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Greece and Southeastern Europe Economic & Financial Outlook

Executive Summary

1. Greece

- With a front-loaded robust fiscal consolidation and structural reforms programme under implementation, supported with € 110 bn financial assistance package from Eurozone countries and the IMF, Greece has entered into a painful adjustment process, severely reducing economic activity and incomes over 2010-2011.
- This adjustment, though unprecedented in size, does not risk derailment due to popular discontent, as it comes on the back of hefty increases of the wage and pension bill in previous years, while public sector unemployment is not expected to increase to any material extent. Moreover, tax and social security reform contribute towards restoring social fairness by tackling tax evasion and abolishing preferential pension treatment of certain groups in the population. If these considerations apply, concerns over debt restructuring are seriously exaggerated.
- With unit labour cost growth improving in relative terms and privatisation, deregulation and infrastructure investment strengthening the potential growth of the economy, the required fiscal adjustment and the economic recovery may come earlier than expected and the economic recovery probably no later than 2011.

2. Romania

- GDP growth is forecast to turn marginally positive in 2010 on the back of a positive contribution by net exports. The pace of economic recovery will depend on the recovery in the country's main trading partners as well as the progress in the implementation of the IMF loan accord, in particularly in the area of fiscal reform.
- Fiscal reform is at the heart of the € 20 billion loan with the IMF and the EU with the target for the 2010 budget deficit set at 6.8% of GDP. Amongst the key measures recently announced to meet this new target are a -25% cut in the public sector wage bill and a -15% cut in public pensions, effective from June 2010.
- The general government deficit came in at 7.2% of GDP just within the revised IMF agreed target. For 2010 the target is 6.8% of GDP following a recent upward revision from 5.9% of GDP..

3. Bulgaria

- Economic growth is forecast to remain stagnant in 2010 before reviving to 2.7% in 2011. In 2009 GDP fell by -5% due to a steep fall in domestic demand. External demand also fell, however the sharper decline of imports relative to that of exports led to net exports making a positive contribution to GDP growth.
- The fiscal position turned negative for the first time after many years. In 2009 there was a fiscal deficit -3.9% on an accrual. This deterioration in the fiscal finances is expected to be relatively short-lived as the government is taking corrective measures.
- With fiscal reserves weakening, Bulgaria has decided to postpone plans to apply for Eurozone Entry.

4. Cyprus

- By 2011, economic activity is expected in recover with GDP growth of around 1.3%, with a forecast decline of -0.4% in 2010 from -1.7% in 2009. Private consumption will remain subdued in 2010 due to a combination of high household debt burden, tight financial conditions and weak consumer sentiment. Likewise, investment is forecast to remain weak, with foreign demand for residential homes dependent on an economic recovery in the Eurozone.
- The most significant challenge facing the economy is Cyprus' fiscal position. The general government deficit is expected to increase to -7.1% of GDP in 2010 from 0.9% of GDP surplus in 2008. This sharp turn in the country's fiscal position was the result of a combination of a steep drop in government revenues due to the deteriorating economic conditions and sharp increases in expenditure, as the government sought to implement measures to help cushion the economy from the impacts of the international financial crisis. Accordingly, general government debt is expected to increase to 62.3% of GDP in 2010 from 48.4% in 2008.

5. Serbia

- The IMF is forecasting GDP growth of 2.0% in 2010 and 3.0% in 2011. Following a decade of stellar economic performance, GDP growth contracted by -3.0% of in 2009. Economic activity already appears to be recovering in 2010 with an initial flash estimate for Q1 GDP growth of 1.0% y/y.
- The 2010 budget projects a consolidated fiscal deficit of around 4.1% of GDP in 2010, before recovering to 3.0% in 2011, in line with Serbia's stand-by arrangement with the IMF. The 2010 budget includes measures such as a freeze on public sector salaries; a cut in the public administration workforce, a reduction in the number of capital spending projects as well as limiting subsides.
- The IMF extended the standby arrangement with Serbia through to the end of 2011, ensuring access to the two remaining tranches under the € 2.94 billion stand-by loan. Talks have already commenced with the IMF under the fourth review of the stand-by arrangement with the focus now on tax and pension system reforms, as well as the adoption of fiscal responsibility law.

6. Albania

- GDP growth is expected to have declined to 3.7% y/y in 2009, from around 6.5% in 2008. Looking to 2010, the IMF has raised its forecast for GDP growth to 2.3% y/y, placing Albania as one of the top-performing economies in the region. Economic activity is expected to accelerate further in 2011 with GDP growth of 3.2% y/y.
- In 2009 the current account deficit decline by -3.1% y/y to € 1.3 billion or -14.5% of GDP. The IMF currently forecasts that the current account deficit will decline to around 12.0% of GDP in 2010 in line with the slow down in economic activity.

7. Former Yugoslav Republic of Macedonia

- After three consecutive quarters of negative growth, economic activity moved into positive territory, posting 1.2% y/y growth in Q4, bringing full-year growth to 0.7% y/y in 2009. The IMF currently forecasts GDP growth of 2.0% in 2010 and 3.0% in 2011.
- After a near fivefold increase to 13.4% of GDP in 2008, the current-account deficit contracted to 7.4% of GDP in 2009. For 2010 the current account deficit is expected to decline to around 6.6% of GDP.

8. Ukraine

- Following a deep economic recession in 2009, GDP growth is expected to recover by 3.5% in 2010 on the back of improved global demand for international commodities, an improved political climate, and also base effects.
- The deficit in the current account has been reduced to an estimated -1.5% of GDP in 2009 and may even post a small surplus in 2010. Net exports are forecast to continue supporting GDP growth in 2010 and 2011.

9. Turkey

- GDP growth is now expected to exceed 4.5% in 2010. The current account deficit reached -2.1% of GDP in 2009 due to weak import demand and lower commodity prices and is expected to remain at the level of -2.8% of GDP in 2010.
- Having experienced a substantial deterioration in its fiscal accounts in 2009 due to stimulus measures to prop up the economy, a fiscal consolidation effort and more restrictive monetary policy are being implemented in 2010 in an effort to stabilise the economy.

1. GREECE

Table 1. Basic Conjunctural Indicators (% change from previous period)	2007	2008	2009	2010	
				available period	
Retail Sales Volume	2.3%	-1.4%	-9.3%	3.9%	Jan-Feb
Automobile sales	4.3%	-7.0%	-17.4%	9.7%	Jan-April
Tax on Mobile telephony	114.2%	5.3%	13.2%	141.0%	Jan-Mar
VAT Receipts	9.8%	8.4%	-9.1%	-0.2%	Jan-April
Consumption Tax on Fuels	9.7%	28.9%	18.6%	8.2%	Jan-Mar
Private Consumption	3.3%	2.3%	-1.8%	-3.2%	2010
Government Consumption	8.4%	0.6%	9.6%	-11.0%	2010
Building activity (Permits)	-5.0%	-17.1%	-27.6%	18.8%	Jan
Cement Production	-9.2%	-3.1%	-21.4%	-8.0%	Jan-Mar
Public Investment	7.6%	9.3%	-2.8%	-39.1%	Jan-April
Fixed Investment	4.6%	-7.4%	-13.9%	-5.5%	2010
Change in Stocks and Stat. D.	1785.2%	147.3%	-2.3%	-50.0%	2010
Unemployment	8.3%	7.7%	9.4%	11.3%	Jan
Manufacturing Production	2.2%	-4.7%	-11.0%	-3.6%	Jan-Mar
Economic Sentiment	107.9	93.4	70.6	69.1	April
-Industry	102.8	91.9	72.1	80.6	April
-Consumer Confidence	-28	-46.0	-45.7	-61.0	April
PMI (Manufacturing)	53.7	50.4	45.3	43.6	April
Exports of goods (El.Stat.)		1.6%	-17.5%	1.1%	Jan-Mar
Imports of goods (El.Stat)		10.5%	-24.4%	-14.9%	Jan-Mar
Tourism Arrivals (airports)	8.5%	-1.4%	-6.7%	10.3%	Jan-Mar
Tourism Receipts (BoP)	-0.3%	3.0%	-10.9%	1.0%	Jan-Feb
Exports goods & services	5.8%	4.0%	-18.1%	1.0%	2010
Imports goods & services	7.1%	0.2%	-14.1%	-9.8%	2010
GDP growth	4.5%	2.0%	-2.0%	-3.5%	2010
Inflation (CPI)	2.9%	4.2%	1.2%	4.8%	Jan-April
Current Account (% of GDP)	-12.4	-12.8	-10.5	-8.0%	2010

Note: Growth rates are calculated on a cumulative basis

FISCAL CONSOLIDATION PROSPECTS: In the last months of 2009 and in H1 2010, Greece has experienced an abrupt change of fortunes. The derailment of its public finances in 2009 was primarily the result of mismanagement as growth went in reverse. In a period of a deep recession in the international economy affecting dramatically Greek tourism and exports of goods and more importantly international shipping and with two electoral contests weighing in the domestic economy, a quasi-stimulus plan was put into effect, notwithstanding the already high fiscal imbalances in 2008. With the domestic tax authorities, however, becoming increasingly dysfunctional due to elections and the government succumbing to pressure groups' demands for income support and subsidies, the stage was set for a surge in fiscal imbalances in 2009. At the same time, sporadic efforts (in the form of additional tax measures) to mitigate adverse budgetary developments in H2 2009 were thwarted by economic policy-making paralysis.

Following the election of the new government in October 2009, the deterioration in public finances assumed a new dimension with the announcement that the deficit was not of the order of 8.5% of GDP, as most analysts were predicting at the time, but rather 12.7% of GDP. This was the result of the new government's "marking to market" all obligations arising from the past and likely to burden future budgets so as to clear the kitchen sink and start with a new slate. This resulted to the unfavourable projections of the European Commission concerning fiscal developments in Greece in 2010-2011 and the implied downgrades of the Greek State by the Rating Agencies, leading to a sudden loss of credibility, which threw Greece at the mercy of the markets.

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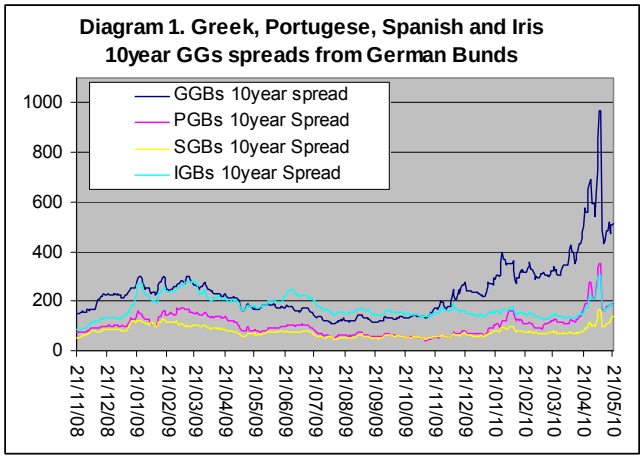


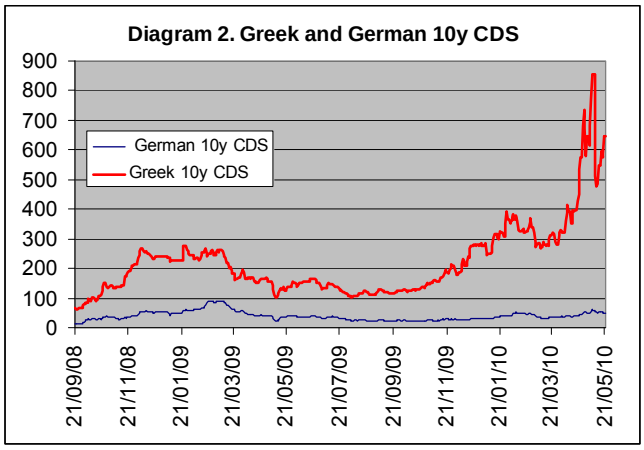
The new government responded to the ensued fiscal and Greek Government Bonds (GGBs) crisis with a substantial delay. The whole quarter Q4 2009 was lost in inaction, contributing to the ballooning of the final general government deficit and debt in 2009 to even higher levels than what was announced in November, to 13.6% and 115.1% of GDP respectively.

Then, at 14 January 2010, the government published the Hellenic Stability and Growth Program 2010-2013 (HSGP), a rather comprehensive program of adjustment, targeting a substantial reduction of the general government deficit to 8.7% of GDP in 2010 and to less than 2.8% of GDP in 2012 (Table 1). This program also included in broad terms the measures and far reaching structural reforms, which were going to be applied in 2010 and the following years, for the implementation of these targets. In particular, for 2010 it included general government revenue increasing measures of the order of € 7.59 billion (3.16% of GDP) and general government expenditure reducing measures of the order of € 3.78 billion (1.57% of GDP), implying a fall of the general government deficit in the current year by 4.74 pps of GDP.

Table 1. The evolution of fiscal adjustment in 2010-2013	2009	2010	2011	2012	2013
GDP (annual % change)	-1,2	-0,3	1,5	1,9	2,5
General Government Deficit (% of GDP)	***12,7***	***8,7***	***5,6***	***2,8***	***2,0***
General Government Debt (% of GDP)	113,4	120,4	120,3	117,5	113,2
Source: HSGP 2010-2013					

However, despite its endorsement by the European Commission, this program did not go far enough to appease the markets. With unrelenting market pressure continuing, the Greek Government came out on February

9, 2010, with a barrage of additional or/and more detailed measures giving content to the reforms sketched in the HSGP. Also, on February 11, 2010, the European Council took a decision effectively offering an implicit guarantee that Greece will not be allowed to be overwhelmed by the markets in its effort to implement its 2010 borrowing requirement, stopping, however, short of a more explicit backing arrangement.



At the same time, pressures were intensified for Greece to come forward with additional, more concrete, measures, which would assure the markets for the swift implementation of the HSGP, not only in 2010 but in the following years as well, and if needed to have also ready additional back up measures to safeguard the achievement of its fiscal consolidation targets for 2010, 2011 and 2013 onwards. The ECOFIN in February 16, 2010, acting under Article 126 (9), imposed the deadline of March 16, 2010 for Greece presenting a timetable for implementing specific budgetary target measures for 2010, and another by 15 May, 2010 when Greece should be ready to outline the exact policy measures needed to bring the deficit to below 3% of GDP by 2012. Quarterly reports were to be submitted thereafter regarding progress on implementation.

Despite all of the above, the GGBs market continued to malfunction and efforts to tap the market in order to cover the 2010 borrowing needs turned out to be very costly for the government and intensified, instead of reducing, the international investor's anxiety concerning the Greek government's ability to carry out successfully its € 54 billion 2010 borrowing program. The 10-year Greek government bonds spread over German bonds continued to hover around the 320 bps during February.

This, in combination with strong demands for additional measures exerted by the European Commission and in particular by Germany, ***obliged the Greek government to announce on 3 March 2010 a new substantial fiscal package*** comprising: a) additional (to the HSGP) revenue increasing measures (including a 2pps increase in VAT rates and further increases in specific taxes of fuels and tobacco) of the order of € 2.8 billion (1.2% of GDP) and expenditure cutting measures (mainly substantial cuts in civil servants wages and pensions) of the order of € 2.1 billion (0.9% of GDP). With these new measures, the total budgetary adjustment for 2010 amounted to € 16.5 billion (6.9% of the 2010 GDP).

Following this decision, S&P estimated in a note on Greece published on 6 April 2010 "the Greek government's fiscal consolidation program as supportive of the ratings at their level on 16 March 2010 (BBB+/Negative/A-2)". Moreover, the new measures received a wholehearted endorsement by the European Commission and the European Central Bank, as well as by most Eurozone governments, including Germany. Nevertheless, their positive effect on the GGBs market was minimal. The 10year Greek–German bond spread fell slightly to the level of 297.7 bps for a few days in March and then it increased again above the 300 bps.

The persistent high level of the GGBs spreads was mainly supported by a barrage of articles which appeared in the international press arguing that Greek government debt had already become unsustainable. The Economist (25 March 2010), published an article based on the simple assumption that in the period of Greece's fiscal adjustment 2010-2014, its nominal GDP will follow a rapid falling trend at a yearly rate of -1.1%, reaching the level of € 225.6 billion in 2014, from € 237.4 billion in 2009. Moreover, the general government deficit was assumed to fall only gradually (it would still be above 9.5% of GDP in 2010) and interest payments for servicing the public debt was expected to surge upwards and exceed the 8.4% of GDP in 2014, from 5.1% of GDP in 2009. With these assumptions, even with a huge primary surplus (e.g. of the order of 5.8% of GDP) the Greek debt/GDP ratio was going to exceed the 152.5% of GDP in 2014. Exactly the same exercise was done by Wolfgang Münchau, who proceeded on 5 April 2010 to publish his now famous article in the Financial Times taking the view that "**Greece is going to default but not this year".** From then on a barrage of articles appeared in the international press repeating day after day exactly the same argument based on the Economist's pioneering article. This argument goes as follows: a) the adjustment effort needed to prevent a debt explosion in Greece is extremely large, b) Greece has to do this without the tool of devaluation, which is needed in order to improve its low competitiveness, and, therefore, c) it can only be done through deflation and negative nominal GDP growth both in the period of fiscal adjustment and after. However, fiscal adjustment is impossible in a period of deflation (of negative nominal GDP growth), therefore Greece will most probably default.

In reality, the above argument was solely based on the following, particularly strong, assumptions: a) that the appropriate reduction of the general government deficit in Greece is an extremely difficult venture, and b) that this can only be achieved through deflation and a negative nominal GDP growth for a prolonged period.

As we will explain in the present report, both these assumptions are not in any way related to the historical

developments and the particular characteristics of the Greek economy or to the nature of the Greek fiscal derailment, mainly in 2008-2009. On the contrary, both the implementation of the Greek budget in January – April 2010 and developments concerning real and nominal GDP growth in Q1 2010 have already shown the frailty of these assumptions. Nevertheless, they continue to be propagated extensively in the international press and to constitute the main trigger which set the stage for the unprecedented upward surge of the Greek spreads and CDSs.

This process became in turn the sole indicator of the pure economic prospects of the Greek economy and international analysts and investors, instead of examining the real economic conditions and prospects of growth of the Greek economy, had only had to look at the spreads. This is exactly how S&P proceeded to downgrade GGBs by 3-notches at a stroke on April 27, 2010, at the end of a trading day in which GGBs spreads surged upwards due to an unsubstantiated remark concerning Greek debt by a German politician. In 20-days S&P changed its views on Greece dramatically. The Greek government's fiscal consolidation program was not any more supportive of the BBB+/Negative/A-2 ratings. The spreads went substantially up. Therefore, the right rating, according to S&P's, is now BB+/Negative.

Following these developments, the GGBs spreads were set in an autoregressive upward trend and the GGBs market became utterly dysfunctional. Therefore, at the end of April 2010 ***the Greek government requested a 3-year official financing arrangement from its Eurozone partner countries and the IMF,*** amounting to a € 110 billion stand-by bridge loan, covering the Greek government borrowing needs for almost the following 2.5-years. This loan was awarded following a thorough examination of the Greek economy by the IMF, the European Commission and the European Central Bank and Greece's adoption of a multiyear adjustment program aiming at: a) the effective reduction of its high general government deficit and debt and domestic excess demand, and b) the improvement of competitiveness and of the supply potential of the Greek economy.

Concerning fiscal adjustment the Greek government has already adopted a new fiscal package, which is to a great extend additional to the previous two fiscal packages presented above. The new package comprises additional revenue increasing measures for 2010 of the order of € 1.25 billion, as well as additional general government primary expenditure reducing measures of the order of € 4.55 billion. Therefore, with the new fiscal package, the total fall of the general government deficit in 2010 could reach € 22.4 billion (9.3% of 2010 GDP).

Moreover, the IMF has calculated the impact of the new revenue increasing and expenditure cutting measures already adopted by the Greek government (e.g., the tax reform, local government restructuring, pension reform, indirect tax hikes and others) for 2011 amounting to the € 9.15 billion or to 4.1% of the 2011 GDP. Finally, there are savings planned for 2012 of the order of € 5.58 billion (2.4% of GDP) and for 2013 of the order of € 4.78 billion (2.0% of GDP). Overall, the total impact of the measures planned to be taken in the period 2010-2013 are estimated at € 42 billion. Instead, the IMF considers that the actual outcome will amount to savings of € 30 billion or to around 13% of GDP.

