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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 firmly under implementation, Greece undergoes a painful adjustment process, with its GDP registering a negative -2.9% yoy growth in H1 2010 and expected to fall by -3.0% in 2010 and -1.0% in 2011.
- Fiscal consolidation progresses successfully, with minimum disruptions from popular discontent as reforms restore social fairness by tackling tax evasion and abolishing pension inequities among various population groups.
- With labour and product market reforms implemented, competitiveness being rebuilt and privatisation, deregulation and infrastructure investment strengthening the supply-side potential of the economy, economic recovery and fiscal adjustment may come earlier than expected, rendering concerns over a possible Greek debt restructuring rather exaggerated.

### 2. Romania

- GDP growth turned positive to 0.3% q/q (-0.5% yoy) in Q2 2010, following a -0.3% q/q (-2.6% yoy) growth in Q1 2010. It is forecast to be again negative, -2.0% in 2010 on the back of substantial VAT rates increases and public sector wage cuts and despite a positive contribution from manufacturing production and net exports. Positive yoy growth is now expected from Q1 2011.
- Fiscal reform, under the € 20 billion loan with the IMF and the EU, remains the main factor affecting Romania's economic prospects. The new target for the 2010 budget deficit is set at 6.8% of GDP, while new drastic measures had to be applied, comprising a -25% cut in the public sector wage bill and a 5.0 pps increase in VAT rates, effective from July 2010.
- The VAT hike will likely push inflation over 7% constraining the government's efforts to finance its deficit at relatively low interest rates. The uncertainties ahead with fiscal reform have weakened the local currency further complicating inflation and interest rate developments.

### 3. Bulgaria

- GDP declined by -2.5% in H1 2010, following a -5.7% fall in H2 2010. It is expected to register 0% growth in 2010 and 2.3% growth in 2011. Domestic demand dropped by -6.7% in Q2 2010, while net exports had a big positive impact on GDP growth. The current account deficit fell to 1.8% of GDP in H1 2010 (H1 2009: 7.8%).
- Public revenues fell by -13.6% yoy in H1 2010, thereby widening the budget deficit to 2.22% of GDP from a surplus of 0.3% of GDP in H1 2009. The return to positive GDP growth is a prerequisite for fiscal surpluses to re-emerge in Bulgaria, needed to prop up the country's currency board-fixed exchange rate arrangement.

### 4. Cyprus

- GDP returned to positive q/q growth of 0.3% and 0.4% in Q1 and Q2 2010 respectively, while yoy growth was still -1.4% and -0.2% respectively. The tourism and the financial services sectors contributed to the pick-up in growth, with fiscal adjustment policies continuing to constrain domestic demand growth.
- The general government deficit is projected to remain high at 6.1% of GDP in 2010 as in 2009, from a surplus of 0.9% of GDP in 2008, with the public debt to GDP ratio reaching the 61% in 2010. The Central Bank believes that Cyprus is in a good position to take the necessary corrective measures towards fiscal adjustment with emphasis on cutting spending.

### 5. Serbia

- GDP in Q2 2010 grew by 1.6% yoy following a 0.6% yoy growth in Q1 2010 and is expected to grow by around 2% in 2010. This is a relatively good performance in a period of continuing efforts for fiscal consolidation. External imbalances are expected to remain low relative to the pre-recession period.
- The € 3.1 billion IMF loan-agreement remains on track. The budget deficit was cut by -19% in H1 2010, reaching 53.4% of its targeted level of 4.8% of GDP for 2010. However, the containment of the deficit to the 3.9% IMF-prescribed target in 2011 will require a greater emphasis on structural measures such as pension reform and a freeze in public wages and pension growth.
- CPI inflation, reaching 4.2% in June, is likely to increase in H2 2010 mainly due to the depreciating trend of the national currency. This prompted the Bank of Serbia to end its monetary easing cycle in August 2010 and increased its policy rate by 50bps to 8.5%.

