14.8	-10.2	-10.8	-14.0
Exports	15.5	14.8	16.6	19.3	22.6	-
Imports	40.7	38.4	46.8	43.8	47.7	-
Trade Balance	-25.2	-23.6	-30.2	-24.5	-25.0	-24.1
FDI	3.6	6.8	4.2	7.7	6.5	-

Source: IMF, Central Bank, Eurostat, Alpha Bank Economic Research

FYROM	2003	2004	2005	2006	2007 (f)	2008 (f)
Real Economy						
Real GDP	2.8	4.1	3.8	3.1	4.3	5.3
Private Consumption	-	-	-	4.0	4.5	4.6
Public Consumption	-	-	-	3.0	3.0	3.0
Gross Fixed Capital Formation	-	-	-	9.0	12.0	15.0
Exports (Goods & Services)	-	-	-	15.2	14.5	15.9
Imports (Goods & Services)	-	-	-	14.5	13.5	14.3
Consumer Prices	1.1	-0.4	0.5	3.2	2.0	2.5
Unemployment	36.7	37.2	37.3	36.6	35.8	34.7
General Government (%GDP)						
Overall Balance	-1.1	0.0	0.2	-0.6	-1.2	-1.5
Gross Debt	42..9	40.0	46.9	39.5	32.9	31.8
Balance of Payments (% GDP)						
Current Account Balance	-3.2	-7.7	-1.4	-0.7	-2.0	-2.6
Trade Balance	-18.4	-20.7	-16.2	-17.6	-19.3	-20.5

Source: IMF, Central Bank, Eurostat, Alpha Bank Economic Research

Albania	2002	2003	2004	2005	2006 (e)	2007 (f)
Real Economy						
Real GDP	2.9	5.7	5.9	5.5	5.0	6.0
Consumer Prices	5.2	2.4	2.9	2.5	2.5	3.0
General Government (%GDP)						
Revenue	24.7	24.5	24.1	24.6	24.6	24.7
Expenditure	31.4	29.0	29.2	28.3	28.7	28.2
Overall Balance	-6.6	-4.5	-5.1	-3.8	-4.1	-3.5
Gross Debt	65.0	61.8	56.5	54.9	55.0	54.5
Monetary						
Credit to non-government	41.0	31.1	36.9	69.1	43.2	35.3
Balance of Payments (% GDP)						
Current Account Balance	-10.0	-8.1	-5.5	-7.0	-8.1	-7.3
Exports	20.5	20.8	21.5	21.9	22.7	23.6
Imports	46.3	45.9	43.2	45.1	46.2	46.2
Trade Balance	-25.9	-25.1	-21.7	-23.2	-23.5	-22.5
FDI	3.0	3.2	4.6	2.9	3.2	3.1

Source: IMF, Central Bank, Eurostat, Alpha Bank Economic Research

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