However, even with this huge fiscal adjustment, the IMF has estimated that the Greek general government debt will still reach the 133% of GDP in 2010, the 145% of GDP in 2011 and the 149% of GDP in 2012 and 2013. ***The IMF assumes as well that the Greek fiscal adjustment effort will be less effective than the estimated impact of the concrete measures already applied and that it will lead to deflation and to a dramatic fall of Greek nominal GDP by -2.8% in 2010 and -3.1% in 2011.*** More specifically: The projection that the general government debt will reach the € 307.5 billion in 2010 is based o***n the assumption that the primary general government deficit in 2010 will only fall by € 14.8 billion, despite the fact that the quantifiable effect of fiscal measures applied in the current year exceeds € 22.4 billion. Thus, the IMF estimates the 2010 overall deficit to fall to 8.1% of GDP.*** The implementation of the 2010 budget in the first four months of the year point to a lower general government deficit (though close to the IMF estimate) in 2010.

Also, the IMF is projecting a fall of nominal GDP of the order of -2.8% in 2010 (real GDP growth: -4.0% and increase in GDP deflator: 1.2%) and -3.1% in 2011 (real GDP growth: -2.6% and increase in GDP deflator: -0.5%). However, real GDP growth in Q1 was only -2.3% and nominal GDP growth reached 0.8% (GDP multiplier: 3.1%). Moreover, inflation in April 2010 reached 4.8% and is expected to exceed 5.3% in May 2010. In fact it is now expected that real GDP will fall by about -3.5% in 2010, with the GDP deflator increasing by more than 3.5%.

Overall, the question of whether the substantial fiscal imbalances of Greece are simple liquidity or fundamental sustainability problems depend greatly on the assumption to be made concerning nominal GDP growth developments in the period of fiscal adjustment.

In this context, the connection of an extensive fiscal adjustment with pervasive deflationary situations is not applicable in the case of small economies like Greece, members of a common currency area as the Eurozone. These countries are price takers (not price setters) in the international markets and excess domestic demand or supply is cleared through their net exports. Excess demand in Greece until 2009 was mainly the result of its huge capital account surplus, which in turn was reflected to Greece's high current account deficit. The fall in domestic demand following the expected fall of Greece's capital account surplus (if foreign investors will be not willing to finance Greece's public borrowing requirement

at an acceptable cost) will imply a rapid increase in domestic savings and a substantial fall of Greece's current account deficit. Exports will increase and imports will fall due to lower domestic demand and improved competitiveness. Of course, there will be a cost of adjustment in the form of a recession in the short run, which may last for one or two years, depending also on developments in the economies of Greece's economic partners as well. But this has nothing to do with the prolonged recession that the models of the aforementioned analysts assume for Greece.

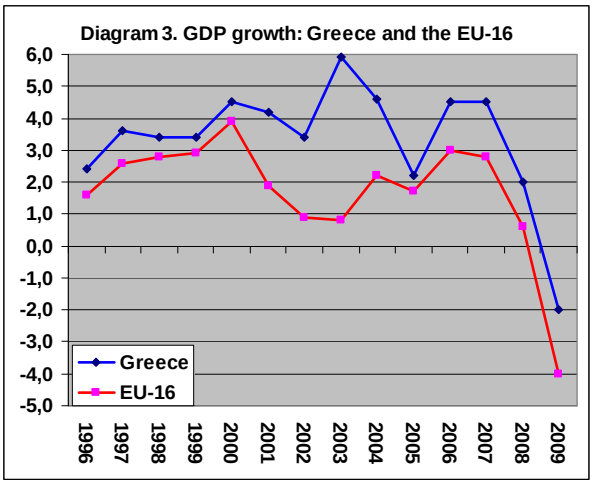
In this respect, it would be erroneous to consider the case of Ireland in 2008-2010 as evidence of possible deflationary effects of fiscal adjustment. Yes, there was negative inflation and negative nominal GDP growth in Ireland, but this had nothing to do with the fiscal adjustment effort. It was rather the result of the exceptionally high negative effects exerted on this country from the international economic crisis and the consequent collapse of both its banking system and its (booming until 2008) real estate sector. The fiscal imbalances in Ireland were the result not the cause of its deep recession and deflation. The same is also true for many other countries, which were badly affected by the international economic crisis (e.g., UK and Spain).

In what follows we analyze in more detail ***the particular characteristics of Greece which explain why fiscal adjustment may lead to inflation in 2010 and in 2011 and to a rationalization and improvement of efficiency and competitiveness of the Greek economy.***

First, fiscal adjustment is taking place to a great extent through the substantial increase in indirect taxes and the fall in subsidies, as well as through increases in the prices of services offered by state controlled entities and businesses in the process of increasing the degree of cost recovery of these services by the users, which is particularly low in Greece. Therefore, fiscal adjustment is taking place through inflation. Instead of financing the deficits of public entities through borrowing, the financing will now take place through the prices of services offered by the state and through indirect taxes.

Secondly, notwithstanding the expected substantial fall of real GDP in 2010 and 2011, fiscal adjustment in Greece will eventually lead to a substantial ***rationalization and improvement of efficiency and competitiveness of the Greek economy.*** Therefore, it will imply a boost to Greece's total factor productivity and to its potential GDP growth, with nominal GDP growth from 2012 onwards gradually returning to trend.

Thirdly, attention should be drawn to the frailty of the suggestion that the Greek growth model until recently "was overly reliant on public spending". Table 4 and Diagram 3, may help to put an end to this kind of reasoning, which is the basis for the assumption of substantially negative nominal GDP growth in the period of fiscal adjustment. As shown in Diagram 3, Greece has a much higher real GDP growth from the Eurozone average for as long as 15 years. This growth performance was achieved in a period in which Greece was registering high general government primary surpluses.



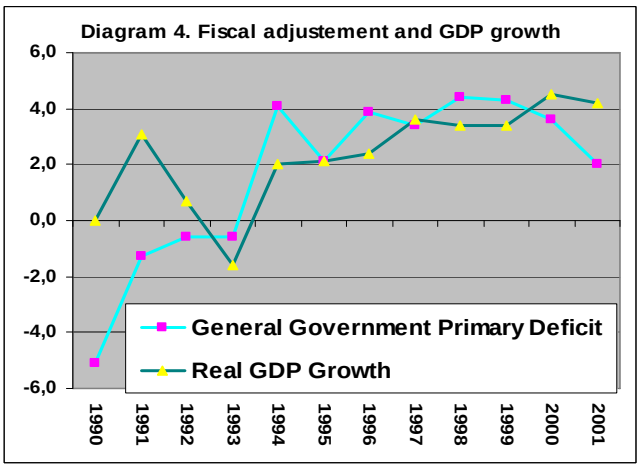


Table 4. GDP and domestic demand growth in various countries: 1995-2008

	Greece	Germany	Italy	Spain
Real GDP	***61,0%***	***19,5%***	***17,8%***	***56,0%***
Private consumption	55,7%	12,3%	19,6%	55,3%
Government Consumption	51,1%	14,7%	21,5%	74,8%
Fixed Investment	102,8%	18,8%	31,6%	95,2%

Source: OECD, Economic Outlook, Volume 2009/2

Moreover, as shown in Table 4, contrary to what happened in Spain and Italy, Greek GDP growth in 1995-2008 was mainly due to investment and to the high growth of employment and productivity, rather than to government consumption. In fact the expected substantial favourable supply effects of the high volume of investment in infrastructure and in the business sector until 2008 has not yet been reflected fully on the potential growth of the Greek economy. This high volume of investment in the past 15-years will boost Greece's GDP growth in the 2010s.

Greece is in a much better position to proceed with fiscal adjustment than markets currently assume.

Greece shares with other OECD countries (Japan, USA, UK, Ireland, Spain, Portugal, and others) the prospect of a substantial fiscal consolidation in the 2010s: For those countries, however, the recent ballooning of their fiscal imbalances was not due to the mismanagement of their public finances, but mainly the result of their effort to accommodate the huge negative effects of the international economic crisis in their economies and in particular in their financial system. Therefore, in these countries fiscal consolidation is risky because a premature withdrawal of fiscal stimulus in them may prevent recovery of their economies from the deep recession of 2009, or it may throw these economies into an even deeper recession.

In Greece, on the other hand, the overblown general government deficit and debt in 2008 and 2009 was mainly due to the overexpansion and extensive mismanagement of the public sector itself, especially in these last two years. This overexpansion and mismanagement constituted a great burden to the growth potential of the Greek economy, far from contributing to its economic growth. The overexpansion of the utterly unproductive public sector in 2008-2009 was extensively crowding out the more productive private sector activities. This is the reason why with the general government primary balance turning into a deficit of -8.6% of GDP in 2009, from a surplus of 0.7% of GDP in 2007 (a 9.3% of GDP fiscal boost) GDP growth fell to 2.0% in 2008 and to negative -2.0% in 2009, from an annual 4.5% GDP growth in 2006 and 2007 (with a general government primary surplus of 1.3% and 0.7% respectively).

Therefore, the current HSGP 2010-2013 as has now been reinforced and endorsed by the IMF, the European Commission and the European Central Bank, aims to: a) the establishment of a much better governance and management of public finances, b) the reversal of the excesses of the 2000s in increasing public sector employment and wages, c) the gradual withdrawal of the Greek state from activities that are better performed by the private sector, d) the rationalization of management of public sector organizations and businesses with a substantial increase of cost recovery in these entities and, finally, e) the long overdue reform of the overgenerous Greek social security system, which is the main source of Greece's fiscal problems. All these stabilization measures and fundamental reforms are instrumental in order to put Greece on a more sustainable and dynamic growth path, based on the exploitation of its substantial comparative advantages (location, history, dynamic human resources and other).

More specifically, g***eneral government primary expenditure reached 45.4% of GDP in 2009, from 42.2% in 2008 and 38.8% in 2006. The fiscal adjustment program of the Greek government contains already a substantial array of measures aiming at the readjustment of this ratio to much lower levels, namely to 42.2% of GDP in 2010 and to 40.5% of GDP in 2012. The most important of these measures are the following:***

Both public sector employment and wages are set to be substantially reduced in the following years, in combination with a substantial increase in productivity and effectiveness in this sector. Related measures adopted in the HSGP 2010-2013 are the following: ***a) A reduction in civil service employment*** with the freeze in public sector hiring in 2010 and a rule for hiring only one new employee for every five that will retire in the following years. Moreover, the government has agreed with the IMF to reduce employment in the public sector in addition to the 5 to 1 replacement rule in such a way as to produce additional savings of the order of € 600 million in 2012 and another € 500 million in 2013. ***b) The new reorganization scheme of local government organizations (Kalikrates project),*** for which the relevant legislative bill has already been submitted to parliament. With this project the municipalities in the country are set to be reduced to 370 from 1.060 currently. This will also lead to a substantial reduction in the number of local administrations, entities and elected and appointed officials. Total savings from Kalikrates project are estimated to reach the € 500 million in 2011, € 500 million in 2012 and € 500 million in 2013. ***c) The rationalization, merging, or abolition of numerous public sector organizations and entities.*** The government is also planning to increase transparency and enhance accountability of state – owned enterprises and entities, which are operating until today virtually without a budget constraint and a very low degree of recovery of the cost of their services from the users of these services. Therefore, budget transfers to public entities are set to be cut by € 800 million in 2012. ***d) Wage and pension income policies:*** With the measures announced until February 2010, the government had decided: (1) an absolute freezing of basic salaries in the public sector, while at the same time reducing income allowances by 10%, (2) a 30% reduction of overtime work (which until 2009 constituted a sizable part of public sector wage payments) and a 30% cut of payments for compensation for travel and out-of-office work, (3) the inclusion in the taxable income statement of state employees of all untaxed or partially taxed income allowances until 2009, (4) the cut of top pay for government appointees to managerial positions of state organizations to less than € 6000 per month with no bonuses and a 50% cut of compensation of all members of board of directors of these organizations. Moreover, w***ith the new IMF sponsored HSGP new substantial cuts in public sector wages were decided as follows:*** (1) The Easter, Summer and Christmas bonuses and allowances will be substituted by small bonuses implying a substantial additional cut in the general government wage bill of the order of € 1.1 billion in 2010 and an additional cut of the 2011 wage bill by € 0.4 billion. (2) The Easter, Summer and Christmas bonuses to pensioners will be substituted by small bonuses implying a substantial additional cut in the general government pension bill by € 1.5 billion in 2010 and an additional € 0.5 billion in 2011. (3) The highest pensions will be cut, producing total savings of €

350 million in 2010 and € 150 million in 2011. (4) A pension freeze in 2011-2013 will produce additional savings of € 100 million in 2011, € 250 million in 2012 and € 200 million in 2013. (5) The elimination of the solidarity allowance (second installment) planned for 2010, implies additional savings of the order of € 400 million in the current year. (6) The introduction of a unified public sector wages scheme is expected to produce additional savings of € 100 million. (7) The reform of the means test unemployment benefit scheme will produce savings of € 500 million in 2012.

These policies are now expected to imply a negative growth of the order of -10.0% of the central government wages and pensions bill in 2010, compared with a 2.8% increase of this bill assumed in the budget of 2010 and an increase of 11.5% in 2009. Also, for the years after 2010, ***compensation of employees in the general government*** is expected to register again negative growth of more than -2.5% in 2011 and even -1.0% growth in 2012 and 2013. ***Therefore, it is expected to fall to less than the 10.0% of GDP in 2013, from 12.7% of GDP in 2009.*** With this policy it is projected that employment in the general government will be reduced by more than 10% in the following 3-years, while the rationalization of operations of various government services would further boost wage cost savings in the broader public sector. Moreover, wage policy will continue to be restrictive in the broader public sector, as there is real need for abolishing the sizable wage advantages which this sector enjoyed until 2009.

In addition to the above ***intermediate government consumption*** which reached 6.0% of GDP in 2009, from 4.9% of GDP in 2006, registering an increase of 21.8% in 2009, was expected to fall by -10.6% in 2010 and to continue to a negative trend in the following years falling to the 3.4% of GDP in 2012 and 2013. With the new IMF sponsored program additional cuts in intermediate consumption were decided of € 700 million in 2010 and € 300 million in 2011. This will be achieved through the rationalization of public sector provisions and also though the substantial increase of the degree of cost recovery in public sector services and entities. This will be the way to apply effective budget constraints to the operation of the above entities.

The contribution of the budget to the pension system (including civil servants' pensions) rose from € 8.9 billion (4.5% of GDP) in 2005 to € 15.8 billion (6.6% of GDP) in 2009. A part of the substantial increase of this contribution in 2009 was due to the surge of social security contribution evasion, which occurred in this year and implied a substantial increase of lost revenue for the funds to € 8 billion at the end of 2009. An additional part constituted advance payment for the needs of pension funds in 2010. Therefore, the relevant payment included in the 2010 budget is € 14.5 billion (6.0% of GDP). This item is expected to be contained further in the following years through the more permanent crackdown on contribution evasion and the essential containment of health care expenditures (which have been increasing at more than 30% per year in the 2000s). Therfore, collected social security contributions are projected to be boosted by € 2.5 billion in 2011 and by € 4.0 billion in 2012. To this end the HSGP has also included a 1.0% increase of contributions to the Farmer's Social Insurance Fund (OGA).

Moreover, the legislative initiatives for the long overdue fundamental reform of Greece's unsustainable pension system are now in the process of being voted into law in the Greek parliament. The main target of this is the reduction of the projected increase in public spending on pensions over the period 2010-2060 to 2.5% of GDP from 14.5% of GDP under the non reform baseline scenario. This will be achieved through the re-establishment of the connection between pension funds benefits and business's and worker's contributions. In fact there are provisions aiming to effectively contain the rate of increase of the transfers from the budget to the various pension funds of the country. To that end ***the main measures included in the pension bill are as follows:***

(1) Measures to increase the average effective retirement age limit from 2011. This will be implemented through the abolition of all early retirement provisions existing today in many funds, the equalization from 2011 of the retirement age in the public sector between men and women (applying the relevant decision of the European Court of Justice), the immediate raising of the retirement age from 58 to 60 for people with 35 years of employment entitled to full pension, the reduction of pensions received for as long as pensioners continue to work, the provision of incentives to stay on the job post-retirement age and other measures.

(2) Measures to make pension benefits to be determined by contributions. This will be implemented through instituting a basic pension for all at age 65 of about € 360 (poverty level) from 2018, which will be supplemented with a fully-funded pension based on life time contributions. For the transition period, the reform amounts to granting reduced benefits to people entitled to partial pensions. Overall, the successful implementation of these measures will affect immediately the rate of growth of contributions to the funds (because from now on benefits will be determined by contributions).

However, perhaps the most important for the current and the following years measures are those entailing an across the board immediate fall in pensions of the order of -10% on average following the substantial cut of Easter, Summer and Christmas bonuses, which are especially important for high income pensioners. Therefore, ***the transfers from the budget to the pension system are projected to fall*** from 6.6% of GDP in 2009 to 5.5% in 2010 and to 5.0% of GDP in 2011 and 2012 and in the following years. In fact, a pension freeze has been decided for the following years 2011-2013 as well. Also, planned health care spending cuts are to be implemented

through a fundamental reform of the country's health care system, have been set at € 0.9 billion in 2011 and at € 1.2 billion in 2012.

As concerns total current budget revenue, it reached 35.5% in 2009, from 37.3% in 2007 and 40.1% in the year 2000. This compares with total current budget revenues in the Eurozone reaching 44% of GDP in 2009, from 45.7% of GDP in 2000. Therefore, Greece lost about 5% of GDP in revenues in 2009 comparing with the year 2000 and trails the Eurozone average of current tax revenues as a percent of GDP by about 9 pps of GDP. There is therefore a huge scope for adjustment in this area, with net current revenues expected to increase to 39.2% of GDP in 2010 and to 41.4% of GDP in 2012.

More specifically, direct taxes are estimated to be less than 19% of GDP in 2009 in Greece, which is much lower than in the other Eurozone countries (26% of GDP). This low contribution of personal income taxes is largely responsible for the low level of net current tax revenue in Greece relative to the other European countries. If the Greek authorities implement successfully the policies (those included in the HSGP and specified in the recently adopted tax bill) aiming at appropriately broadening Greece's tax base concerning direct taxes, then they can increase tax revenues by as much as € 15 billion (6,2% of GDP), just by reaching the European average direct tax revenues as a percent of GDP. This is an estimate that does not account for Greece's sizable parallel economy (estimated at about 35% of GDP in 2009), which lowers considerably current taxation trends and estimations.

Table 4. Impact of 2010 revenue measures

Permanent Measures	€ Million
Increase in VAT rates	**1.600**
Unique tax scale and elimination of tax exemptions	1.100
Property taxes	400
Higher exise tax on cigaretes and alcohol	960
Higher tax on mobile phones and petrol (carry over from 2009)	400
Higher exise tax on gaziline and petrol	1.050
Total	***5.510***
One-off measurs	**€ Million**
Special levy on profitable firms	870
Special levy on high value real estate	180
Revenue from liquidity scheme for banks	280
Total	***1.330***
Revenues from reducing tax evation	***1.000***
Public Investment Budget revenues	***1.700***
Grand total	***9.540***
Grand total % of GDP	***3,97%***

Source: Update for the Stability and Growth Program 2010-2013, January 2010

In addition to the above, the government has proceeded with substantial increases of indirect taxes, including a 4 pps hike in VAT rates and sizable increases in excise taxes on fuel, cigarettes and alcohol, as well as to a rationalization of property taxes and a substantial array of measures aiming to combat tax evasion and substantially improve tax assessment practices. It is notable that VAT revenues fell by -10% in 2009, compared with a -0.4% growth of nominal GDP. In fact, more than € 1.5 billion VAT revenues in 2009 were lost through outright tax evasion. Most of these revenues should be recovered in 2010 and in the following years.