### 6. Albania

- In July 2010 the IMF revised up its projection for 2010 GDP growth to 2.6% (from 2.3%), following a 2.8% GDP growth in 2009. This is consistent with a fall of the fiscal deficit to 5.2% of GDP from 7.4% of GDP in 2009, and an increase of the public debt to 62.8% of GDP from 59.7% of GDP in 2009.
- The IMF has praised government's efforts to cut public spending in H1 2010, indicating, however, that the country needs to act decisively in order to rebuilt its exhausted monetary and fiscal defenses to a possible new crisis arising from adverse shocks in the region or/and the world economy.

### 7. Former Yugoslav Republic of Macedonia

- The FYROM economy registered a -0.7% negative growth in 2009, and is expected by the IMF to grow by about 2.0% in 2010. The budget deficit reached 2.7% of GDP in 2009 and its debt/GDP ratio does not exceed the 25%.
- The Greek debt crisis has prevented FYROM from issuing Eurobonds, which has raised prospects for a possible IMF stand-by arrangement.

### 8. Ukraine

- In July 2010 the IMF approved a 29-month $ 15.15 billion "stand-by" loan program for Ukraine. Around $ 2 billion will be allocated to the budget and $ 13 billion to the central bank. Key conditionalities attached are the reduction of general government deficit to 3.5% of GDP in 2011 and 2.5% in 2012, from 9.9% of GDP in 2010.
- Real GDP growth is expected to reach 3.7% in 2010 and 4.3% in 2011, following a huge negative growth of -15.1% in 2009. The new IMF arrangement will promote policies aiming at a flexible exchange rate regime with the exchange rate regime, geared towards establishing a low-inflation environment.

### 9. Turkey

- GDP grew by an impressive 11.7% in Q1 2010 following a contraction of -4.7% in 2009. The current account deficit surged to $20.7 billion in H1 2010 from $7 billion in H1 2009, following an appreciation of the lira (TRY) and a pick-up in domestic demand.
- High GDP growth has boosted budget revenues leading to a decrease by -33% of the budget deficit in H1 2010. However, the observed delay in structural fiscal adjustment is likely to further postpone agreement on a new loan-deal with the IMF and put pressure on the Lira.

## 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% | 0,8% | Jan-May |
| Automobile sales | 4,3% | -7,0% | -17,4% | -27,0% | Jan-July |
| Tax on Mobile telephony | 114,2% | 5,3% | 13,2% | 67,6% | Jan-May |
| VAT Revenue | 9,8% | 8,4% | -9,1% | 1,5% | Jan-June |
| Consumption Tax on Fuels | 9,7% | 28,9% | 18,6% | 20,0% | Jan-June |
| Private Consumption | 3,3% | 2,3% | -1,8% | 1,4% | Q1 2010 |
| Government Consumption | 8,4% | 0,6% | 9,6% | -9,9% | Q1 2010 |
| Building activity (Permits) | -5,8% | -17,3% | -26,5% | -22,4% | Jan-May |
| Cement Production | -9,2% | -3,1% | -21,4% | -5,2% | Jan-June |
| Public Investment | 7,6% | 9,3% | -2,8% | -39,4% | Jan-July |
| Fixed Investment | 4,6% | -7,4% | -13,9% | -14,6% | Q1 2010 |
| Change in Stocks and Stat. Dis. | 1785,2% | 147,3% | -2,3% | -44,7% | Q1 2010 |
| Unemployment | 8,3% | 7,7% | 9,4% | 11,9% | April |
| Manufacturing Production | 2,2% | -4,7% | -11,0% | -4,7% | Jan-June |
| Econ. Sentiment (1998-2006: 100) | 107,9 | 93,4 | 70,6 | 66,3 | July |
| -Industry | 102,8 | 91,9 | 72,1 | 75,8 | July |
| -Consumer Confidence | -28 | -46,0 | -45,7 | -66,0 | July |
| PMI (Manufacturing) | 53,7 | 50,4 | 45,3 | 45,3 | July |
| Exports of goods (El.Stat.) | | 1,6% | -17,5% | 2,5% | Jan-June |
| Imports of goods (El.Stat.) | | 10,5% | -24,4% | -17,7% | Jan-June |
| Tourist Arrivals (airports) | 8,5% | -1,4% | -6,6% | -0,2% | Jan-July |
| Tourism Receipts (BoP) | -0,3% | 3,0% | -10,9% | -8,8% | Jan-May |
| Exports goods & services | 5,8% | 4,0% | -18,1% | -0,5% | Q1 2010 |
| Imports goods & services | 7,1% | 0,2% | -14,1% | -6,6% | Q1 2010 |
| **GDP growth** | 4,5% | 2,0% | -2,0% | -2,5% | Q1 2010 |
| **Inflation (CPI)** | 2,9% | 4,2% | 1,2% | 5,2% | June |
| Current Account (% of GDP) | -12,4 | -12,6 | -9,9 | -5,2% | Jan-May |