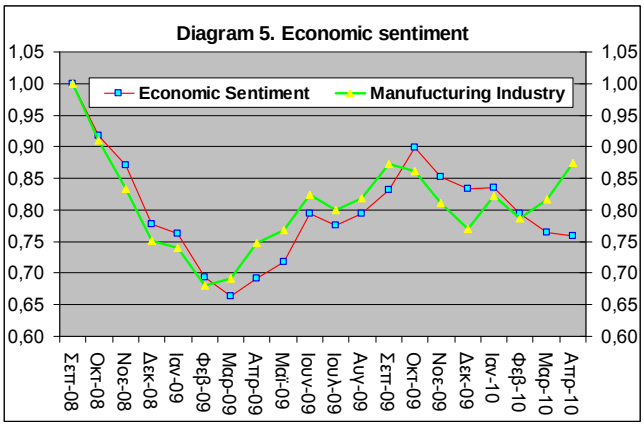
Overall additional general government revenues implied by the various fiscal packages applied by the Greek government (including the measures sponsored by the IMF) are presented in Table 4. Total additional revenue in 2010 is estimated at € 9.5 billion or to 3.95% of GDP.

Concerning the increased revenues in the Government Investment Budget, by an amount equal to € 1.7 billion in 2010, this is based on the fact that the Greek government absorbed only € 2.0 billion from EU structural funds in 2009, compared with planned revenues of € 3.7 billion. This is one of the reasons explaining the negative GDP growth in 2009. The failure to absorb available community funds of more than € 1.7 billion in 2009 implied a fall of fixed investment in Greece by at least € 4.0 billion (-1.75% of GDP). Also, it implied an increase of the general government deficit of 2009 by about 0.7% of GDP. In fact, Greece, has to absorb from the EU structural funds an amount equal to € 24 billion in the period 2010-2015, of which at least € 16.0 billion will be absorbed in the period 2010-2013. This will be one of the main factors that will boost investment and GDP growth in the Greek economy in the following years, while at the same time contributing to the reduction of general government deficit.

RECENT ECONOMIC DEVELOPMENTS: The negative developments in the Greek economy in 2009 were mainly due to the dismal economic and financial environment that prevailed world wide in this period, in which international trade (affecting in particular Greek shipping) has fallen by -10.7% in 2009, from positive growth of 2.8% in 2008. Also, international tourism traffic was down by about -8.0% world wide in 2009 and has fallen by about -10.0% in the European Mediterranean countries. Finally, Greece's exports of goods and services have been negatively affected by the deep recession that prevailed in the main European Union countries and in South Eastern Europe, which constitute the main trading partners for Greece. These utterly unfavourable international economic conditions set the stage for a substantial fall in Greek private consumption, investment and in particular exports of goods and services. However, the fall in domestic demand was mainly directed towards luxury items, durable consumer and investment goods and energy products, which in Greece are to a great extent imported from abroad. As a result, the fall in domestic production and output was cushioned to a certain extent by the sizable fall in net exports.

Although the substantial improvement of the world economy and financial markets from Q3 2009 onwards had contributed to a notable improvement in Greek consumer sentiment and business expectations until October 2009, economic sentiment relapsed again to a rapid falling trend in November–December 2009 following

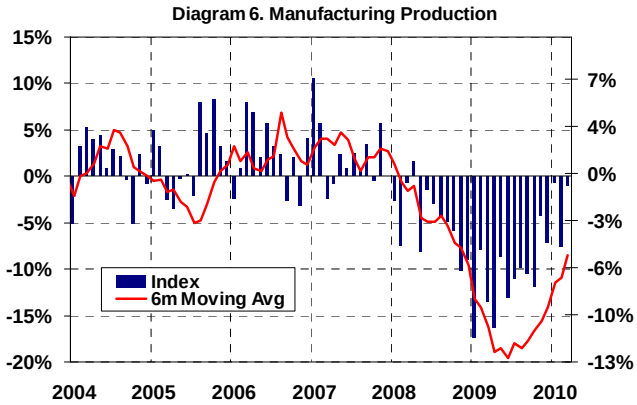
the announcement of the 12.7% of GDP deficit by the new government. This deteriorating trend continued unabated in the first five months of 2010, which was a period of unprecedented crisis in GGBs market (Diagram 5). ***Consumer sentiment*** had improved to the -27.1 in October 2009, from -39.4 in September and -56.2 in March 2009, but fell also to -47.2 in Jan. 2010 and to -67 in Apr. 2010. Moreover, the substantial improvement in business expectations registered until October 2009 was also downgraded in the following months to December 2009 and the first four months of 2010.



The performance of the tourist sector in 2009 was much better than expected, in a year in which Europe, the main source of international tourism for Greece, registered a substantial negative growth. Arrivals of foreign tourists in Greece fell by -6.7% in 2009 (-8.6% in H1 2009), while revenues from foreign tourism fell in 2009 by -10.9% (-15.8% in January-July 2009). ***Overall, the tourist sector (mainly hotels and restaurants) have registered a fall in turnover (in current prices) by -9.1% in*** 2009 (Q1 2009: -20%, Q2 2009: -4.6%, Q3: - 2.3% and Q4: -18.8%). ***In the first 2-months of 2010*** revenues from foreign tourism are up by 1.0% from a substantial fall of -18.4% in the first 2-months of 2009.

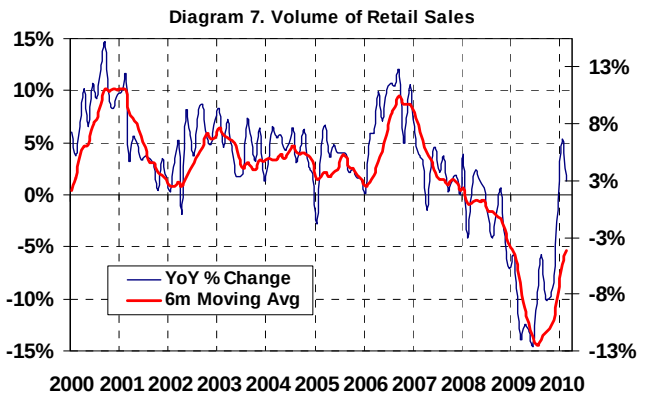
Greece's net merchant shipping receipts have fallen substantially by -34.4%, to € 6.48 billion in 2009, from their record level of € 9.9 billion in 2008. This is one of the factors which have negatively affected domestic consumption and housing investment in 2009. Overall, the total shortfall of net merchant shipping receipts and of net international tourism receipts reached € 4.45 billion in 2009. However, this shortfall was lower than Greece's total savings from lower payments for net imports of oil, which reached € 4.56 billion in 2009. ***In the first 2-months of 2010*** revenues from international shipping are slightly down by -0.8% from a substantial fall of -25.1% in the first 2-months of 2009.

In the manufacturing industry, the falling trend of production is decelerating, to -3.6% yoy in Q1 2010, from -8.3% Q4 2009, -10.6% in Q3 2009, -12.8% in Q2 2009 and -12.9% in Q1 2009. Overall, the manufacturing production registered a substantial fall of -11.0% in 2009, following a fall by -4.5% in 2008.



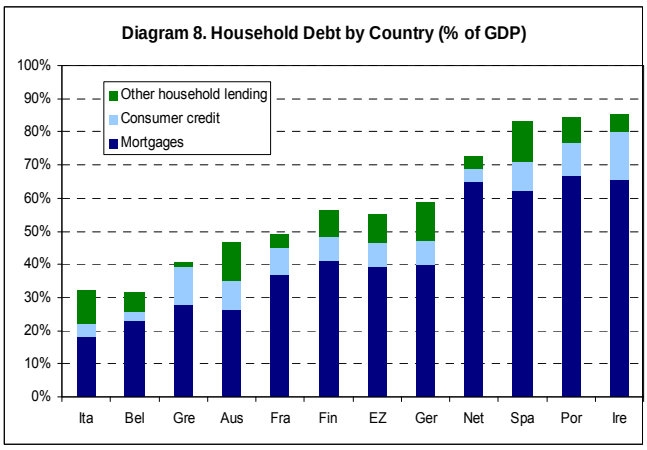
Relatively sound was the performance of the food - beverages and tobacco sectors, which constitute 26.5% of the Greek manufacturing industry, with a yearly fall of production in 2009 of -3.3%, -5.8% and -2.7% respectively. However, the performance of these sectors in Q1 2010 was less promising, as they register a higher fall in their production of -4.5%, -5.0% and -17.4% respectively. On the other hand, a positive growth in production in Q1 2010 are registering some other important sectors of the Greek economy, as the chemical industry (Q1 2010: 3.7%, Q1 2009: -18%), the pharmaceutical industry (Q1 2010: 7.4%, Q1 2009: 9.3%), the basic metals industry (Q1 2010: 6.2%, Q1 2009: -22%), the construction of metal products industry (Q1 2010: 6.3%, Q1 2009: -21.2%), the motor vehicles industry (Q1 2010: 6.0%, Q1 2009: -38.3%) and other manufacturing activities (Q1 2010: 17.8%, Q1 2009: -21.2%). Finally, the fast falling trend of production of the textiles, clothing and footwear sectors continue unabated in Q1 2010 aw well. Overall the index of business sentiment in Greek industry had improved to 79.4 in October 2009 from 62.8 in February 2009, but fell back to 71 in December 2009. However, this index started increasing again to 75.8 in January 2010 and to 80.6 in April 2010. Also, the relevant PMI index has fallen back to 42.9 in March 2010, from 46.5 in January 2010, and increased slightly to 43.6 in April 2010.

Concerning private consumption, ***the volume of retail sales, there was an impressive recovery in January and February 2010, with the general index registering positive growth in both months and a 3.4% growth in Jan.-February 2010, compared with a fall of -7.2% in Jan.-February 2009.*** This impressive performance is in contradiction with the substantial deterioration of consumer confidence, falling to -61 in April 2010, from -47 in January 2010 and -27 in October 2010. Also, ***the index of business sentiment in retail trade*** had improved substantially to 99.0 in October 2009, from 60.2 in March 2009, but fell back to 81.0 in December 2009 and to the very low 54.5 in March 2010, in order to recover slightly to the level of 64 in April 2010.



The recovery of the volume of retail sales in Jan.-February 2010 is due to the recovery of the volume of sales of all sectors, excluding the big department stores, which have registered a fall in sales of -9.4%. Even the sales of durable goods, including furniture, electrical appliances and electronics have recovered from the very low level in Jan.-February 2009. Moreover, ***new passenger car registrations*** have also registered a substantial increase by 9.7% in Jan.-April 2010 (to 76.9 thousand, from 70.15 in Jan,-April 2009). This development follows the substantial fall of car registrations by -17.4%, to 242.6 thousand in 2009, from 293.8 thousand in 2008 and 315.8 thousand in 2007. However, payments for imports of passenger cars fell to € 3.3 billion in 2009, from € 5.2 billion in 2008, while the payments for imports of cars in Jan.-February 2010 reached € 458.5 million, from € 524.4 million in Jan.-February 2008. These developments contributed to ***the substantial fall of imports of goods*** in 2009 and are expected to contribute to this fall even more in 2010. No one is buying big and expensive cars now in Greece.

Contrary to the above, the falling trend of residential construction activity – as measured by the volume (m^3) of building permits – continues registering a new fall of -10.6% in Jan-February 2010, following its big fall by -27.6% in 2009, -17.1% in 2008, -5.0% in 2007 and -19.5% in 2006, from a big increase of 35.2% in 2005. These developments led to a negative growth of residential investment for 2009 of -22.0%, following its substantial fall by -29.1% in 2008 and by -8.6% in 2007. Moreover, residential investment is expected to fall again by about -17.5% in 2010, with recovery seen not earlier than 2011. In fact, support of demand for residential investment from growth of mortgage lending has also weakened in resent months, as growth of mortgage loans decelerated to 3.5% at end-March 2009, from 3.7% at end-December 2009, from 6.0% at end-June 2009 and 11.5% at end-2008. Finally, ***the averse consequences of the substantial deterioration of Greece's fiscal position on consumption and business confidence is expected to further delay the eventual revival of both residential investment and economic activity in this sector as well.*** In fact, the index of business sentiment in construction reached the high level of 72.4 in November 2009, from 52.8 in March 2009, but then fell also back to 68.1 in December 2009 and to 39.7 in March 2010, in order to recover slightly to 44.6 in April 2010. The upward trend will resume in this sector as well, as soon as the market becomes confident that the successful implementation of the 2010 budget is well under way and the thereat of bankruptcy for the Greek economy fade away.



The Greek financial sector, despite the tensions in international financial markets and more importantly in the Greek government bonds market, remains in 2010 fundamentally sound, safe and liquid. Leverage of domestic households and businesses is lower than that in the Eurozone, with loans to GDP at 102%, compared with 135.4% in the Eurozone and above 170% in some overleveraged economies (See also the Diagram 8). Toxic asset write-offs by Greek banks related to the global financial crisis were insignificant and their capital base remained relatively strong. Moreover, some banks have implemented new rights issues in 2009 to further strengthen their core capital position. Therefore, the capital adequacy index and the core capital index for Greek banking groups reached 11.8% and 10.7% respectively at the end of December 2009, from 9.4% and 7.9% respectively at end December 2008.

Concerning turbulence in the GGBs market, Greek banks are primarily funded by customer deposits, with the loan to deposit ratio at the end of December 2009 reaching 108.4% for banks and to 114% for banking groups. However, some moderate deposit outflows were noted during the first months of 2010. More specifically at end March 2010 household and business deposits were lower by -4.4% yoy (€ 10.6 billion), from the very high level of these deposits at end-March 2009, when they had registered an increase by 14.8% yoy. Despite the small fall, sight and time deposits reached 98% of total M3, while M3 reached 101.9% of GDP at end-December 2009, from 98.3% of GDP at end-December 2008 and 90.8% of GDP at end December 2007. Nevertheless, during 2009 and in early 2010 the Greek banks continue using ECB funding (using as collateral securitized loans and government bonds) for the financing mainly of profitable liquid investments. The banks have been negatively affected by the downgrades suffered by the

Greek State and are very much aware of the problems arising currently from the extensive disturbances in the GGBs market. The ECB has come forward declaring that it will continue accepting as collateral for bank financing GGBs, independently of their credit rating, supporting both the Greek GGBs market and the Greek banks. Also, the ECB maintains intact the ability of banks for unlimited 3-month financing at variable rate tender procedures. Moreover, to assist the banks in the present difficult times the Government has extended the € 28 billion banking assistance package (of which the banks had used only € 11 billion until the end of 2009) in order to provide additional liquidity to the banks of the order of € 17 billion. Finally, the Government and the Bank of Greece are in the process of putting in place a new fund dictated by the IMF agreement in order to preserve a sound level of bank equity capital and the proper financing of the economy.

Concerning credit risk the banks are facing the problem of increasing NPLs in an economy experiencing negative growth conditions and an unfavorable external economic environment. As a result NPLs increased to 7.7% of total loans at the end of December 2009, from 5.0% at end December 2008. NPLs for mortgage loans have reached 7.7%, for consumer loans 13.4% and for business loans 6.7%. Nevertheless, bank credit growth stabilized to 3.5% on a yearly basis at end March 2010, from 3.9% at end February 2010 and 4.2% at end December 2009. Taking into account the negative effect on the financial market arising from the crisis in the GGBs market, we can not assume a recovery of bank credit is rather unlikely until the end of 2010. Overall, the Greek banks are still well placed to withstand any problems that may arise from the GGBs market, while their liquidity and capital adequacy position remain satisfactory. They also press for an essential rationalization of Greek state finances, in order to be able again to press ahead with a more appropriate financing of the Greek business and household sectors.

GDP GROWTH DEVELOPMENTS AND PROSPECTS: Uncertainties and risks concerning economic growth in Greece in 2010 and 2011 remain high. Despite the substantial improvement in the international economic environment and financial system since Q3 2009, the need to substantially improve public finances implies a much lower public and private consumption growth in 2010 and the following years, which may offset the expected increase in exports and other improvements elsewhere. As a result, GDP growth in 2010 is expected to be negative at -3.5%, following a -2.3% negative growth in Q1 2010 and a -2.0% growth in 2009. The above projection takes into account the observed so far delays in the implementation of the investment program assigned for 2010 and the fact that business and consumer confidence remain at very low levels until May 2010. A GDP fall by -3.5% is primarily the result of private consumption falling by a further -4.5% in 2010, following the decline by -1.8% in 2009, and investment falling by another -6.8%, on top of the -13.9% fall in 2009. Net exports' contribution to growth is set at 3.6 percentage points vs. the 0.7 pps contribution in 2009, as the goods and services deficit will continue to improve.

More specifically, **private consumption registered a fall of -1.8% in 2009,** from an increase of 2.3% in 2008. This fall took place despite the substantial increase of gross disposable income of the private sector by more than 5.1% (3.9% in real terms). As a result, in 2009 Greece registered a surge of the gross saving rate of the private sector to levels above 17.5%, from 12.9% in 2008. It should be noted hear that the wage bill of the Central government registered an increase of 11.5% in 2009 and the same or even higher increases occurred in the broader public sector, affecting overall more than 1.5 million employees, while in the private sector effective wage increases may have been contained. Also, in the labour market employment fell in 2009 by -1.1%, less than expected, with an increase in the unemployment rate to 9.4%, from 7.6% in 2008. However, this increase in the unemployment rate was also due to the increase in the labour force by about 50 thousand people. Therefore, the substantial deceleration of growth of private consumption in 2008 and its actual fall in 2009 is mainly due to the negative impact of weak consumer sentiment, which led to a substantial increase of precautionary household savings. ***Assuming a -7.7% real disposable income growth in 2010, but (1) with an estimated improved consumer sentiment (from Q3 2010), (2) with current developments in Jan.-February 2010 indicating a positive growth in the volume of retail sales and (3) a zero (or negative) consumer credit growth in 2010,*** we are projecting a -4.5% real private consumption growth in the current year, following its -1.8% fall in 2009. Moreover, real private consumption growth will remain negative to the order of -3.2% in 2011, with ***the gross saving rate*** increasing again to 17.0% in the following year from its fall to 14.9% in 2010.

Growth in government consumption reached 9.6% in 2009, from 0.6% in 2008 and 7.7% in 2007. For 2010, fiscal adjustment entails that government consumption growth will be substantially negative, of about -10.0% in real terms, due to the measures already announced to cut public spending. Moreover, government consumption growth will remain negative in 2011 and in 2012, falling at annual rates of about -5.0% and -4.0% respectively, as the fiscal adjustment effort will continue unabated until the deficit falls bellow the 2.8% of GDP in the year 2012. This will constitute a substantial withdrawal of the public sector from the economy, allowing more room for the private sector to participate more actively in offering various categories of goods and services.

Total fixed investment is now estimated to have fallen substantially by -13.9% in 2009, from -7.4 in 2008 and an increase of 4.9% in 2007. Under the current economic conditions, we are projecting an additional negative growth of fixed investment of -6.8% for 2010. This will be mainly due to the following developments:

(1) To ***the estimated new fall of housing investment in the current year*** by -19.5%, from -22% in 2009, -29.1% in 2008 and -7.5% in 2007. ***The Greek housing sector*** is in the midst of a substantial slowdown in 2007-2010.

This was initially in response to the extraordinarily high level of residential investment in 2006, following a tax related building permits explosion in 2005. However, in 2009 this sector has been negatively affected by the international economic crisis, while from October 2009 onwards it has been affected by Greece's own debt crisis. Therefore, residential investment has fallen substantially in 2009 and it is expected to fall again in 2010. ***Housing price inflation*** had also slowed down to around 1.7% in 2008, from 5.1% in 2007 and 12.4% in 2006, and has now turned negative, falling by –3.4% in 2009. In fact the fall in the Athens area reached -4.6% (Q1 2009: -4.3% yoy, Q2 2009: -4.7% yoy, Q3 2009: -5.2% yoy and Q4 2009: -4.1% yoy). Finally, in Q1 2010 the falling trend decelerated to -2.0% yoy. On the other hand, the abrupt fall in residential investment in 2007-2010 imply that, despite the fall in demand for houses, excess supply in the market does not increase. Moreover, Greece's status as a favoured tourist destination, in combination with its increasing attractiveness as a destination for the establishment of summer homes for European citizens, may enable both tourism and the housing sector in Greece to benefit from the expected recovery of the European economies in 2010 onwards.

Greek GDP developments 2008-2013						
	%Δ'08	%Δ'09	%Δ'10	%Δ'11	%Δ'12	%Δ'13
Final Consumption	2,0%	0,3%	-5,6%	-3,5%	0,5%	1,4%
Private Consumption	2,3%	-1,8%	-4,5%	-3,2%	1,5%	2,1%
Government Consumption	0,6%	9,6%	-10,0%	-5,0%	-4,0%	-2,0%
Investment	-7,4%	-13,9%	-6,8%	2,6%	6,8%	9,1%
Housing	-29,1%	-22,0%	-19,5%	4,0%	9,5%	10,2%
Other Construction	2,2%	1,8%	1,0%	3,0%	7,5%	11,5%
Equipment	6,3%	-15,9%	-4,5%	2,0%	5,5%	7,6%
Other investment	-14,6%	-3,0%	1,0%	1,0%	4,5%	8,3%
Chnange in stocks and Stat. descrepances	147,3%	-2,3%	-45,5%	-44,4%	-9,1%	-10,0%
Final domestic demand	1,0%	-2,5%	-6,4%	-2,9%	1,6%	2,8%
Exports of goods and services	4,0%	-18,1%	1,0%	3,0%	4,1%	5,1%
Imports of goods and services	0,2%	-14,1%	-10,9%	-3,5%	2,8%	4,0%
External balance	-6,7%	-6,0%	-32,3%	-21,0%	-1,8%	-0,1%
GDP, 2000 prices	2,0%	-2,0%	-3,5%	-1,5%	1,8%	2,9%
GDP components as % of GDP						
Final Consumption % of GDP	88,8	90,9	89,0	87,1	85,5	84,2
Private consumption % of GDP	72,8	73,0	72,3	71,0	70,5	69,9
Gross savings % of GDP	11,2	9,1	11,0	12,9	14,5	15,8
Investment % of GDP	21,0	18,5	17,8	18,6	19,9	21,1
Exports of goods and services % of GDP	24,0	20,1	21,0	22,0	22,4	22,8
Imports of goods and services % of GDP	35,6	31,2	28,8	28,2	28,3	28,6
External balance % of GDP	-11,6	-11,1	-7,8	-6,1	-6,0	-5,8
Change in stocks and stat. descrepances % of GDP	1,8%	1,8%	1,1%	0,6%	0,6%	0,5%
Contribution to GDP growth						
Net exports	0,85	0,69	3,60	1,64	0,11	0,01
Private consumption	1,67	-1,30	-3,29	-2,31	1,06	1,48
Government consumption	0,09	1,53	-1,79	-0,83	-0,64	-0,30
Investment	-1,71	-2,92	-1,25	0,47	1,29	1,81
Housing investment	-2,35	-1,23	-0,87	0,15	0,38	0,44
Chnange in stocks and Stat. descrepances	1,11	-0,04	-0,83	-0,46	-0,06	-0,06
GDP, 2000 prices	*2,0*	*-2,0*	*-3,5*	*-1,5*	*1,8*	*2,9*

(2) To the expected increase by 1.0% of other construction investment which is co-financed by the Community Support Framework 2007-2013 (CSF IV). This investment category registered positive growth in the previous years, 1.8% in 2009 and 2.2% in 2008 and it is expected that its rate of growth will be positive in 2010 and that it would accelerate from 2011 onwards. The absorption of EU funds by the government and the private sector was unexpectedly low in 2009 (€ 2.0 billion, from planned absorption of € 3.7 billion), despite the fact that funds more than € 9.0 billion were to be absorbed from the EU during 2009-2010. For 2010, the absorption of CSF IV funds is expected to exceed the 15% of the total (€ 24 billion), from a mere 3.0% of the total until the end of 2009. However, substantial delays continue to characterize government activity in this sector, at least in the first five months of 2010. On the other hand, ***the general government investment is now expected to fall by about -2.0% in 2010,*** following its fall by -2.0% in 2009 and by -0.1% fall in 2008. This will be mainly due to the expected fall in spending under the Public Investment Budget (PIB) by -3.0% in real terms, following its -2.8% fall in 2009 and its increase by 9.3% in 2008. For 2010, PIB expenditure has been already cut by € 1.0 billion from its budgeted level in the MOU with the IMF. The projected new fall of the general government investment in 2010 is also due to the expected new delays in the absorption of funds awarded to Greece from EU structural funds. Overall, a more dynamic growth of other construction investment is expected from 2011 onwards, as Greece has to absorb more than € 16 billion of EU funds in the period 2010-2013.

(3) To the expected new fall by -4.5% of investment in equipment, following its fall by -15.9% in 2009 and its increase by 6.3% in 2008. In fact it is now evident that various categories of investment projects were delayed or postponed in 2009 on the back of the unprecedented uncertainty due to the global economic and financial crisis and the domestic political turmoil. In particular IOBE research has shown that manufacturing sector investment may have fallen as much as -40% in 2009. Moreover, the delays and postponements of most of these projects are set to continue in 2010 as well on the back also of the extensive uncertainty created by the domestic fiscal debacle. For example, it appears that zero activity is taking place currently in the field of Public Private Partnerships (PPP). In the previous years the government has attempted to implement most of the public sector investment projects through PPPs, thus justifying the aforementioned fall in general government investment. Following a relatively long gestation period, a number of important infrastructure projects (budgeted at € 5.7 billion) were awarded to consortia of construction companies (domestic and foreign) in 2007 and 2008 and had been planned to be implemented mainly in 2009 and in the following years. However, the implementations of these PPP projects have not taken place in 2008 and in 2009. In this later period, the government has only accelerated the implementation of projects financed through the public investment budget, but none of the PPP projects have yet entered the implementation phase. This inactivity looks to continue in 2010 as well. ***Business investments*** were also expected to be boosted by the expansion of project development via PPPs on the one hand and by the large number of investment projects approved under the investment incentives law (3299/2004) in the period 2005-2008 on the other. About 6,543 projects were submitted, of which 4,300 were approved in H1 2009. Total budgeted value of investment in these projects reached € 8.9 billion, in which a government subsidy of € 3.7 billion was included. Most of these investment projects were to be implemented and completed in the period 2008-2009,

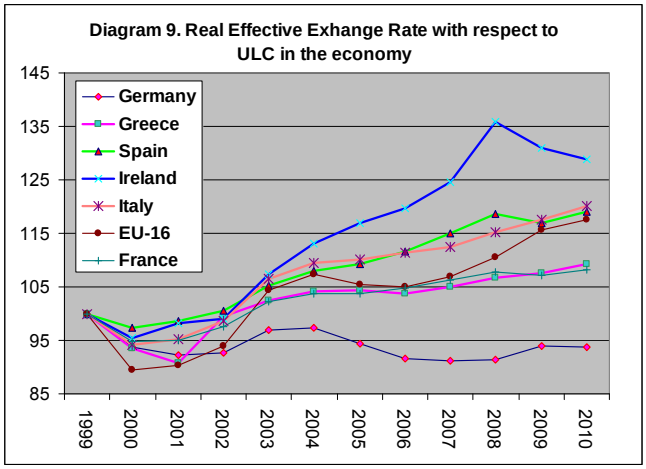
but, due to the international turmoil, may have been postponed to a great extent for implementation in 2010. The government is arguing that the implementation of most of these investments is indeed taking place, as the relevant government contribution has already been paid for many important projects. However, government activity should be intensified in this area as well.

The above assumptions concerning final consumption and fixed investment, with the assumption of a fall in stocks by an estimated -45.5% in 2010, imply that **the overall domestic demand will register a negative growth of -6.4% in 2009,** contributing to a sizable improvement of the external goods and services deficit (national accounts basis) to 7.8% of GDP in 2010 from 11.1% of GDP in 2009 and 11.6% of GDP in 2008.

The domestic demand slowdown in 2010 will be reflected mainly **in total imports of goods and services,** which are expected to register a -10.9% fall in 2010, following their fall by -14.1% in 2009 (when the fall in domestic demand was a mere -2.5%). On the other hand, **exports of goods and services** are expected to recover slightly, by 1.0% ın 2010 on the back of the recovery of the European economies and in particular the economies of SE Europe, as well as of the recovery of the volume of the international trade (2010: +7.0%, 2009: -10.7%) affecting Greek shipping. On these grounds, overall, net exports are expected to have a substantial positive effect on GDP growth of 3.6pps in 2010, from 0.7pps in 2009 and are expected to continue exerting a positive effect on Greek GDP growth of 1.6pps in 2011.

COMPETITIVENESS: From 2010 onwards the international competitiveness of the country will be improving following a negative growth of its domestic unit labour cost, in combination with the substantial devaluation of the effective exchange rate of the Euro for Greece. This will exert a substantial positive effect on growth from 2011 onwards vie the private sector. More specifically:

Greece's GDP growth and domestic employment have been negatively affected by the continuing high growth of domestic unit labour costs, which is contributing to a gradual erosion of its international cost competitiveness (against the 36 countries included in the basket used by the European Commission). In fact, recent (revised) data from the European Commission (Diagram 9.) show that Greece's ULC-based real effective exchange rate (REER) against the above 36-countries had appreciated at the end of 2009 by 7.6%, compared with 1999. This deterioration of Greek competitiveness, however, is much less than the appreciation in the case of Ireland, Spain, Portugal and other Eurozone countries. Therefore, although a case can be made concerning Greek international competitiveness against most emerging economies and especially China and other countries of SE Asia, the case of deteriorating Greece's international competitiveness within the Eurozone does not stand.



Moreover, according to the latest report by the European commission (European Economic Forecast, Spring 2010) the Greek REERULC appreciation reached the -0.6% in 2006, 1.3% in 2007, 1.5% in 2008 and 3.9% in 2009, compared with -0.4%, 1.6%, 3.4% and 4.7% respectively in the Euro area. Therefore, Greek international competitiveness in 2006-2009 has actually improved against the Eurozone average, while it has worsened with respect to Germany (a country in which the average annual growth of nominal compensation of employees per head in the period 2001-2009 did not exceed the 1.4%) and with respect to countries which are experiencing exchange rate depreciation with respect to the Euro. Overall, the challenge for Greece to reign in domestic wage growth is now accepted by economic makers and constitutes one of the central pillars of the process of fiscal adjustment in the Greek government –IMF-European Commission- ECB MOU.

In any event, Greece is a very small economy and can regain its growth dynamics through exports of goods and services (tourism, shipping and other services) in a world economy which is entering a robust growth path. In the period of fiscal adjustment, Greece's REERULC will turn downwards, while at the same time Germany's and other developed country's REERULC will turn gradually upwards. Greece will become more competitive and more export oriented. This way it can again have positive growth from 2012 onwards. At the same time Germany's growth in the following years can only be based on its success to boost domestic demand. Imports from Germany by Greece, Spain, Portugal, and Italy will actually assume a negative annual growth from 2010 onwards. For example, Greek payments for imports of cars fell to € 3.3 billion in 2009 from € 5.2 billion in 2008. Moreover, payments for car imports in 2010 are expected to fall to € 2.2 billion (€ 3.0 billion less than in 2008). Similar trends are expected from other Mediterranean countries following fiscal adjustment programs.

Overall, on the basis of Diagram 5 and the evolution of competitiveness indicators in the period 2006-2009, it is more than evident that the various recent reports by international economists pointing out, among others, Greece's loss of international competitiveness in

recent years as one of the main causes of its over indebtedness have been misleading to say the least.

THE IMPLEMENTATION OF THE 2010 BUDGET: The implementation of the 2010 Budget during January – April 2010 reflects the strong possibility that targets for fiscal adjustment set by the Greek government –IMF-European Commission- ECB MOU for 2010 may be easily surpassed. The main developments are the following:

(a) The increase in net current revenues by 10.0% to € 15.3 billion, compared with a -0.4% increase of these revenues to € 14.5 billion in January-April 2009 and a targeted increase of 11.7% for the year as a whole. This outcome is satisfactory if one takes into account the following: (1) The base effects will be much stronger in the remainder of the year, as for 2009 as a whole the fall in net current revenues reached -7.9%. (2) The functioning of the tax administration in the first 4-months of 2010 was still problematic. In fact, the revenues from taxes verified in previous years and from overdue tax liabilities were 40% lower in the first 4-months of 2010. The tax administration has now started functioning in fool speed and is getting help by the relevant provisions of the new tax bill in its efforts to combat tax evasion and fraud. Therefore, the collection of tax revenues verified in previous years is expected to exceed in 2010 their level in 2009. (3) The basic measures for net current revenue boost instituted in 2010 were not in application until April 2010. For example, direct income tax was -6.0% lower in the 4-months of 2010, but the new tax bill and the broadening of the tax base is applicable from May 2010. Moreover, revenues from VAT registered a small 0.3% increase in the 4-months of 2010 but the 4 pps hike in VAT rates applies mainly from May 2010. (4) No revenues have been recorded yet from the new property taxes, but revenues from this source for the year as a whole will exceed € 1.0 billion. Overall, net current tax revenues growth in 2010 are now expected to exceed the 11.7% projected by the Stability and Growth program 2010-2013 (SGP)

(b) Current primary expenditure reached € 16.9 billion in January-April 2009, down by -8.6% yoy, following its increase by 15.5% in January-April 2009 and a projected fall in the SGP by -4.4%. This is again a satisfactory development, while ***current primary expenditure is expected to fall at a higher rate in the following months of 2010,*** as in these months will fall the recent additional cut by € 2.95 billion of the general government wage bill due to the substantial reduction of the Easter, summer and Christmas bonuses and allowances of the public sector employees and pensioners and the additional cut of highest pensions. Also in the following 8 months will fall most of the cut of intermediate consumption, estimated at € 0.7 billion.

(c) Interest payments in January – April 2010 reached € 3.34 billion, and it was less than the € 3.5 billion paid in Jan.-April 2001. Taking into account the lower cost of the Eurozone – IMF financial package for Greece applicable in May-December 2010, it is now expected that total interest payments for 2010 will not exceed the € 13.1 billion, compared with € 12.95 projected in the SGP.

(d) In the Public Investment Budget (PIB), expenditure reached € 2.3 billion in Jan.-April 2010, down from the € 3.79 billion absorbed in Jan.-Apr. 2009. For the year 2010 as a whole PIB expenditure has now been cut by € 1.0 billion from the budgeted level, expected now to reach the level of € 9.3 billion. On the other hand, PIB revenues reached € 0.3 billion in Jan.-April 2010, down from € 0.5 billion in Jan.-April 2009. It is projected that PIB revenue will reach at the end the targeted level of € 3.86 billion.

The above developments indicate that the implementation of the B2010 in the period Jan.-April 2010 is satisfactory and much within the targets set by the Greek government-European Commission-ECB-IMF MOU.

INFLATION: Inflation in Greece reached 4.8% in April and is expected to exceed 5.5% in May. This is of course mainly due to the fact that fiscal adjustment in Greece is set to take place to a great extent through VAT and excise taxes increases, as well as through the hike of prices of services offered by deficit ridden public sector organizations (e.g. local government) and entities. Therefore, inflation surged in 2010 and is expected to remain rather positive in 2011 as well, despite the expected substantial fall of domestic demand. Moreover, as we have explained in the case of passenger cars the fall in domestic demand is mainly reflected to a substantial fall in imports and increase in exports. Greece is a price taker in the international markets for tradable goods (65% of the total) and it faces higher government determined prices (another 20% of the total). The remaining 15% of non tradable prices may fall some time in the future, if domestic demand will not recover timely. But inflation is determined mainly by the 85%. Therefore, ***average inflation for 2010 is now expected at 3.8% and 1.2% in 2011***. For inflation in 2011 to fall to a substantially lower level, will require that (1) the international price of oil fall to below $ 50 p/b, (2) the weather for agricultural products to remain as favourable in 2011 as it was in 2010 and (3) the Euro appreciate to above 1.4 USD/EUR, which is rather unlikely given the recent substantial depreciation and the belief in the markets that the Euro will fall to 1.0 USD/EUR by the end of 2011.

BALANCE OF PAYMENTS: ***The current account deficit (CAD),*** which includes net capital transfers, ***surged in Q1 2010 by 44.0% yoy,*** reaching € 9.82 billion or 4.1% of GDP, from € 6.82 billion or 2.9% of GDP in Q1 2009. This Development was mainly due to the higher payments for imports of fuels (€ 0.99 billion) and the substantial fall on income and capital transfers from the EU by € 2.3 billion. Nevertheless, the fall of imports of goods excluding fuels and ships was minor, -6.5% yoy in Q1 2010, with a bigger fall by -9.3% of exports of goods excluding ships and fuels. In the remainder of the year, it is expected an even higher fall in imports and a much lower fall of exports.

In the services balance of particular importance is the recovery of revenues from international shipping by 7.9% yoy and the small fall by -1.5% of revenues from the international tourism.

In the capital account, we note the important inflow of FDI by foreign residents to Greece, of € 1.06 billion ***in Q1 2010,*** from € 0.24 billion in Q1 2009. Moreover, net capital inflow for portfolio investment fell to € 1.3 billion in Q1 2010, from € 9.0 billion in Q1 2009, while there was also net inflow from domestic residents from liquidation of portfolio investments abroad of the order of € 3.5 billion in Q1 2010, from inflow of € 6.2 billion in Q1 2009.

Table 4. Greek Balance of Payments (€ Billions)

	2007	2008	2009	Jan.-Mar.2009	Jan.-Mar. 2010
Trade Balance (TB)	-41,50	-44,05	-30,76	-7,71	-8,28
Exports	17,45	19,81	15,32	3,66	3,51
Imports	-58,94	-63,86	46,08	11,37	1,79
Services Balance	16,59	17,14	12,57	1,22	1,13
Tourism Receipts	11,32	11,66	10,37	0,49	0,48
Shipping Receipts	16,94	19,19	13,55	3,41	3,68
Income Balance	-9,29	-10,64	-9,80	-2,19	-2,11
Payment of Interest, Divid. & Profits	-13,51	-15,81	-13,52	3,29	2,98
Transfers' Balance	5,92	6,85	3,31	1,86	-0,56
Current Account (CA)	-28,27	-30,71	-24,69	-6,82	-9,82
CA (% of GDP)	-12,4%	-12,8%	-10,4%	-2,87%	-4,11%
Capital Account	27,89	29,94	24,56	6,86	9,49

Source: Bank of Greece

Balance of Payments in 2009: The current account deficit (CAD), which includes net capital transfers, fell in 2009 by -19.6%, reaching € 24.7 billion or 10.4% of GDP, from 12.8% of GDP in 2008. Developments in the Greek BoP in 2009 reveal the effect of the fall of domestic demand due to the international economic crisis, as well as the fall in exports of goods and services.

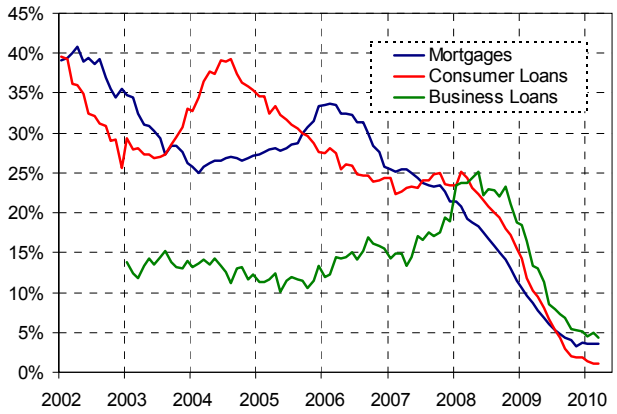
Of particular importance was the substantial fall of the deficit of the trade balance by -30.2% as a result of the fall of exports of goods by -22.7% and the even higher fall of imports of goods by -27.9%. In fact, payments for imports of fuels were € 5.75 billion lower than in 2008. Also, payments for imports of goods excluding fuels and ships were lower by € 9.9 billion, while the corresponding fall in exports excluding fuels and ships did not exceed the € 2.49 billion.

A second important development was the fall by -26.7% of the surplus of the balance of services, as a result of the fall by -10.9% of earnings from external tourism, as well as the fall by -34.4% of net receipts from international shipping. Payments for services imports were also lower by -15.0%. Thirdly, the deficit of incomes balance was lower in 2009 on a yearly basis, mainly due to the fall of payments for interest, dividends and profits to foreign investors in Greek financial assets (government bonds and shares) by -14.5%, from a 17.0% increase in 2008. Finally, the surplus of the balance of current and capital transfers was substantially lower on a yearly basis in 2009, by € 3.5 billion, constraining an even bigger fall of the current account deficit.