Note: Growth rates are calculated on a cumulative basis
Source: Bank of Greece, Hellenic Statistical Authority (EL.STAT.)

***On Thursday, 5 August 2010, a combined mission of the European Commission (EC), the International Monetary Fund (IMF) and the European Central Bank (ECB) ended a crucial two-week review of Greece's fiscal adjustment measures and structural reforms, saying the country had made "a good start" and that*** "the programme is on track". The EC/ECB/IMF mission is not yet prepared to change their real GDP growth projection, of -4.0% in 2010, despite the fact that GDP fell by -2.9% in H1 2010 and developments in the economy until July 2010 (see the above Table) indicate that the fall in real GDP will be nearer to -3.0% in 2010. However, the mission is now prepared to change its CPI inflation projections making it 4.75% on average in 2010 (from 1.9%) and 1.5% - 2.0% in 2011 (from a previous projection of -0.4%). This implies that nominal GDP growth will be positive in 2010 (instead of the previous IMF projection for a fall by -2.8%) and around zero in 2011 (instead of -2.6%). This of course has implications for debt dynamics. Three months into the IMF program, already the debt is stabilised no longer at 150% but at 145% of GDP! In our projections, this ratio will never exceed the 13% mark.

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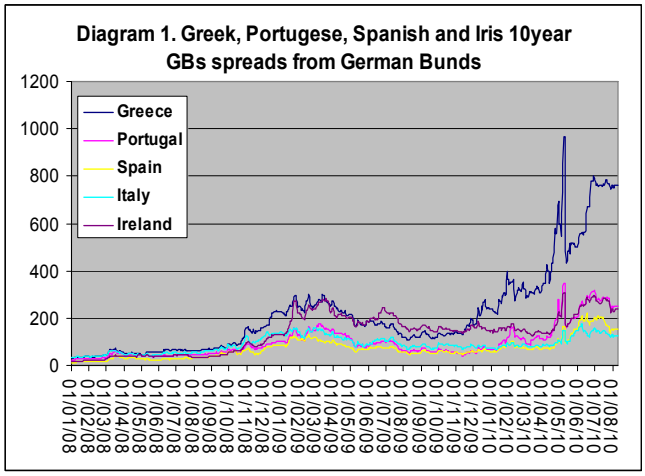
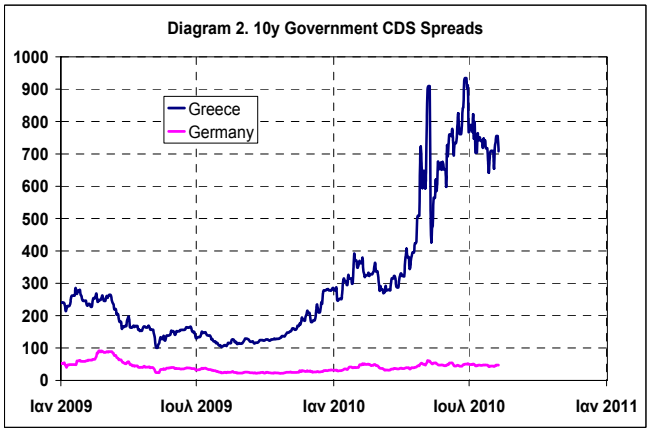
***Moreover, the IMF/EC/ECB mission now believes that Greece is on track to hit the target for the deficit reduction in 2010 (a fall in the deficit by 5.6 pps of GDP). In fact, this deficit may even be lower than 8.1% of GDP, as data concerning the implementation of the budget in January-July 2010 indicate a spectacular fall in the central government deficit by -39.4% yoy.*** Also, the IMF/EC/ECB mission gave the thumbs up that Greece ***has completed successfully the fundamental reforms*** on its pension system, its labour markets and its local government administration, which imply an essential boost for its productivity and potential output growth in the following years.