In ***the capital account,*** net capital inflows fell to € 24.5 billion in 2009, from € 29.9 billion in 2008. ***Net capital inflow through foreign direct investment (FDI)*** reached € 1.0 billion from € 1.42 billion in 2008. This was mainly due to higher FDI by foreign firms in Greece of € 2.42 billion (2008: € 3.07 billion), as well as to the substantial fall of FDI by Greek firms abroad to € 1.3 billion (2008: € 1.65 billion). ***Net Capital outflows for portfolio investment abroad by Greek residents*** revived in the last months, resulting in a net outflow of € 4.5 billion in 2009. On the other hand the year 2009 witnessed a substantial increase of net capital inflows from foreign residents for portfolio investment in Greece to € 31.6 billion, from € 16.7 billion in 2008. Finally, there was a net outflow of other investments (primarily bank borrowing and lending) of € 3.6 billion in 2009, from a substantial net inflow of € 12.1 billion in 2008. This net outflow comprises an inflow of € 20,2 billion from foreign banks to Greek banks and an outflow of € 23.9 billion from Greek banks to banks outside Greece.

MONEY & FINANCIAL MARKETS: Credit expansion to businesses and households decelerated further to 3.5% in March 2010, from 4.2% at end- Dec.'2009, 7.6% at end-June 2009 and 10.8% at end-March. In particular, mortgage and consumer lending growth reached 3.5% and 1.1% respectively at end March 2010, from 3.7% and 1.8% respectively at end-Dec.'2009, from 4.4% and 2.9% respectively at end September, 6.0% and 6.6% at end June 2009 and 11.5% and 13.7% at end-December 2008. Loans to domestic households reached 50.3% of GDP in end-March 2010 (49.9% of GDP in end Dec 2009), compared to 64.4% of GDP in the Eurozone in end-March 2010.

Diagram 6. Credit Expansion

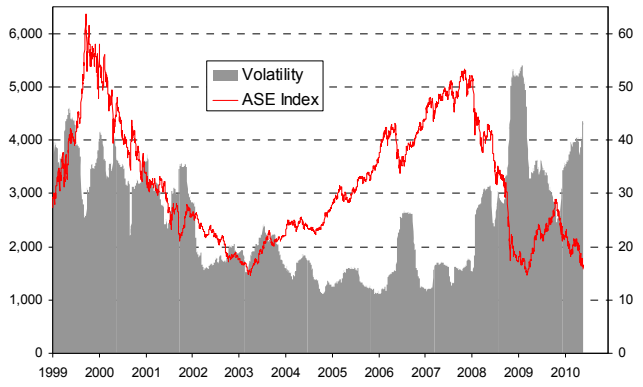


Moreover, lending growth to businesses decelerated to 4.3% at end March 2010, from 5.1% at end-Dec.'2009, from 6.2% at end-September 2009, 8.8% y/y at end June 2009, and 18.7% at end-Dec.'2008. Overall, credit expansion to the private sector is expected to decelerate further to -1.5% by year-end 2010, which is in line with an expected nominal GDP decline of about 2.5%. The substantial improvement of the international economic environment from Q3 2009 onwards and in particular of the main financial markets will not lead in 2010 to an eventual revival of the demand for credit by the private sector, as domestic demand is expected to remain

subdued. The problems of liquidity and capital adequacy structures that banks face will accelerate in following months, given the expected low pace of activity in the Greek economy.

By the end of April 2010, the main ASE composite index was down -9.0% on a yoy basis (FTSE-20 stocks: -12.2%, mid-cap FTSE-40: -11.6% and small caps FTSE-80: -27.7%), from 22.9% at end-2009. Following these developments, at the end of April 2010 50.35% of the total stock exchange value of listed firms was in the hands of foreign investors (€ 36,220 billion), up from 48.5% at end 2009 (€ 40,7 billion).

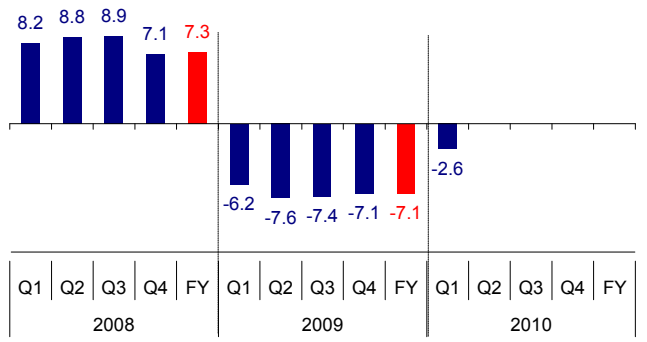
Athens Stock Exchange



2. Romania

Economic Overview: Following a sharp decline in 2009, Q1 2010 GDP growth remains negative though the pace of decline is less severe. However, the pace of economic recovery will depend on the progress in implementing the reform measures attached to the IMF loan program, and on the pace of economic recovery in Romania's trading partners, in particularly other EU countries. A wider issue is the ability of the economy to develop a model of economic development that is more export oriented and less reliant on private consumption which has tended to exacerbate current account and budgetary imbalances.

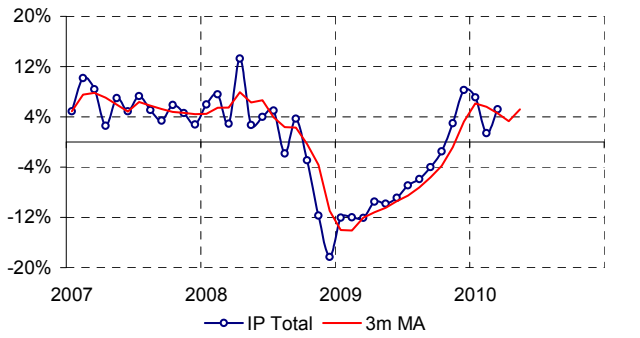
Real GDP (%Δ YoY)



GDP growth contracted by -7.1% in 2009, led by sharp declines in private consumption (-10.5%) and investment (-25.3%). In the last quarter of 2009 the yoy decline in private consumption decelerated to -3.5% and investment actually grew by 3%. Public consumption retained a small but positive rate of growth, apart from Q3, growing by 0.7% for the year as a whole. External trade balance provided a significant positive contribution to GDP growth as the trade deficit declined by almost -40%, following a steep decline of -20.6% in imports and a much weaker decline in exports of -5.0%.

On the supply side, industrial production fell by around -5% in 2009 though it returned to positive territory in the last two months of the year due to base effects as well as a pick up in external demand. Construction was especially hard hit and registered a fall in gross value-added by almost -14% in 2009. The services sector was also severely affected by the contraction in private consumption with a decline in value-added of -7.9% in 2009. Wholesale and retail trade was the worst affected with a decline of -11.2%. After a drop of around -10% in the first half of 2009 (value-added), the agricultural sector grew by almost 2%.

Industrial Production - (%Δ YoY)



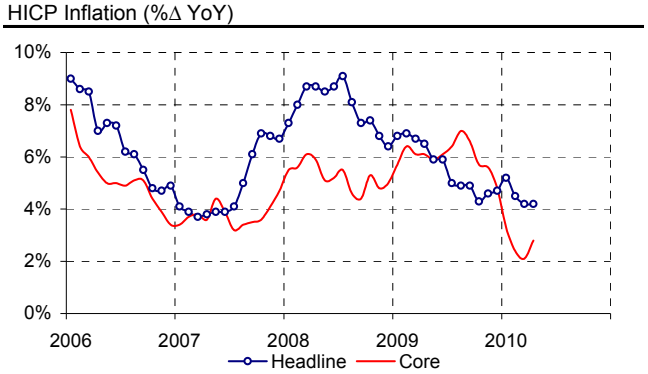
In Q1 of 2010 GDP declined by -2.6% yoy (from -6.5% in Q4 2009). It is expected that the external sector was the biggest contributor to this slowdown of the recession. The index of industrial production increased by 6.6% yoy in March 2010 pointing to continued improvements in the coming months. In 2010 construction works continued to drop by more than -20% on an annual basis into March.

The IMF recently revised its estimate on GDP growth for 2010 to between 0% and negative growth of -0.5% from 1.3%. On the other hand, the European Commission revised its own forecast upwards to 0.8% growth in 2010 from an earlier forecast of 0.5%.

Fiscal policy: Fiscal policy reform is at the heart of the economic conditions attached to the IMF loan accord of € 20 billion that was agreed with the authorities in March 2009 (total disbursement so far amounts to almost € 12 billion). The government has committed to overhauling the pension system, reducing the public sector wage bill, and enforcing new legislation on fiscal responsibility. A key quantitative goal is the reduction of the general government deficit from 7.2% of GDP in 2009 to 6.8% of GDP in 2010 (recently revised upwards from 5.9% of GDP). It is to be reminded that following its re-election the government enjoys only a very fragile majority which raises potential obstacles in pushing through tough measures. The implementation of the 2010 budget is

touch and go. In Q1 of 2010 the budget deficit was RON 8.22 billion (1.5% of GDP) only marginally below the target of RON 8.25 billion. The public revenues declined by -1.4% yoy in Q1 (instead of the small increase envisioned in the budget) and the public expenditure by -0.5%, including a decrease of -8.7% of expenditure on public sector wages. One concern is that accumulated government arrears will increase public expenditure in the months ahead, resulting in a widening of the deficit. Following the completion of the fourth review of the economy in the context of the loan with the IMF, the government has agreed to take additional cost-cutting measures to counter dwindling public revenues, including a -25% cut of the public sector wage bill and a -15% cut of public pensions, effective June 2010. The IMF and the EU will release a combined € 2.02 billion euros in the context of the multilateral loan but only after progress is observed in terms of policy implementation. It is to be reminded that the state payroll absorbs 9% of GDP per year, which is very high in comparative terms.

HICP Inflation (%Δ YoY)



INFLATION: The contraction in private consumption and economic activity led to an unwinding of inflationary pressures. The consumer price index (CPI) increased by 5.6% in 2009 against an increase of 7.9% in 2008. By April 2010 the annual increase in the CPI had decelerated to 4.28% mainly because of trends in food prices. Reduced volatility in the foreign exchange market also contributed to this trend. The central bank is targeting an inflation rate of 3.7% by end of 2010 and 2.8% by end of 2011 (plus/minus 1%). The lowest point of annual increase in the CPI was March 2010 at 4.2%.

BALANCE OF PAYMENTS: The economic slowdown affected domestic demand resulting in a sharp fall in imports. Exports also fell but from a lower base and also by much less, and so the very high current-account deficit that characterised the economy until 2008 fell to just -4.4% of GDP in 2009 after declining by -68%. These developments are mirrored in the capital and financial account where the surplus fell by -65.5% in 2009 to € 6.1 billion, including a fall in foreign direct investment (FDI) by -53%, in other capital investment (inter-bank loans, etc.) by -79% and portfolio investment by -191%.

In Q1 of 2010 the deficit in the current-account was increased to € 1.5 billion from some € 910 million in Q1 of 2009 despite the trade deficit decreasing by 10.5% yoy in Q1 2010. This development reflected the sharp drop in the surplus of current transfers, which are comprised mostly of remittances of Romanians leaving abroad, to € 454 million in Q1 2010 from € 1.2 billion a year ago. In Q1 2010 both exports and imports registered annual increases of 11.4% and 7.8% respectively. The inflow of FDI declined to € 754 million in Q1 2010 and covered just over 50% of the current account deficit down from € 1.5 billion in Q1 2009 and a coverage ratio over 160%.

As the economy moves further away from the peak of the crisis private consumption and investment will gain some momentum. As a result, imports are forecast to pick up somewhat in the coming quarters. Accordingly, the current account deficit is projected to increase to between -5% and 6% of GDP in 2011.

EXTERNAL DEBT: Gross external debt increased in 2009, albeit at a slower pace than in previous years (by 8.7% in 2009 as against 23.4% and 42.3% respectively in 2008 and 2007). In absolute terms, gross external debt increased by € 6.3 billion to € 78.7 billion in 2009. Long-term external debt increased by 28% whereas short-term debt decreased by -35.6%, reflecting on the one hand the influx of finance from the IMF loan accord and on the other the outflow of capital in the context of the global liquidity squeeze. The disbursement of money from the IMF loans increased the external debt of the monetary authority to € 5.8 billion at the end of 2009 from € 303 million at the end of 2008. The total external debt of banks declined by -13.8% in 2009 to € 21.5 billion. Direct investment and inter-company lending continued to increase (by 12.5% in 2009 to € 16.4 billion) albeit at a lower pace compared to previous years.

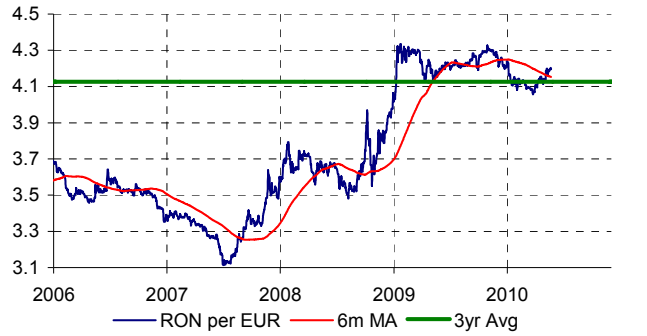
In response to the increased demands for social spending and the implications of declining revenues in the context of the economic contraction, the general government accumulated debt, increasing its liabilities by 32.8% in 2009 as against 6.5% in 2008 and negative rates in 2007 and 2006. These trends continued in the first two months of 2010. At the end of February 2010 82.3% of total external debt was medium- and long- term and 17.7% was short- term.

MONEY & FINANCIAL MARKETS: It is to be reminded that the Leu had lost over 24% of its value against the Euro in the period between August 2008 and January 2009. It has since fluctuated around RON/EUR 4.2. More recently (since late March 2010) the general tendency is towards Leu depreciation. The deceleration of inflation and the relative stability of the Leu since March 2009 enabled the National Bank of Romania to undertake a series of policy rate cuts. The basic rate was reduced from 8% in December 2009 to 6.25% in April 2010. The Central Bank's foreign exchange reserves stood at € 32.4 billion end of April 2010, from € 28.3 billion in December 2009, and € 26.2 billion in December 2008.

(Data reported in Euros). Following the global credit squeeze, credit expansion to the private sector decelerated rapidly. From yearly growth rates as high as 65% in 2007, credits to the private sector turned negative in June 2009, reaching a low of -11.2% yoy in October 2009. In the first three months of 2010 there was again positive yearly growth in credits to the private sector. In March 2010 credit expansion to the private sector grew by 2.1% in yearly terms, though the growth of consumer credit remained negative. Deposits have also started to pick up pace, growing by 12.5% yoy in March 2010.

The deterioration in quality of the assets of the banking sector evidences the effects of the recession. The share of non performing loans (past due 91 days and over) to total loans increased to 13.4% in March 2010 from 6.5% a year ago.

Exchange Rate Developments



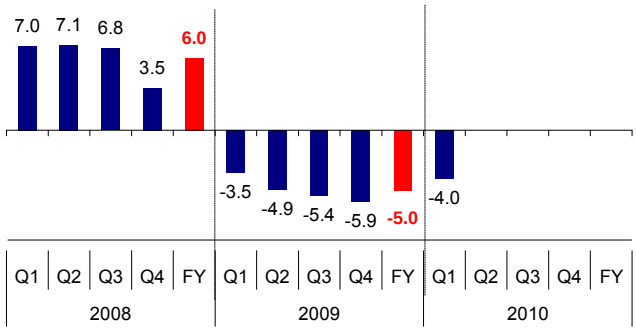
3. Bulgaria

Economic Overview: Following the shock to the economy from the world financial crisis, and under the strain of a hefty current account deficit, Bulgaria's economy went into recession in 2009. Unlike neighbouring Serbia, Romania, and Greece, Bulgaria has so far evaded asking the IMF for financial assistance. However troubles remain as evidenced by the smaller (than in 2009) yet significant fall of GDP in Q1 2010. The conjuntural indicators do not yet point to a convincing recovery in Q2 2010, whilst the fiscal position of the country – traditionally strong – has deteriorated.

GDP declined by -5.0% in 2009 (revised down from -5.1%) following a sharp contraction in domestic demand of -13%. Key drivers of economic growth in previous years, private consumption and investment, both registered declines of -6.3% and -27% respectively in 2009. The less voluminous public consumption also fell by -5.5% in 2009. These trends gathered pace as the year progressed, peaking in Q4 of 2009, when GDP fell by -5.9%.

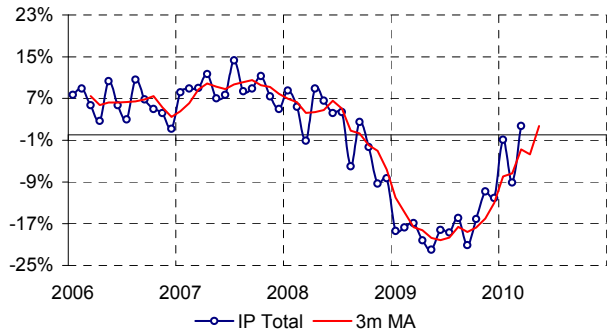
On the positive side, the fall in external demand has forced a partial redress of the imbalance in the trade account, offsetting some of the GDP decline. The trade deficit nearly halved to € 6.6 billion in 2009 (from € 12.9 billion in 2008) as imports fell by -22.3% against a -9.8% fall in exports. However, there is light at the end of the tunnel in the form of rising exports, which is why the government is considering an upward revision of the forecast for GDP growth in 2010 to 1% from 0.3% compared to the EC's forecast of zero growth and the IMF's 0.2%. Already exports grew by 0.8% yoy in Q4 2009 (imports fell by -20%) and are showing increased momentum in the first quarter of 2010.

Real GDP (%Δ YoY)



Most sectors felt the repercussions of the economic downturn. In terms of value-added, manufacturing fell by -8.3% in 2009 and construction by -7.1%. In the services-sector wholesales and retail trade fell by -6.2% in 2009, public administration remained stagnant and financial intermediation was able to hold on to positive, albeit low by historical standards, growth of 1.6%. There was also a negative contribution from agriculture and hunting where value-added fell by -3.4% in 2009.

Industrial Production - (%Δ YoY)



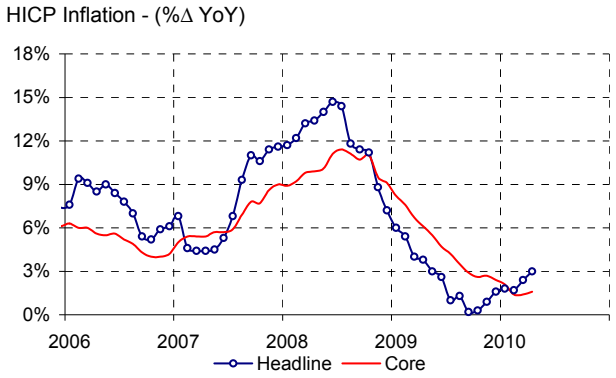
In Q1 of 2010 GDP fell by -4% yoy with declines in all sectors of the economy: agriculture (-3.4%), industry (-1.3%) and services (-2.2%). From the expenditures point of view, only net exports made a positive contribution to GDP growth, in contrast to private and public consumption and consumption of investment goods. Conjuctural indicators do point to a weak recovery in industry and in business sentiment, however construction and retail sales remain subdued. The annual change in the index of industrial production turned positive (to 1.7%) in March. The annual decline in construction works accelerated to over -30% yoy from late 2009 until February 2010 and sustained a further fall of -20% in March. In retail trade (excluding motor vehicles and

motorcycles) the annual decline of the turnover index accelerated to over -12% in both January and February 2010 and remained at a steep -11.6% in March. Still, the April 2010 composite index of business sentiment points to less depressing expectations in all sectors. Wage growth decelerated to 13.3% in 2009 from nearly 22% in 2008 and is forecast to grow by just 2.2% in 2010 according to the IMF due to weak economic recovery and fiscal adjustment.

FISCAL POLICY: A significant revision of the 2009 budget deficit to 3.9% of GDP on an accrual basis (from an initial 1.9% of GDP) revealed the extent of the deterioration in the fiscal finances, leading to a postponement of the country's application to enter ERM II which demands a deficit bellow 3% of GDP (unless some government contracts are annulled and budget arrears written off). On a cash-basis (which includes only paid expenses) the 2009 budget deficit was 0.8% of GDP. The significant difference in the estimated budget deficit according to the accrual-basis methodology stems from the inclusion, in the latter, of incurred expenses which have not yet been paid (i.e. to contractors) and which are estimated at BGN 2.1 billion. Making good on these contractual obligations is also likely to put added pressure on the general government budget in 2010.