***These developments contributed initially to a fall of the interest rate spread between Greek 10-year bonds and the corresponding German bunds*** to 762 bps on 6 August 2010, from more than 965 bps at the beginning of May 2010. Also, the cost of the Greek 5-year CDSs, fell to as low as the 712, from above 950 in the middle of June 2010. These levels of Greek spreads and the CDSs are still very high and volatile and show that the markets are still not certain that Greece has definitely avoided an outright default. However, Greek spreads are now determined without any intervention from the ECB through trading is very thin.




In this report we provide an analysis of Greece's recent fiscal and economic developments, as well as of the progress it has made in the field of fundamental structural reforms, showing that both ***fiscal adjustment and higher than expected growth will bring the economy out of the crisis faster than anticipated.***

On early May 2010, the Greek Parliament approved the Memorandum of Understanding (MOU) between the Greek Government and the EU, the ECB and the IMF, comprising the fiscal adjustment and structural reform measures which Greece had to implement as the

condition for receiving the € 110 bln of official financing, with an average interest rate below 5.0%, provided to her by the countries of the Eurozone and the IMF. This official financing had become necessary in order to avert a possible near-term funding crisis in Greece's public debt refinancing operations. The Greek Government Bonds (GGBs) crisis had peaked by the end of April 2010, making it impossible for Greece to fund through the markets bond redemptions of € 19 billion scheduled for 19th May 2010. The official Eurozone/IMF financing will be provided to Greece in instalments in the following three years, with the release of each instalment conditioned on the successful implementation of the fiscal adjustment and reform package incorporated in the MOU.

In May, Greece received the first installment of € 20 billion of the loan, of which € 14.5 billion came from the countries of the Eurozone and € 5.5 billion from the IMF. Two more installments are pending in 2010, each of € 9.0 billion (€ 6.5 billion from the Eurozone and € 2.5 billion from the IMF), the first in September 2010 and the second in December 2010. The total amount of 3-year official loans that Greece will receive within 2010 will reach € 38 billion, leaving aside € 72 billion to be received in the following two years. From this total, an amount of € 10 billion will be used for the financing of ***the Financial Stability Fund (FSF)***, which will be established in order to provide additional funds to the Greek banks in the event that these banks will need additional capital which cannot be found from the private sector.

The refinancing of positions in short term Greek Government T-bills is scheduled to be implemented through regular market auctions. In fact, the Greek Government has already issued successfully 6-month T-bills absorbing € 1.63 billion at 4.65% (versus 4.55% in April 2010) and 3-month T-bills absorbing € 2.3 billion at 4.05% (versus 3.65% in April 2010).

The long term government borrowing requirements in 2011 are estimated at around € 42 billion (from € 50 billion in 2010), which implies that the Greek Government will have available enough official financing in order to cover its borrowing needs even in the first half of 2012. This time span of 2.5 years should be enough to enable Greece to re-enter the bonds market at acceptable cost for the following reasons:

***a)*** Macroeconomic and fiscal adjustments in 2010 and in 2011 are expected to be much better than those projected in the Greek Government – EU/IMF MOU.