Already in Q1 of 2010 the budget deficit rose to BGN 1.7 billion, or 2.5% of GDP, on the back of falling revenues (down by -19.2% yoy) and rising expenditures (+16.2%). The government has adopted a series of measures to prevent the budget deficit from swelling further, such as the imposition of a tax on luxury goods and deposits over BGN 100.000; the constraining of monthly salaries in the public sector at around BGN 3.200; the adoption of a 10% tax on winnings from lottery-type games; and 7% and 2% taxes on the incomes of general-insurance and life-insurance businesses respectively. The government was also considering raising VAT to as high as 25% from 20%, but abandoned this plan after public protest, opting instead for a reduction of planned public-spending by -20% with estimated savings of around BGN 900 millions. The EC projects that the authorities will just about achieve their fiscal objectives and forecasts a budget deficit of 2.8% of GDP in 2010.

The low level of general government debt as a percentage of GDP (14.8% in 2009 according to the EC), provides some assurance as regards the potential impact of what will likely be only a temporary deterioration in the public finances. The recent decline of the fiscal reserve, which the government is obliged to keep in order to support its' currency board, is of more immediate concern. The fiscal reserve stood at BGN 6.6 billion at the end of April 2010, up 3.8% on the month, but some BGN 1.7 billion less than April 2009. The government had plans to issue debt in order to raise the fiscal reserve but has revoked these plans due to unfavourable market conditions following the onset of the Greek fiscal crisis.



INFLATION: Declining domestic demand and production, and lower international commodity prices resulting from the global economic downturn, put downward pressure on incipient inflationary tendencies in 2009. A pick up in commodity prices, such as energy prices, in 2010 will act to partially reverse the deceleration of inflation. However this process will be tamed by weak wage and credit growth. Overall inflation will likely remain modest throughout 2010.

The annual growth Consumer Price Index (CPI) went below 1% from September 2009 and even turned marginally negative in October and November. The average annual growth in the CPI has since recovered to 1.8% in April of 2010.

BALANCE OF PAYMENTS: The onset of the economic recession led to a sustained drop of the current-account deficit which stood at a historically high € 8.2 billion, or 22.9% of GDP, in 2008, to € 3.2 billion or 9.6% of GDP in 2009. The fall in the current account deficit started already from Q4 in 2008 and persisted through to Q1 of 2010 when it declined to 1.4% of GDP. The dynamics in the balance of trade are driving this drop in the current account deficit. Firstly, the decline in exports has, in every quarter of 2009, been smaller than the decline in imports both in percentage and in absolute terms. Similar dynamics are observed in the services balance. Furthermore, exports made an impressive come-back, rising by 12.2% yoy in Q1 of 2010 with decelerating but still negative import growth of -5%.

In the financial account the surplus position dropped to just € 2.2 billion in 2009 from € 11.4 billion in 2008. Inflows of foreign direct investment, which had fallen from a high of € 9 billion in 2007 to € 6.7 billion in 2009, more than halved on annual basis to € 3.2 billion in 2009. Net portfolio investment continued to decline in H1 of 2009 as in 2007 and 2008 but turned marginally positive in H2 of 2009. Net inflows in the category for 'other investments' (including inter-bank loans, etc.) declined almost tenfold in 2009 despite registering positive growth on base effects in Q4 of 2009. These developments continued in

Q1 of 2010 when it is especially noticed that net FDI turned negative to -€ 41 million in Q1 of 2010 from a surplus of € 904 million a year ago.

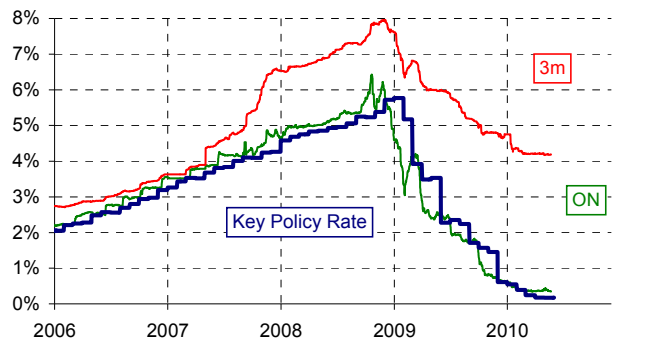
EXTERNAL DEBT & INT. RESERVES: Gross external debt staged a small decline in 2009 compared to its level in 2008 (end of period). Long-term external debt declined by -1.4% in 2009 and short-term external debt by -2.1%. All the decline is attributable to the private sector as the (long-term) external debt of the government sector increased by 4.9% in 2009 due to increased issuance to finance a growing budget deficit.

In the first two months of 2010 the decline in short-term external debt has picked up pace, reaching -5.6% at the end of February as has the increase in the external debt of the general government which reached 12.2%. As a percent of GDP, long-term external debt stood at 29.9% at the end of February and short-term external debt at 35.5%.

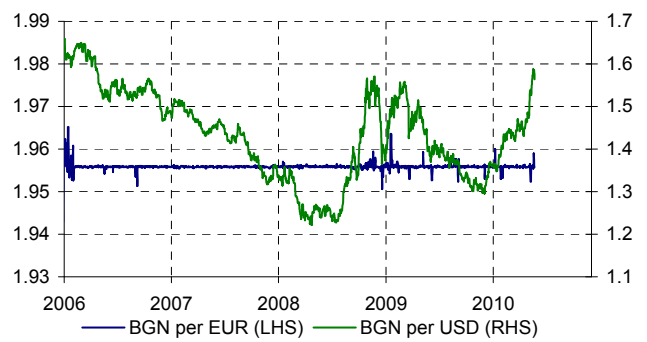
The ratio of foreign reserves with the National Bank of Bulgaria (NBB) to short-term debt was 99.3% at the end of February 2010 as against a low of 90% in May 2009. It is noted that foreign reserves with the NBB stood at € 11.9 billion on the 15th of May 2010 from € 12.4 billion end of March and € 12.9 billion end of 2009.

MONEY & FINANCIAL MARKETS: Bulgaria maintains a currency board tying the Bulgarian Lev (BGN) to the euro at a fixed exchange rate of 1.95583 BGN to 1 Euro Political commitment to the arrangement remains strong.

Interbank Market (%)



Exchange Rate Developments



The economic recession has led to a deterioration of credit quality leading Moody's to attach a negative outlook to the banking system in March 2010, despite acknowledging that profitability remains adequate and also the existence of strong capital buffers.

Bank lending has continued to slow, from 31.6% in 2008 to 3.8% yoy in 2010 and 2.6% yoy in February and also March 2010. Lending to households slowed to 4.4% yoy in March 2010 from 5.8% in December 2009. Lending to businesses slowed to 1.6% in March 2010 from 2.6% in December 2009. Deposits growth has recently picked up pace to over 10% in February and March 2010, from a low 3.7% in August 2009.

4. CYPRUS

ECONOMIC OVERVIEW: After a decade of stellar economic expansion, with average annual GDP growth of around 4.4%, Cyprus' economy hit a wall in the form of the international financial crisis. In the wake of the 2009 crisis, weak domestic demand and an adverse external environment constrained economic activity resulting in a decline in GDP growth of -1.7% y/y. Despite the boost to real wages from much lower inflation, the combination of high household indebtedness, tighter lending conditions and a worsening labour market led private consumption to register a decline of -3.0% y/y (8.4% y/y in 2008). Similarly, investment declined by -12.0% y/y (8.6% y/y in 2008) with activity in the construction sector having slowed as foreign demand for residential housing declined, corporate balance sheets were restructured and several major infrastructure projects were completed. While weaker domestic demand lead to a sharp decline in the imports of goods and services which registered negative growth of -19.8% y/y in 2009 (8.0% y/y in 2008), weak external demand led to a drop off in exports of goods and services of -11.8% y/y (-2.1% y/y in 2008).

Economic activity is expected to remain weak in 2010, with a flash estimate of Q1 GDP declining by -2.4% y/y and a full-year forecast GDP of growth of around -0.4%. Private consumption growth will remain subdued, a consequence of the worsening labour market outlook (unemployment is expected to reach 6.7% in 2010 from 3.6% in 2008) and weaker wage growth. Moreover, the combination of high household debt burden, tight financial conditions and weak consumer sentiment will act to constraint consumption even further. Likewise, investment is likely to remain weak, with foreign demand for dwellings by non-residents dependent on an economic recovery in the Eurozone. Tourism, demand for undeveloped land and construction, which were fuelled in part in recent years by the purchase of holiday homes by non-residents, especially Britons, are expected to remain weak in 2010-11. The British economy was one of the worst hit by the global financial crisis and sterling has weakened sharply against the euro, which will dampen foreign demand for real estate as well as tourist arrivals.

FISCAL POLICY: Cyprus' fiscal position underwent a significant deterioration in 2009 on the back of the economic slow-down, reversing the major improvement

achieved in preparation for membership of the euro area. Indicatively, the general government balance swung from a surplus of 0.9% of GDP in 2008 to a deficit of 6.5% in 2009 and is forecast to increase to 7.1% of GDP in 2010. Driving this reversal of fortune was a sharp rise in expenditure and a sudden drop in revenue. The increase in expenditure was due, amongst other factors, to the government's much needed response to the economic crisis with the adoption of fiscal stimulus and structural measures amounting to 1.5% of GDP. The stimulus package was addressed to construction sector (1.25% of GDP) and tourism (0.25% of GDP). Moreover, government revenue declined in tandem with the weakening of domestic demand. While the forecast deficits are clearly well above the ceiling-limit of 3% of GDP, Cyprus is one of many Eurozone members who will exceed this limit in the coming two to three years. The general government debt-to-GDP ratio is expected to increase to 63% by end-2011, versus 48.4% at end-2008.

INFLATION: Even though consumer price inflation declined steeply in 2009 to an estimated 0.2%, from 4.4% in 2008, inflation is expected to stage a rapid return to the trend rate of around 2.5%. This increase in inflation is due mainly to a combination of powerful base effects and increases in international oil prices (more than 90% of Cyprus's electricity is produced from oil and Cypriots are highly dependent on private transport). Consumer price inflation has already started to accelerate, rising to 2.5% in January and 2.8% in February 2010. Average harmonised CPI inflation is forecast to increase to 2.7% in 2010 and 2.5% in 2011.

BALANCE OF PAYMENTS: While weaker import demand and lower global commodity prices reduced Cyprus's import bill, leading to an important correction in the current account deficit to -8.5% of GDP from -17.7% in 2008, exports of goods and services also fell substantially. This marked a -52.5% reduction in the deficit to € -1.45 billion from € -3.05 billion in 2008. Indicatively the deficit on the trade balance declined by -23.3% to € -4.26 billion, with merchandise exports declining by -15.7% and merchandise imports declining by -22.0% for the year. The surplus on the services account was also lower, declining by -4.6% to € 3.4 billion. Services receipts declined by -11.2% to € 5.7 billion while services payments declined by -19.1% to € 2.4 billion. The financial account recorded a sharp reversal from a surplus of € 2.95 billion in 2008 to a deficit of € -3.22 billion in 2009. While net FDI increased to € 3.72 billion (from € 311 million), net portfolio outflows of € 12.8 billion in 2008 reversed to become net portfolio inflows of € 6.6 million. Given that imports are forecast to decline in 2010 and resume growth only in 2011 on the back of the muted recovery in domestic demand, the current-account deficit is expected fall to around 7.0% of GDP in 2010.

MONEY & FINANCIAL MARKETS: Credit expansion slowed in 2009, with growth easing from 34.3% in December 2008 to 6.9% in December 2009. Since the start of 2010, credit growth has remained muted, increased by 8.3% y/y and 1.7% m/m in March, following the -0.15% m/m decline in February. Credit to businesses eased to 5.% in December 2009, from 44.7% December 2008 and has since registered growth of 7.0% in March 2010. Likewise, credit expansion to households decelerated to 8.8% in December 2009 from 21.7% at end-2008, while registering a small pick-up with growth of 10.3% in March 2010.

5. SERBIA

ECONOMIC DEVELOPMENTS: Following a decade of stellar economic performance, GDP growth contracted by -3.0% in 2009 following growth of 5.5% in 2008 and 6.9% in 2007. Economic activity began to slow in the Q3 2008, and moved into negative territory in the Q1 of 2009 and remained there for the rest of the year. Driving the decline in 2009 was the mining sector which contracted by -4.9% y/y (4.5% :2008), construction sector by -17.1% (4.6% :2008), manufacturing by -15.3% (1.2% :2008). Sectors which recorded positive growth were agriculture, increasing 2.2% (8.6% :2008), transportation up 7.2% (12.5% :2008), financial services up 5.1% (13.5% :2008) and real estate increasing by 2.0% (5.6% :2008).

Economic activity appears to be recovering in 2010 with an initial flash estimate for Q1 GDP growth of 1.0% y/y. On a seasonally adjusted basis, GDP increased by 1.2% q/q in Q1 2010 following the -0.1% q/q contraction in Q4 2009. Echoing this recovery is industrial output which increased by 3.7% y/y in January and 1.3% y/y in December 2009. The strong pickup in the first month of 2010 was due to the 15.9% y/y growth in mining and quarrying and 8.1% growth in manufacturing. On a seasonally adjusted basis industrial output increased by 1.4% m/m in January 2010 with manufacturing output having increased by 0.9% m/m. Serbia's central bank has revised its full-year GDP forecast for 2010 to 2.0% from 1.5%. Likewise, the IMF is forecasting GDP growth of 2.0% in 2010, 3.0% in 2011 and 5.0% in 2011.

Standard & Poor's reaffirmed Serbia's long and short-term sovereign ratings at BB- and B respectively with a negative outlook for the economy. While Fitch affirmed Serbia's long-term foreign and local currency Issuer Default Ratings (IDRs) at BB-, with a negative outlook for the economy.

FISCAL POLICY: The 2009 general government deficit narrowed by 9.2% y/y to RSD 95.3 billion (€ 978.1 million) or -4.2% of GDP, marking a substantial increase in the deficit from 2008. During Jan-Apr 2010 the budget deficit reached RSD 30.8 billion (€ 308 million) or roughly 30% of the projected budget deficit under Serbia's stand-by agreement with the IMF. During the four month period, budget revenues reached RSD 209 billion with VAT proceeds of RSD 26.6 billion. Corporate tax revenues reached RSD 12.6 billion, while excise tax revenues reached RSD 33.7 billion. Non-tax revenues totalled RSD 77.1 billion. Budget expenditure equalled RSD 240 billion,

with salary expenditure reaching RSD 62.6 billion and social outlays at RSD 87.6 billion. Under the stand-by arrangement with the IMF, the budget deficit is projected at RSD 102.2 billion or around -4.1% of GDP.

The 2010 budget includes measures such as a freeze in public sector salaries; a cut in the public administration workforce, a reduction in the number of capital spending projects as well as limiting subsides. In addition, the IMF extended the standby arrangement with Serbia through to the end of 2011, ensuring access to the two remaining tranches under the € 2.94 billion stand-by loan. Talks have now commenced with the IMF under the fourth review of the stand-by arrangement with the focus now on tax system and pension system reforms, as well as the adoption of fiscal responsibility law.

Moreover, the World Bank has also earmarked $ 580 million of fiscal support for Serbia during the next 12 months. A total of $ 460 million will be used to fund the government budget, while the remainder will be earmarked for revitalisation of the `Bor region and construction of transport Corridor 10. Furthermore, a $ 200 million budget support programme was agreed to with Russia. This latest agreement forms part of the $ 1 billion budget support loan agreed to in 2009. The remaining $ 800 million will be used to finance large infrastructure projects in Serbia.

INFLATION: CPI inflation accelerated from 3.9% y/y in February to 4.7% y/y in March, registering a 1.2% m/m jump in March from 0.3% m/m growth in February. This increase was due to the 10% hike in electricity prices which came into effect this March. As a consequence, utility prices increased by 5.3% m/m and 9.2% y/y, following a 3.8% y/y in February. Food prices, the largest component in the CPI index, registered a -1.3% y/y decline in March, following the -1.2% y/y drop in February. For 2010 the IMF now expects end-of-year inflation to ease to 6% y/y and 4.5% y/y in 2010 and 2011 respectively.

BALANCE OF PAYMENTS: In 2009, the current account deficit declined by -71.4% to € -1.74 billion, reaching an estimated -5.7% of GDP, marking a substantial correction from the -17.1% y/y of GDP level reached in 2008. Merchandise exports declined by -19.4% y/y, while merchandise imports declined by -28.1% y/y, leading to an overall decline in the trade balance of -36.7% y/y. Current transfers increase by 37.8% y/y to € 3.8 billion following the -11.2% y/y decline registered in 2008. As was to be expected given the international financial crisis, foreign investment remained weak. The financial account declined by -69.9% y/y on the back of the -24.8% y/y decline in FDI which fell to € 1.3 billion.

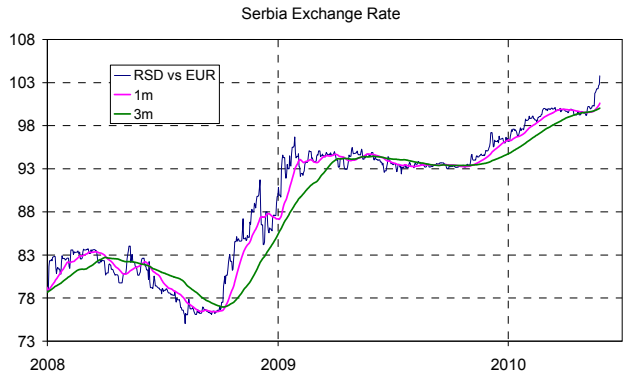
Looking to 2010, the current account deficit contracted by -26% y/y to € 725 million during Jan-Apr, equal to roughly 2.2% projected full-year GDP. This contraction was again the result of a correction in trade deficit which declined by -21% y/y to € 1.2 billion. Merchandise imports declined by -5% y/y, while merchandise exports recovered increasing by 14% y/y. The services' deficit shrunk by over -50% y/y to € 18.1 million, while the deficit on the net income account increased by 35% y/y to € 166.8 million. The surplus on the current transfers' account declined by -6% y/y to € 611.4 million. Net FDI remained weak, declining by -56% y/y to € 284 million, reducing coverage of the current account deficit to 39% versus 66% during the same period of 2009. Portfolio investment returned to € 38 million surplus from € 4 million deficit in the same period of 2009, while the other investments' account registered € 14.2 million deficit in Jan-Apr 2010, versus a € 76.4 million surplus in Jan-Apr 2009.

EXTERNAL DEBT & INT. RESERVES: By end-March 2010, gross external debt increased by € 338.6 million m/m to € 23.3 billion reaching 70.5% of the projected full-year GDP. Serbia's external debt has increased by € 491.4 million or 2.2% since the start of 2010. The March increase was due to slight increase of both public and private sector long-term debt. Government debt increased by 0.7% m/m (€ 52 million) to € 7.6 billion, a 5.0% year-to-date increase. Meanwhile private sector debt increased by 1.9% m/m (€ 287 million) to € 15.7 billion marking 0.9% year-to-date increase. Short-term debt accounted for 9.4% of the overall figure in March, improving from 9.8% in the month before and nearly 10% at the end of 2009.

The National bank of Serbia's (NBS) foreign currency reserves decreased by 1.2% m/m or € 130.6 million in March to € 10.4 billion. Since the start of 2010 reserves have declined by 1.5%. This decline was largely due to interventions in the local forex market which were geared towards preventing large daily fluctuations of the dinar. Including reserves of commercial banks, total foreign currency reserves reached nearly € 12 billion in March, up by 0.4% m/m, albeit lower by -0.8% year-to-date. Data for April is expected to reflect an increase in reserves due to the withdrawal of the € 180 million instalment under the stand-by loan deal with the IMF.