***b)*** In 2012 Greece will be one of the few countries in Europe with a general government deficit below 5.5% of GDP and a declining (though still very high) general government debt/GDP ratio. This ratio will be in 2012 comparable with that of other EU countries. More specifically, the above fiscal adjustment and growth developments are expected to lead to a debt/GDP ratio in Greece below the 133% of GDP in 2012 and below the 106% of GDP in 2020.

***c)*** Structural reforms in Greece's pension system, the labour and product markets and the public sector imply a substantial increase in Greece's medium to long term potential income growth and a drastic improvement of Greece's long term public finances.

Thus, the EU/IMF decision to cover Greece's financing needs in the period of its drastic fiscal adjustment and economic reform is combined with the Greek Government's willingness and determination to implement as needed and on a timely manner these front-loaded fiscal adjustment and reform measures as included in the GG-EU/IMF MOU. Moreover, now it is also evident that this effort for adjustment is also supported by the great majority of the Greek people. Under these conditions, any assumption about a possible restructuring of the Greece's government debt at the expense of its borrowers is obviously exaggerated and misguided.

**MACROECONOMIC AND FISCAL PROJECTIONS:** The projections for the Greek economy included in Greek Government (GG) - EU/IMF MOU were based on the following perceptions:

First, the perception that the needed fiscal adjustment was unprecedented in size and that it would prove extremely painful for Greece, facing the risk of a new derailment due to popular discontent.

Second, this huge fiscal adjustment (10 percentage points of GDP in 3-4 years) would imply a substantial fall of domestic demand and, therefore, it would lead to a dramatic fall not only of real GDP but also of nominal GDP. It would lead to an outright deflation, which would make the needed fiscal adjustment impossible. Indeed, Martin Feldstein (April 2010), concluded that: "there simply is no way around the arithmetic implied by the scale of deficit reduction and the accompanying economic decline: Greece's default on its debt is inevitable".

Third, Greece suffers from extraordinarily low international competitiveness which cannot be corrected through devaluation, being a member of the Eurozone. Had it not been a member of the Eurozone, Greece could somehow devalue and export its way out of the crisis. Now this is impossible. Except if it would decide to get out of the Euro.

Through this line of reasoning many analysts reached to the impressive conclusion of an imminent departure of Greece from the Eurozone. Thus, there was a big rush among the emerging Greek experts to point to the experience of Argentina in 2001-2002, which many considered as the perfect example showing the road that Greece would travel in the following months and years.

In fact, the Eurozone/IMF financial mechanism of € 110 billion, covering Greece's finances for the following two and a half years, stopped many analysts short from predicting an imminent default for Greece. Then, the most popular prediction became that "**Greece is going to default but not this year"!!** In fact, this prediction was based on macroeconomic and fiscal adjustment projections, essentially similar to the projections that were finally included the Greek Government-EU, ECB and IMF MOU. These projections are shown in Table 2 below:

| Table 2.Macro-economic and Fiscal Adjustment Projections of the GG - EU/IMF MOU (Percentage change; or percent) | | | | | | | |
|---|---|---|---|---|---|---|---|
| | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 |
| Real GDP growth | -2,0 | -4,0 | -2,6 | 1,1 | 2,1 | 2,1 | 2,7 |
| Nominal GDP growth | -0,7 | -2,8 | -3,1 | 2,1 | 2,8 | 3,1 | 3,8 |
| GDP Deflator | 1,3 | 1,2 | -0,5 | 1,0 | 0,7 | 1,0 | 1,1 |
| CPI Inflation | 1,3 | 1,9 | -0,4 | 1,2 | 0,7 | 0,9 | 1,0 |
| Primary Gen. Gov. Balance (% of GDP) | -8,6 | -2,4 | -0,9 | 1,0 | 3,1 | 5,9 | 6,0 |
| Interest Payments (% of GDP) | -5,2 | -5,6 | -6,6 | -7,5 | -8,1 | -8,4 | -8,1 |
| Gen. Government Surplus (% of GDP) | -13,6 | -8,1 | -7,6 | -6,5 | -4,9 | -2,6 | -2,0 |
| Gen. Government Debt (% of GDP) | 115,1 | 133,0 | 145,0 | 149,0 | 149,0 | 145,0 | 139,0 |
| IMF (May 2010) : Greece : Staff Report on Request for Stand-By Arrangement | | | | | | | |

Concerning fiscal consolidation, all these perceptions fail to take into account the following:

***a) The fiscal adjustment in 2010-2011*** comes on the back of the huge fiscal derailment in 2008-2009 and of big increases of the public sector wage and pension bill in previous years. This implies that the undoing of these policies would go a long way to reduce the general government deficit to a level below the 5.5% of GDP in 2011, from its high 13.6% of GDP in 2009, without actually rendering the Greek civil servants and public sector pensioners destitute. With this adjustment in place, such incomes and pensions will come back to their already high level of 2007, bringing a realignment of wages with the corresponding labour productivity in the public sector. ***Moreover, b)*** the substantial current budget expenditure savings from the much needed restructuring and reorganization of central and local government may only have minor net negative effects on GDP growth in the short term, but substantial net positive effects on growth in the medium and long term. ***Finally, c)*** the needed increase of the general government net current revenues from their extraordinarily low 2009 level of 35% of GDP, to a level nearer to 42% of GDP (with the Eurozone average fluctuating at 45% of GDP) could be the result of increasing cost recovery in government services to the public, of substantial increases of the indirect taxes in Greece to levels nearer to Eurozone average levels and of a substantial expansion of the tax base capturing a multitude of high incomes which tax evade.

***The main fiscal adjustment measures increasing general government revenue and reducing general government expenditures for the period 2010-2012,*** have already been fully legislated and are being gradually implemented. Their general government deficit reduction effect in 2010-2012 is calculated to reach the € 36.8 billion (€ 20 billion from higher revenues and € 16.8 billion from lower expenditure), as shown in Table 3. This saving compares with a general government deficit in 2009 of € 32.2 billion. In fact, the bulk of fiscal adjustment, amounting to € 22.1 billion (9.3% of 2010 GDP) is scheduled for 2010 and another € 9.2 billion (3.9% of GDP) is scheduled for 2011. This means that ***the Greek general government deficit is set to fall below 7.0% of GDP in 2010 and below 5.5% of GDP in 2011, even with a substantial underperformance of the fiscal adjustment program included in the GG – EU/IMF, MOU.*** Nevertheless, as shown in Table 2, the IMF is projecting a general government deficit of 8.1% of GDP in 2010 and of 7.6% of GDP in 2011.

| Table 3. Fiscal adjustment 2010-2013 | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | Revenue Increasing Measures | | | Expenditure Reducing Measures | | | Total | | |
| | 2010 | 2011 | 2012 | 2010 | 2011 | 2012 | 2010 | 2011 | 2012 |
| HSGP | 7,6 | | | 3,8 | | | 11,4 | | |
| March 3, 2010 | 2,8 | | | 2,1 | | | 4,9 | | |
| MOU May 5, 2010 | 1,3 | 6,6 | 1,7 | 4,6 | 2,6 | 3,9 | 5,8 | 9,2 | 5,6 |
| Total | 11,6 | 6,6 | 1,7 | 10,4 | 2,6 | 3,9 | 22,1 | 9,2 | 5,6 |
| ***Total 2010-2012*** | | | ***20,0*** | | | ***16,8*** | | | ***36,8*** |
| 2013 | | | | | | | | | 4,8 |
| ***Grant Total*** | | | | | | | | | ***41,6*** |