MONEY & FINANCIAL MARKETS: The Central Bank of Serbia (NBS) is now targeting the consumer price index as part of a planned transition to a full inflation-targeting regime with the two-week repo rate functioning as the Bank's main policy rate. The Bank lowered its key policy rate by a cumulative 825 bps to 9.5% in 2009 and by a further 150bps thus far in 2010 to 8.0%. The NBS cited lower than projected inflation and slow recovery of both world and domestic economy as the reasons for the move. The NBS also said the inflation would stay below the lower end of targeted range in the coming period, as weak domestic demand and slow recovery abroad was supportive of disinflationary trends. At the start of January 2010, following considerable rise in dinar liquidity in the banking system due to funds received from the IMF, the central bank took to selling € 17 million with the aim of boosting support for the Dinar. More recently in May 2010 the central bank arranged 3-month FX swap auctions worth €

30 million to bolster interbank swap transactions and encourage development of the FX hedging market. Moreover in May the central bank sold € 50 million to prevent excessive daily volatility of the dinar against the backdrop of increased demand. The Serbian Dinar is now trading at around 101/€ in May from 99.47/€ in April 2010.



Credit expansion slowed from growth of 35.1% in 2009 to 16.2% in 2009. In 2010, growth remains modest at 14.4% y/y both for Q1 2010 and in March itself. Credit to businesses eased to 15.3% in December 2009, from 42.2% in December 2008 and now 15.3% in March 2010. Credit expansion to households declined to 10.1% in December 2010, from 23.5% in December 2008 and is showing a solid recovery to 28.9% y/y in March 2010. As of end-March 2010 Loans-to-Deposits reached 1.25. The government announced that it would continue its the programme of providing incentives for the banking sector in the form of state-subsidized liquidity loans. The government will set aside RSD 3.5 billion (€ 35.7 million) versus € 1.5 billion which was disbursed in 2009. These additional funds would permit the banks to approve an additional RSD 90 billion (€ 918 million) in loans.

6. Albania

Economic Outlook: GDP growth is expected to have declined to 3.7% y/y in 2009, from around 6.5% in 2008. Growth in Q4 2009 declined by -0.8% y/y after having decelerated to 3.9% y/y in Q3 from 6.3% y/y and 3.8% y/y in Q2 and Q1 2009 respectively. On a seasonally adjusted basis, growth declined by -2.4% in Q4, from 0.4% y/y growth in Q3. The sharp drop in growth in the final quarter was due to the -14.4% y/y decline in the construction sector combined with a -4.1% y/y decline in the industrial sector. The strongest growth was recorded in the communications sector, which increased by 8.3% y/y, followed by the 7.2% y/y increase in the retail trade sector. The transportation sector recorded a 3% y/y increase, down from the 15.5% y/y increase in Q3. Finally, the agriculture sector registered weaker growth of 1.7% y/y in Q4. Despite these sectors of the economy having posted positive growth, it proved insufficient to offset the contraction in the construction and industrial sectors. Looking to 2010, the IMF has raised its forecast for GDP growth to 2.3% y/y, placing Albania as one of the top-performing economies in the region. Economic activity is expected to accelerate further in 2011 with GDP growth of 3.2% y/y, reaching 5% y/y in 2015.

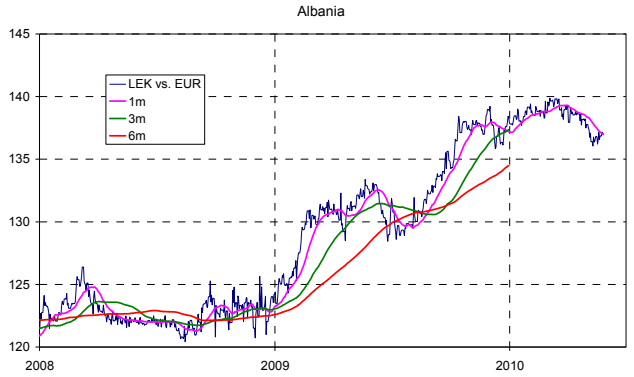
Fiscal Policy: While fiscal policy has become more prudent following the parliamentary election, which was preceded by a rush to finish large public investment projects, the general government budget still posted deficit of ALL 79 billion (€ 566 million) in 2009, equal to 6.9% of projected full-year GDP. This marked a substantial increase from the 5.5% of GDP reached in 2009. This increase reflects pre-election spending pressures, and a weakening of tax receipts in-line with the weakening of the economic performance. Indicatively, budget revenues increased by a marginal 2.4% y/y to ALL 298.3 billion, while budget expenditures increased by 7.2% y/y to ALL 377 billion. Tax revenues reached ALL 271 billion or roughly 91% of expected revenues. This lower outcome was mostly due to lower revenues from indirect taxes, and personal tax, while revenues from taxation of corporate profit dropped -4.8% y/y. Budget expenditure increase by 7.2% y/y to ALL 377 billion as current spending increased by 12.9% y/y due to larger outlays on social security. However, with tighter fiscal policy the deficit is expected to narrow to around 4.7% of GDP in 2010 and 3.4% of GDP in 2011.

Inflation: Headline CPI inflation increased by 3.9% y/y in March, down from the 4.4% y/y increase in February but higher than the 1.6% y/y recorded in March 2009. The price of food slowed to 6.1% y/y in March from 7.5% y/y in February. While the decline in food prices was a result of the 10.5pps drop in vegetable prices, these prices still remained relatively high, increasing 33.9% y/y. Regulated prices such as electricity and fuels increased by 7.9% y/y following the government's decision to increase electricity prices by 13% at the beginning of 2010. Average annual inflation is expected to increase to an average of 3.5% in 2010-11, moving closer to the ceiling limit of 3% ±1pp set by the central bank. Likewise, the IMF has raised the projection for average annual inflation to 3.5% y/y, up form 2% y/y forecasted in October 2009. Inflation is then expected to decelerate to 3.0% y/y by 2015, remaining within the target of the central bank.

Balance of Payments: In 2008, the current account deficit increased by 55.3% y/y to € 1.3 billion reaching 16.2% of GDP, up from 11% in 2007. In 2009 the current account deficit decline by -3.1% y/y to € 1.3 billion or 14.5% of GDP. The trade deficit declined by -5.3% y/y, with merchandise exports declining -18.2% y/y and merchandise imports declining by -8.8% in 2009. The services balance increased by 74% y/y to a surplus of € 120 million. Capital transfers remained flat at € 935 million, of which, emigrant remittances accounted for € 779 million, down 6.6% y/y. Net FDI remained relatively strong, increasing 7.1% y/y to € 664 million. Portfolio investment moved from net outflow of € -44.5 million in 2008 to a net inflow of € 12.7 million. The other investment account however registered a -72.5% y/y decline in 2009, dropping from € 927 million in 2008 to €

255 million in 2009. The IMF currently forecasts that the current account deficit will decline to around 12.0% of GDP in 2010 and to around 5.0% in 2015.

MONEY & FINANCIAL MARKETS: In 2009 the Albanian Lek depreciated by an annual average of 7.6% versus the Euro and by 13.2% versus the US dollar, driven by concerns regarding the country's external imbalances and fiscal expansion in the first half of the year. The Lek is expected to receive support in 2010-11 in the form of increased foreign-currency remittances and by relatively high local currency interest rates. As such, the Lek should remain stable versus the euro at around LEK 137/€ over the forecast period. The Albanian Central Bank last cut its key policy rate by 50bps to 5.25% in October 2009, citing subdued inflationary pressures and a marked deceleration in credit growth. More recently, the Bank has also taken steps to inject more liquidity into the money market in an effort mitigate the impact of the credit squeeze. Steps have also been taken to strengthen regulations and supervision in an attempt to guard against a deterioration in banks' loan portfolios.



In the first quarter of 2010, private sector deposits have increased by 12.2% y/y. Following net-withdrawals during many months of 2009, deposit growth reached 14.7% y/y in March 2010. Household deposits (which account for over 80% of total deposits) increased by 15.9% in March 2010, while business deposits increased by 8.5% y/y. Private sector credit growth slowed rather dramatically in 2009 to 11.1% y/y in December from 34.9% y/y in December 2008. In 2010 credit growth has continued to decline to 7.6% y/y in March from 10.4% y/y in January 2010. Credit expansion to business (which constitutes around 65% of total outstanding credit) has slowed to 11.4% in March 2010 from 14.9%% in December 2009 while credit to households has slowed to 0.6%% in March 2010 from 4.0% in December 2009.

7. FYROM

ECONOMIC DEVELOPMENTS: The global economic crisis has had a significant impact on the country's three primary growth drivers, exports, remittances and foreign direct investment. After three consecutive quarters of negative growth, economic activity moved into positive territory, posting 1.2% y/y growth in Q4, bringing full-year growth to 0.7% y/y in 2009. Underlying this outcome was the -1.0% y/y decline in private consumption (5.8% y/y in 2008), while investment declined by -6.0% y/y (6.0% y/y in 2008). A modest recovery with growth of around 1.5% is expected for private consumption this year, as growth will be limited by the lingering impact of the recession in 2009, and the resultant increase in unemployment. Likewise, investment growth of around 2.0% is expected, albeit constrained as access to credit is also likely to remain difficult, as local subsidiaries of foreign-owned banks continue to be affected by the aftermath of the global financial crisis. Government consumption declined -1.0% y/y (2.0% y/y in 2008) and is expected to increase by 0.2% y/y in 2010, restricted by the need to rein in the budget deficit. Exports of goods and services registered a -32.3% decline (7.5% y/y in 2008), while imports declined by -26.4% y/y (11.8% y/y in 2008). A weak recovery in key export markets, namely the euro area and the Balkans, is expected to hold back more robust growth until later. As such, exports of goods and services are forecast to expand by 2.5% y/y in 2010 and imports of goods and services by 2.0% y/y.

The IMF currently forecasts GDP growth of 2.0% in 2010 and 3.0% in 2011. The agency noted that the country's economic and financial situation has improved and that the risks of instability have decreased. Moreover it expressed the view that FYROM had dealt with the risks from the global economic crisis better than many countries in the region due to its sound macroeconomic and monetary policies. Likewise, the World Bank is forecasting GDP growth of 1.9% in 2010 and 3.8% in 2011.

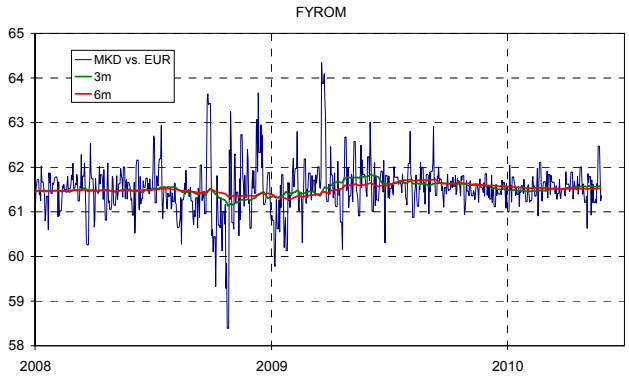
FISCAL POLICY: Due to the combination of a decline in revenues and an increase in expenditure, the general government deficit increased to 2.77% of projected 2009 GDP inline with target. For the year, government revenues declined by 7.2% y/y to MKD 128.5 billion (€ 2.1 billion). The decline in revenues was driven by a 7.6% y/y drop in tax collection to MKD 70.8 billion. Despite various cost-cutting measures, government expenditure increase by 6.1% y/y to MKD 139.4 billion. The current parliament-approved draft 2010 budget foresees a budget deficit of MKD10.5 billion or 2.5% of the projected 2010 GDP.

During Q1 2010, the general budget deficit more than doubled to MKD 4.1 billion (€ 66.5 million) at the end of March from MKD 1.8 billion in Q1 2009. This negative result was due to both by a decline in revenues and increase in expenditures. Indicatively, total revenues dropped by 6% y/y to MKD 29.5 billion, mainly on the 4.9% y/y contraction of tax revenues to MKD 25.3 billion. Non-tax revenues narrowed by 11.44% y/y to MKD 1.9 billion. Meanwhile, expenditure increased by 1.2% y/y to MKD 33.6 billion. The 2010 budget envisages a budget deficit of MKD 10.5 billion, equal to roughly 2.5% of the projected GDP.

INFLATION: Peaking at more than 10.0% during the summer months of 2008, consumer price inflation averaged 8.3% in 2008, before falling to -0.8% in 2009.

CPI inflation remains low, albeit on the rise, increasing by 0.7% y/y in March after 0.6% y/y in February. The prices of goods increased by 0.9 y/y in March and 0.8% y/y in February. Prices of services on the other hand declined by -0.6% y/y versus the -0.3% y/y decline the previous month, while food prices declined by -1.9%. For 2010, CPI inflation is expected to reach 2.1% y/y by year-end and average 1.5% for the year as a whole.

BALANCE OF PAYMENTS: After a near fivefold increase to 13.4% of GDP in 2008, The current-account deficit contracted to 7.4% of GDP in 2009, or by -43% y/y, following weakening domestic demand and low international oil prices. The trade deficit declined by -11% y/y on the back of the -28% y/y decline in merchandise exports, while merchandise imports declined by -22% y/y. The surplus on the Services account increase to € 28 million in 2009 from € 4 million in 2008. Likewise, the surplus on the Current Transfers account increased by 15% y/y to € 1.08 billion. The financial account declined by -48% y/y to € 446 million, with foreign direct investment declining by -58% y/y to € 172 million. Portfolio investment however saw an outflow of € 51 million in 2008 turn into an inflow of € 104 million. Although international energy and commodity prices should strengthen in 2010, the recovery in the euro zone should help to increase exports, and help contribute to a rise in workers' remittances. Import demand is expected to remain weak on the back of weak private consumption. Indicatively merchandise exports increase by 17.7% y/y in January 2010 versus at -12.9% y/y decline in merchandise imports. For the month, the current account deficit was down -72.7% y/y. For 2010 as a whole, the current account deficit is expected to decline to around 6.6% of GDP.



MONEY & FINANCIAL MARKETS: Monetary policy remains subordinated to a de facto currency peg to the euro, albeit within a rather wide trading band. The Dinar has proven to be highly volatile, after strengthening to MKD58.4/€1 in mid October 2008, it declined to MKD61.35/€1 in mid-May 2009, a level around which it has since stabilised. The central bank has continued to ease the interest rates on its 28-day bills, which were raised sharply in the 15 months to April 2009 so as to reduce the previously rapid growth in domestic credit. Since December 2009, the rate has been lowered by 2.5pps, to 6.5%, to encourage economic growth, and the rate may be cut further if bank lending does not increase.

On the banking front, private sector credit expansion remains muted. Following growth of 34.4% y/y in December 2008, credit expansion slowed to 3.5% y/y in December 2009 and now 2.5% y/y in March 2010. Credit expansion to businesses (which constitutes roughly 60% of total outstanding credit) has slowed from 32.6% y/y in December 2008 to 3.8% y/y in March 2010, while household credit expansion has slowed from 32.6% y/y in December 2008 to 0.6% y/y in March 2010.

8. UKRAINE

ECONOMIC OVERVIEW: .Ukraine's economy was deeply affected by the world economic crisis which took a heavy toll on the local economy. In 2009 GDP contracted by a sharp -15.2% from a slow, relative to previous years, growth of 2.3% in 2008. Even so in the first quarter of 2010 GDP grew by 4.8% yoy (albeit from a low base). Moreover there are supporting signs that the Ukrainian economy may be back on track to regain some of its earlier dynamism (annual average GDP growth of 7.5% in 2000-2007). These include, improved policy coordination and external relations with major trading partners (notably Russia), renewed talks with the IMF on a loan accord of $ 19 billion, and increased demand for Ukraine's key exports such as steel and chemical products on the back of the global economic recovery. Reflecting the improved outlook S&P upgraded the country's foreign and local currency sovereign credit rating to 'B/B' and 'B+/B' respectively in May 2010.

The economic slump in 2009 was driven by a fall of –19.7% in final domestic demand including a -46.6% fall in gross fixed investment. Inventories also declined by -5.7% in 2009 as businesses run down their stocks. In terms of valued added, all sectors had negative growth in 2009 apart from financial intermediation services which grew by 14.4% despite registering negative growth in the final quarter. Notably, value added in manufacturing fell by -26.6% and in construction by -45.9%.

The economic upturn so far 2010 is largely based on a recovery in industrial production which rose by 12.6% yoy in the first four months of the year. The external sector, which made a positive contribution to GDP in 2009 is expected to continue to do so in 2010.

FISCAL POLICY: The fiscal stance was pro-cyclical during much of the high growth period 2000-2007 leaving little room for manoeuvre during the recent period of economic distress. The 2009 consolidated budget deficit is reported by the ministry of finance at UAH 21.6 billion or 2.4% of GDP. However it is widely believed to be much higher. A recent report by Fitch estimates this at 11% of GDP. Also according to estimates of the Economist Intelligence Unit, the 2009 budget deficit approached 11.5% of GDP, or 6.5% of GDP excluding Naftogaz support and bank recapitalisation.

The new government passed a Budget for 2010 which aims at a fiscal shortfall of 5.3% of GDP (excluding Naftogaz support and bank recapitalisation) on the back of a fairly optimist projected growth in public revenues of 22%. This is seen as a milestone in the ongoing talks with the IMF for a deal on further financial assistance. Russia supports quick progression on the talks between Ukraine and the IMF evidencing the rapid improvements in its relationships with Ukraine following the election of the new president. Bilateral talks between Russia and Ukraine have included possible cooperation in the energy, aviation and agricultural sectors. Already they have concluded on a deal for a -30% reduction in gas tariffs for 2010 (estimated to yield savings of just under 3% of GDP on an annualised basis) as well as annual investments into the country to the tune of $ 4 billions per year (or around 3% of GDP).

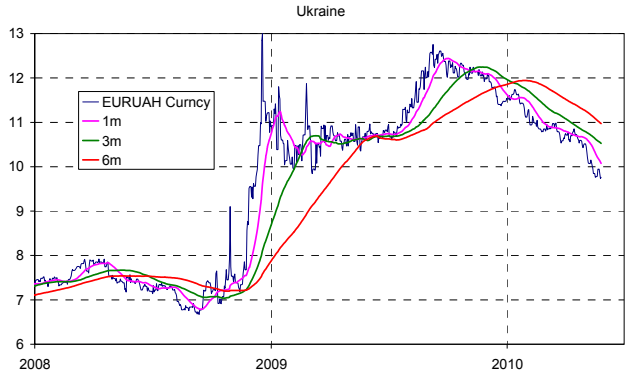
Net public debt almost doubled in 2009 to around 20% of GDP, though it remains at a relatively 'safe' level. Total state debt was $ 41.3 billion at the end of March 2010 (40% foreign, 33% domestic, 27% state guarantees) up from $ 39.7 billion at the end of 2009. The government plans to issues a $ 1.3 billion euro-bond in 2010.

INFLATION: Inflation has been a major source of instability during the years leading to the recession. Inflationary pressures where exacerbated by high annual nominal wage growth (averaging 29% during 2000-2007), capital inflows and high regulated prices. The annual average consumer price index (CPI) increased from just 0.2% in 2002 to 13.5% in 2005 and 25.2% in 2008. The onset of the recession which was accompanied by a precipitous decline in international commodity prices (the price of steel fell by around -45% in 2009) and a contraction of domestic demand led to an unwinding of inflationary pressures. In April of 2010 the annual increase in the CPI was 9.7%.

BALANCE OF PAYMENTS: Over the years, high nominal wage growth rates led to deterioration of international competitiveness and from this to deficits in the current account from 2006. The deficit in the current account reached -7.1% of GDP in 2008. During the 2009 recession both exports and imports plunged: exports by -26% from around $ 68 billion in 2008 and imports by -41% from $ 84 billion. As a result the current account deficit deflated to just -1.5% of GDP. On the basis of the improved economic outlook external trade is likely to strengthen somewhat in 2010. However while exporters benefit from the recovery in international commodity markets, imports will remain subdued in line with domestic demand.

In Q1 of 2010 the deficit in the current account was $ 69 million or -0.1% of GDP as against $ 654 million or -0.6% of GDP in Q1 of 2009 following a 22% yoy increase in exports and 18% in imports. In the financial account there was a notable improvement in net 'other investment' (inter-bank loans, etc.) to negative $ 351 million from negative $ 3.7 billion a year ago.