***Concerning the effects of fiscal adjustment on real and nominal GDP growth,*** the IMF's and the European Commission's assumption seems to be that Greece is a closed self-sufficient economy with no comparative advantages and overall uncompetitive internationally. According to the IMF, "Greece's growth model so far was overly reliant on public spending". Therefore, now, "the dual challenge of achieving an internal devaluation and strong fiscal adjustment is bound to weigh heavily on growth for a prolonged period". Hence, their projections in their report for the MOU in May, according to which both real and nominal GDP would fall dramatically by -4.0% and -2.8% respectively in 2010 and by -2.6% and -3.1% respectively in 2011. For the nominal GDP projections they assumed that the Greek economy was heading for an outright deflation with GDP deflator increasing only by 1.2% in 2010 and falling by -0.4% in 2011.

These arguments fail to take into consideration the following:

a) Greece is a very small open economy full member of the Eurozone and, obviously, price taker in international markets for traded products. Therefore, its inflation in the internationally traded goods sectors could not be different than Eurozone inflation. Moreover, fiscal adjustment in Greece, as it was promulgated by the MOU, mean increases in VAT and excise taxes (on fuel, cigarettes, beverages, etc), as well as increases in the prices of services provided by the public sector in order to reduce the deficits of the entities providing these services. ***Therefore, fiscal adjustment means initially inflation, not deflation, with the final outcome depending on how fast confidence is restored and spending resumes through structural adjustment improving the supply side of the economy.***

| Table 4. Public Spending in Greece and the EA-16 | | | | |
|---|---|---|---|---|
| | Current Government Expenditure (% of GDP) | | Government Fixed Investment (% of GDP) | |
| | Greece | EA-16 | Greece | EA-16 |
| 1995 | 41,40% | 46,20% | 2,80% | 2,60% |
| 2000 | 40,20% | 43,50% | 3,60% | 2,50% |
| 2007 | 40,50% | 42,30% | 2,90% | 2,60% |
| 2009 | 45,90% | 46,50% | 2,90% | 2,80% |
| Source: European Commission, Statistical Annex of the European Economy, Spring 2010 | | | | |

b) The Greek economy has been growing consistently by 1.6 percentage points above the Eurozone average for the whole period 1995-2009. This is hardly a performance expected by an economy suffering from low international competitiveness. Moreover, in the period 1995-2007 GDP growth in Greece was higher than total current government expenditure and general government investment growth (Tables 4). This shows that GDP growth in Greece was not due to excessive public spending, as the IMF suggests. On the contrary, growth fell substantially to negative territory when current

government expenditure surged upwards in the years of the fiscal derailment, 2008-2009.

Moreover, as shown in Table 5, 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.

**Table 5. 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

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 is well set to boost Greece's GDP growth into the next decade.

c) Greece has considerable comparative advantages in tourism, in international shipping, in Mediterranean agriculture and food industries and in some important exporting manufacturing industries. Moreover, it has considerable growth drivers in the short and longer term (e.g., the absorption of € 24 billion of investment financing from the EU, the long delayed investment in the energy sector, the privatization of stagnant industries, ports, airports and state controlled banks, the proper management of public real estate property in combination with the exploitation of the substantial location advantages of Greece, etc). These advantages and growth drivers tend to lift the Greek economy even in H2 2010 and in 2011, that is in a period in which the extraordinarily painful fiscal adjustment measures exert substantial negative effects on domestic demand.

d) The main part of the substantial fall of domestic demand due to this huge fiscal contraction in Greece is affecting mainly imports, not domestic production. For example, a -2.4% fall in domestic demand in 2009 was combined with a -14.1% fall in imports. Also, in H1 2010 exports of goods registered positive growth by 2.4%, while imports of goods fell substantially by -17.7%.