MONEY & FINANCIAL MARKETS: Under the impact of the economic recession, the coincidence of a hefty debt burden and low international competitiveness destabilised the foreign exchange market with the consequent fall in the value of the national currency from UAH/USD 4.5 in 1.7.08 to UAH/USD 9.2 in 24.2.09. It has since stabilized at around UAH/USD 8.0 The cost of insuring government debt widened considerably to a peak of 5.300 bps (5Y-CDS) in March 2009. It has since declined to 589 bps. The reserve assets with the Bank of Ukraine were $ 26.35 billion at the end of April 2010 from $ 24.15 in March and $ 31.54 at the end of 2009. The key policy rate remains at 10.25% since December of 2010.



Growth of credits to the private sector (euro basis) continues to be in the red although the pace of annual decline has decelerated from -27.1% in October 2009 to -2.9% in March 2010. Deposit growth turned positive again in February of 2010 and accelerated to 6.1% yoy in March 2010. The loans to deposit ratio reached a high of around 240% around April of 2009 and has since dropped somewhat but remains high at around 219%.

9. TURKEY

ECONOMIC OVERVIEW: Following solid 6% average annual economic growth between 2004-2008, 2009 saw economic activity tumble on the back of constrained domestic lending, limited foreign capital inflows, falling real disposable income and weak external demand. Fiscal and monetary stimulus, combined with a healthy banking sector, helped cushion the blow, highlighting the economy's enhanced resilience to external shocks. Even so, private consumption declined by -2.3% for the year as a whole, while investment declined by -19.2% as well. Weak domestic demand led to a -14.4% decline in imports of goods and services, while crisis hit economies abroad constrained foreign demand, leading exports to decline by -5.4% in 2009. Government consumption increased by 7.8% as measures were undertaken to support the economic during the crisis period. All told, GDP growth registered negative growth of -4.7%. The silver-lining in these figures was the strong recovery recorded in the final quarter of 2009. Following consecutive quarters of negative year-on-year growth, GDP expanded by 6% y/y in Q4 2009. While investment continued to decline on year-on-year terms, private consumption, which accounts for roughly 72% of GDP,

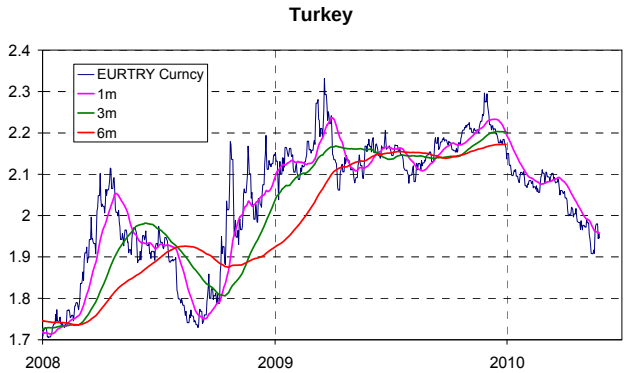
increased by 4.7%, while government consumption increased by 17.9%. The external balance contributed negatively to GDP growth, with imports of goods and services increasing by 10.5% versus with 6.4% growth in exports.

Building on the recovery in Q4 2009, government officials are now projecting double-digit growth in Q1 2010 of between 10-12% y/y. Indicatively, industrial production increased by 21.1% y/y in March, although this was in large part due to a significant base effect, with industrial production having declined by 20.9% y/y in March 2009. Based on seasonally & calendar-adjusted data, industrial production increased by 0.9% m/m in March, building on the 1.6% m/m increase in February and 0.7% m/m increase in January 2010. Looking forward, private consumption is forecast to recover in 2010-11, with the expected easing of credit conditions, modest growth in employment and an improvement in consumer confidence. Likewise, investment is expected to improve, supported by low interest rates, improving consumer and business sentiment and public spending ahead of the 2011 general election. As such, GDP growth is now expected to exceed 4.5% in 2010, with the European Commission forecasting 4.7% growth, the IMF forecasting 5.2% growth for the year

FISCAL POLICY: In 2009 the general government deficit increased to -5.5% of GDP from -2.2% in 2008. The primary cause of this deterioration was increased public spending, in particular of transfers to social security institutions, which recorded a deficit of 3% of GDP. In addition there were various government stimulus packages, which amounted to roughly 2% of GDP, some of which have since been withdrawn. However, in the first three months of 2010, the budget performed quite strongly, on the back of improved economic activity and the government's move towards balancing spending increases with revenue raising measures. The general government deficit is expected to decline to -3.5% of GDP in 2010 and -3.0% in 2011.

INFLATION: While average consumer price inflation slowed to 6.5% in 2009, from 10.1% in 2008, prices are expected to accelerate once again in 2010. The consumer price index has already accelerated from 6.5% y/y in December 2009 to 10.1% y/y in February 2010, 9.6% y/y in March and now 10.2% y/y in April 2010. Prices also increased by 0.6% m/m in April following the 0.58% m/m increase in March. Inflation is expected to remain at elevated in 2010, averaging around 10.0% for the year, owing to base effects, higher commodity prices and increase to administrative price, as well as excise tax hikes. However, by the end of 2010 and start of 2011 inflation should start to ease as monetary policy is tightened and base effects become more favourable.

BALANCE OF PAYMENTS: After reaching 5.7% of GDP in 2008, a combination of weak import demand and lower commodity prices should help to reduce current account deficit to 2.2% of GDP in 2009. The current-account deficit is now forecast to rise to around 4.5% in 2010 and above 5.0% in 2011 as domestic demand recovers and commodity prices head higher. In the first quarter of 2010, the current account deficit increase to $ -9.95 billion versus $ -1.98 billion in the same quarter of 2009. The deficit on the trade balance increase to $ -8.44 billion in Q1 2010 ($ -1.27 billion), with merchandise exports having increase by 7.5% y/y to $ 28.08 billion, while merchandise imports increased by 33.3% y/y in Q1 2010 to $ -36.52 billion. The services balance declined by -49.2% to $ 463 million, as service receipts declined by -4.6% while service payments increased by 6.1% y/y. The current transfers surplus declined to $283 million in Q1 2010, from $ 456 million. However, the financial account registered a solid surplus of $ 7.85 billion in Q1 2010 versus a deficit of $ -3.4 billion Q1 2009. While Net FDI declined by -50% to $ 1.03 billion, portfolio investment registered a net inflow of $ 2.63 billion versus a net outflow of $ -3.14 billion during Q1 2009.



MONEY & FINANCIAL MARKETS: Following the numerous stimulus measures undertaken in late 2008 and in early 2009 by Turkey's Central Bank in response to the crisis, an "exit strategy" has officially been announced, outlining the steps that will be taken to unwind these measures. Amongst some of the measures being taken, the Bank will (1) increase the reserve requirements for foreign-currency bank (2) raise interest rates for its limited foreign-exchange lending to the banks (3) reduce the maturity of such lending from three months to one week (4) reduce of the amount of short-term funds that it lends through repo tenders and soaks up through overnight borrowing (5) fix the interest rate on the one-week repo tenders, initially at 50 basis points above its overnight policy rates. Between the end of Q2 2008 and Q1 2009 the Turkish Lira depreciated by 57% and 35% vis-à-vis the Dollar and the Euro. After reaching a low of around TRY 2.35/€, the Lira has since recovered and is trading around TRY 1.9/€ and TRY 1.5/$ in May 2010. In response to the current economic crisis, the central bank has opted to reduce its key policy rate by a staggering 1,025 bps to 6.5% in November 2009 from 16.75% in November 2008.

9. ECONOMIC DATA – GREECE

(% change unless otherwise noted)

Yearly Data	2005	2006	2007	2008	2009	2010f	2011f
Real GDP Growth	2.9	4.5	4.5	2.0	-2.0	-3.5	-1.5
Gross Fixed Total Investments (including stocks)	-3.6	8.1	4.9	-7.4	-13.9	-6.8	2.6
- Residential Investment	0.0	29.1	-6.8	-29.1	-22.0	-19.5	4.0
- Equipment	-1.0	14.2	9.1	6.3	-15.9	-4.5	2.0
Manufacturing production	-0.8	1.4	1.8	-4.2	-10.7	-3.5	5.0
Unemployment (percent)	9.5	8.6	8.0	7.4	-0.5	11.8	14.6
Employment	1.5	2.5	1.3	1.2	-1.4	-2.6	-3.2
Consumer Price Index (year average)	3.5	3.2	2.9	4.2	1.2	3.8	1.2
Unit Labor Cost	3.7	0.7	3.5	3.9	6.3	0.3	0.1
Credit Expansion (Private Sector)	21.8	19.7	20.0	15.9	3.3	-1.5	2.0
Government Deficit (as % of GDP)	-5.1	-2.6	-3.6	-7.8	-13.6	-7.8	-6.0
Current Account (as % of GDP)	-6.3	-9.6	-12.4	-12.6	-9.9	-8.0	-6.0

Source: Alpha Bank Research, IMF

Quarterly Data	2006	2007	2008	2008	2009	2010	
				IV	I	(cumulative period)	
Economic Activity (period average)							
Retail Sales Volume	8.0	2.3	-1.4	-4.0	-9.4	3.4	(2month 10)
Construction Activity	-19.5	-5.0	-17.1	-23.9	-16.3	-10.6	(2month 10)
Industrial Production (Manufacturing)	0.8	1.8	-4.2	-8.5	-11.7	-3.7	(3month 10)
PMI (manufacturing)	52.4	53.7	50.4	43.8	39.0	43.6	Apr-10
Economic Sentiment Indicator	103.0	108.4	88.9	67.8	48.4	69.1	Apr-10
Index of Business Expectations in Manufacturing	101.5	102.8	91.9	76.7	64.9	80.6	Apr-10
Consumer Sentiment Index	-33.0	-28.0	-46.0	-56.0	-53.0	-61.0	Apr-10
Credit Expansion (end of period)							
Private Sector	21.1	21.5	15.9	15.9	10.8	3.5	Mar-10
Consumer Credit+Other	23.9	22.4	16.0	16.0	10.9	1.1	Mar-10
Housing	26.3	21.9	11.5	11.5	8.7	3.5	Mar-10
Business	17.2	20.6	18.7	18.7	12.2	4.3	Mar-10
Tourism	11.5	23.8	19.7	19.7	13.4	8.2	Mar-10
Prices (end of period)							
Consumer Price Index	3.2	2.9	4.2	2.9	1.5	4.8	Apr-10
Core Inflation	2.7	2.9	3.4	3.5	3.2	2.9	Apr-10
Interest Rates (period average)							
Savings	0.98	1.14	1.17	1.18	0.89	0.37	Jan-10
Short-term Business Loans	7.18	7.54	7.61	7.48	6.56	5.52	Jan-10
Consumer Loans (up to 1 year)	10.37	10.39	11.03	11.61	11.82	11.11	Jan-10
Housing Loans (over 10 years)	4.64	4.61	4.80	4.87	4.79	4.80	Jan-10
3 month Euribor	3.08	4.28	2.89	2.89	1.51	0.66	Feb-10
10 year Bond Yield	4.07	4.50	4.80	5.03	5.35	6.46	Feb-10
National Accounts							
Real GDP	4.5	4.5	2.0	0.7	-0.5	-2.3	(Q1/10)
Final Consumption	3.9	4.9	2.0	1.1	1.4	0.3	(Q4/09)
Investment	9.2	2.8	-2.5	-1.3	-9.7	-25.8	(Q4/09)
Exports	10.9	1.2	4.0	0.8	-20.9	-15.5	(Q4/09)
Imports	9,7	6,2	0,2	-1.2	-14,9	-18.0	(Q4/09)
Balance of Payments (in € mn - Cumulative)							
Exports of Goods	16.2	17.5	19.8	19.8	3.7	3.5	(3month 10)
Imports of Goods	51.4	58.9	63.9	63.9	11.4	11.8	(3month 10)
Trade Balance	-35.3	-41.5	-44.1	-44.1	-7.7	-8.3	(3month 10)
Invisibles Balance	14.6	13.5	13.2	13.2	0.9	-1.5	(3month 10)
Invisibles Balance / Trade Account	41.4%	32.5%	29.9%	29.9%	11.2%	18.6%	(3month 10)
Current Account	-20.6	-28.1	-30.9	-30.9	-6.9	-9.8	(3month 10)
Direct Investments	0.9	-2.5	1.7	1.7	0.1	0.9	(3month 10)
Portfolio Investments	8.1	17.4	16.4	16.4	15.2	4.9	(3month 10)
Athens Stock Exchange (end of period)							
Composite Index	4,394.1	5,123.4	1,786.5	1,786.5	1,684.4	1,870.0	Apr-10
% change	19.9	17,9	-65,5	-65.5	-57,7	-9.0	Apr-10
Market Capitalization ASE (% of GDP)	74,1	85,7	27,7	27.7	25,4	30.0	Apr-10

Source: National Accounts, 2007 Official and Alpha Bank Research

10. ECONOMIC DATA – SOUTHEASTERN EUROPE

Romania	2006	2007	2008	2009 (e)	2010 (f)	2011 (f)
Real Economy						
Real GDP	7.9	6.3	7.3	-7.1	0.8	3.5
Private Consumption	121.7	11.9	9.5	-10.5	0.7	4.2
Government Consumption	-4.1	-0.1	7.1	0.8	-2.5	1.0
Gross Fixed Investment	19.9	30.3	16.2	-25.3	2.3	5.8
Exports (Goods & Services)	10.4	7.8	8.7	-5.5	5.5	6.5
Imports (Goods & Services)	22.6	27.3	7.8	-20.6	3.9	7.6
Prices						
HICP Inflation (Avg)	6.6	4.9	7.9	5.6	4.3	3.0
General Government (%GDP)						
Overall Balance	-1.4	-3.1	-4.9	-7.2	-6.8	-4.4
Balance of Payments (% GDP)						
Current Account Balance	-10.6	-13.6	-12.7	-4.4	-4.4	-5.6

Bulgaria	2006	2007	2008	2009 (e)	2010 (f)	2011 (f)
Real Economy						
Real GDP	6.3	6.2	6.0	-5.0	0.0	2.7
Private Consumption	9.5	5.3	4.8	-6.3	-2.3	2.1
Government Consumption	-1.3	3.1	0.1	-5.5	-1.6	0.6
Gross Fixed Investment	14.7	21.7	20.4	-26.9	-6.3	3.2
Exports (Goods & Services)	8.7	5.2	2.9	-9.8	4.2	5.2
Imports (Goods & Services)	14.0	9.9	4.9	-22.3	-2.0	4.3
Prices						
HICP Inflation (Avg)	7.4	7.6	12.0	2.5	2.3	2.7
General Government (%GDP)						
Overall Balance	3.5	3.5	3.0	-0.8	-1.8	-0.3
Balance of Payments (% GDP)						
Current Account Balance	-18.6	-22.5	-22.9	-9.6	-6.0	-5.2

Cyprus	2006	2007	2008	2009 (e)	2010 (f)	2011 (f)
Real Economy						
Real GDP	4.1	5.1	3.6	-1.7	-0.4	1.3
Private Consumption	4.7	9.4	8.4	-3.0	-1.1	2.1
Government Consumption	7.3	0.3	6.2	5.8	1.6	1.5
Gross Fixed Investment	10.2	13.4	8.6	-12.0	-12.9	-3.8
Exports (Goods & Services)	3.5	6.1	-2.1	-11.8	0.6	3.3
Imports (Goods & Services)	6.7	13.3	8.0	-19.8	-1.3	2.4
Prices						
HICP Inflation (Avg)	2.2	2.2	4.4	0.2	2.7	2.5
General Government (%GDP)						
Overall Balance	-1.2	3.4	0.9	-6.1	-7.1	-7.7
Balance of Payments (% GDP)						
Current Account Balance	-7.0	-11.7	-17.7	-8.5	-7.1	-7.0

Serbia	2006	2007	2008	2009 (e)	2010 (f)	2011 (f)
Real Economy						
Real GDP	5.2	6.9	5.5	-2.9	2.0	3.0
Private Consumption	7.3	2.3	12.9	-2.0	-0.3	0.9
Government Consumption	4.2	18.3	13.1	-5.0	-4.2	-4.6
Gross Fixed Investment	14.5	25.6	-8.3	-27.4	9.7	16.7
Exports (Goods & Services)	4.9	17.2	8.9	-11.0	6.5	14.1
Imports (Goods & Services)	7.8	26.0	9.4	-18.3	0.6	8.5
Prices						
Consumer Price Inflation (Avg)	12.7	6.5	12.4	8.1	4.8	4.8
General Government (%GDP)						
Overall Balance	-1.6	-1.9	-2.6	-4.2	-4.1	-3.0
Balance of Payments (% GDP)						
Current Account Balance	-10.1	-15.6	-17.1	-5.7	-8.5	-9.1

Albania	2006	2007	2008	2009 (e)	2010 (f)	2011 (f)
Real Economy						
Real GDP	5.4	6.0	7.8	2.8	2.3	3.2
Private Consumption	-	-	-	-	-	
Government Consumption	-	-	-	-	-	
Gross Fixed Investment	-	-	-	-	-	
Exports (Goods & Services)	-	-	-	-	-	
Imports (Goods & Services)	-	-	-	-	-	
Prices						
CPI Inflation (Avg)	2.4	2.9	3.4	2.2	3.5	2.9
General Government (%GDP)						
Overall Balance	-3.2	-3.3	-5.4	-6.9	-4.7	-3.4
Balance of Payments (% GDP)						
Current Account Balance	-5.6	-10.4	-15.2	-14.0	-12.6	-11.3

FYROM	2006	2007	2008	2009 (e)	2010 (f)	2011 (f)
Real Economy						
Real GDP	4.0	5.9	4.9	-0.7	1.3	2.0
Private Consumption	6.0	9.8	6.9	0.2	1.0	2.0
Government Consumption	1.8	0.4	9.7	-4.7	-1.5	-0.5
Gross Fixed Investment	11.6	13.1	20.3	-9.2	4.0	6.0
Exports (Goods & Services)	8.4	14.3	-4.3	-8.2	5.5	7.0
Imports (Goods & Services)	10.9	17.4	5.8	-10.7	4.0	6.1
Prices						
CPI Inflation (Avg)	3.2	2.3	8.3	-0.8	1.3	2.0
General Government (%GDP)						
Overall Balance	-0.5	0.6	-1.0	-2.7	-2.5	-2.5
Balance of Payments (% GDP)						
Current Account Balance	-0.9	-7.2	-13.1	-4.2	-6.2	-7.9

Ukraine	2006	2007	2008	2009 (e)	2010 (f)	2011 (f)
Real Economy						
Real GDP	7.3	7.9	2.4	-15.2	3.5	4.0
Private Consumption	15.4	17.0	10.0	-12.3	-0.8	3.0
Government Consumption	4.0	1.8	0.8	-4.8	0.8	1.5
Gross Fixed Investment	20.9	24.4	1.9	-46.6	2.3	12.0
Exports (Goods & Services)	-5.8	2.8	5.5	-26.1	7.0	6.0
Imports (Goods & Services)	8.3	23.9	16.8	-41.2	8.4	7.5
Prices						
CPI Inflation (Avg)	9.1	12.8	25.2	15.9	11.5	10.5
General Government (%GDP)						
Overall Balance	-0.7	-1.1	-1.5	-6.5	-6.0	-4.0
Balance of Payments (% GDP)						
Current Account Balance	-1.5	-3.7	-7.1	-1.5	0.2	0.1

Turkey	2006	2007	2008	2009 (e)	2010 (f)	2011 (f)
Real Economy						
Real GDP	6.9	4.7	0.9	-4.7	4.7	4.5
Private Consumption	4.6	5.5	-0.1	-2.3	3.5	3.7
Government Consumption	8.4	6.5	1.9	7.8	2.2	1.0
Gross Fixed Investment	13.3	3.1	-5.0	-19.2	4.6	8.4
Exports (Goods & Services)	6.6	7.3	2.3	-5.4	5.7	7..2
Imports (Goods & Services)	6.9	10.7	-3.8	-14.4	9.5	9.6
Prices						
CPI Inflation (Avg)	9.3	8.8	10.4	6.3	10.0	7.8
General Government (%GDP)						
Overall Balance	-1.2	-1.0	-2.2	-5.5	-3.5	-3.0
Balance of Payments (% GDP)						
Current Account Balance	-6.1	-5.9	-5.7	-2.2	-4.5	-5.4

* Note: the fiscal balance is estimated excluding Naftogaz support and bank recapitalisation.

Source: IMF, Economist Intelligence Unit, Central Bank, Eurostat, Alpha Bank Economic Research

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