**Table 6.Macro-economic and Fiscal Adjustment Projections of EAD Alpha Bank (Percentage change; or percent)**

| | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 |
|---|---|---|---|---|---|---|---|
| Real GDP growth | -2,0 | -3,0 | -1,0 | 1,8 | 2,8 | 2,9 | 3,3 |
| Nominal GDP growth | -0,7 | 0,2 | 0,5 | 3,2 | 4,6 | 4,9 | 5,3 |
| GDP Deflator | 1,3 | 3,2 | 1,5 | 1,4 | 1,8 | 2,0 | 2,0 |
| Primary Gen. Gov. Balance (% of GDP) | -8,3 | -1,5 | 1,0 | 2,4 | 3,6 | 4,1 | 4,5 |
| Interest Payments (% of GDP) | -5,2 | -5,5 | -6,4 | 7,2 | -7,2 | -7,2 | -7,0 |
| Πλεόνασμα Γεν. Κυβέρνησης (% ΑΕΠ) | -13,5 | -7,0 | -5,4 | 9,6 | -3,6 | -3,1 | -2,5 |
| Privatization - Government guarantees | -17,5 | 1,0 | 2,0 | 2,0 | 2,0 | 1,5 | 1,0 |
| Χρέος Γεν. Κυβέρνησης (% ΑΕΠ) | 115,1 | 129,2 | 133,7 | 133,4 | 130,4 | 126,6 | 122,2 |

Πηγή: ΔΟΑ, Alpha Bank

Therefore, assuming that growth in the international economy and especially in Europe turns out as expected by the IMF and other international organizations, then Greece can indeed ***net export*** its way to a much lower recession in 2010 and to a possible recovery of positive yoy growth from Q3 2011 onwards. Taking into account these considerations, our own macroeconomic and fiscal adjustment projections are shown in Table 6.

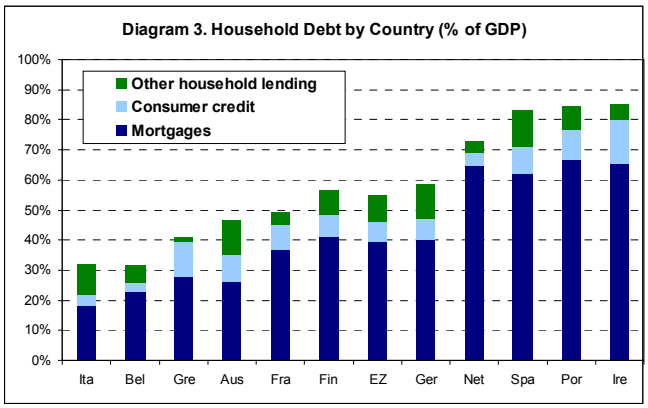
**GREECE IS IN A BETTER POSITION TO PROCEED WITH FISCAL ADJUSTMENT THAN MARKETS CURRENTLY ASSUME.**

**First,** ***Greece's overblown general government deficit and debt in 2008 and 2009 was mainly due to the overexpansion and extensive mismanagement of its utterly unproductive public sector.*** This unfavorable development crowed out more productive private sector activities. In fact, the huge fiscal expansion in 2008-2009 had a negative (not positive) effect on Greece's GDP growth. Therefore, notwithstanding the fact that the current drastic fiscal adjustment and structural reform effort imply a substantial fall in GDP and higher unemployment in 2010 and 2011, which are years of rationalization of public sector expenditure and employment, fiscal consolidation is expected to increase productivity and the growth potential of the Greek economy from 2012 onwards.

This is unlike the case of other OECD countries (Japan, USA, UK, Ireland, Spain, Portugal, and others), which also face the challenge of a substantial fiscal consolidation in the 2010s. For those countries, the recent ballooning of their fiscal imbalances was mainly due to their effort to accommodate the huge negative effects of the international economic crisis on their economies and in particular on 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.

***Second, the Greek financial sector remains in 2010 fundamentally sound, safe and liquid.*** This is so despite the substantial negative effects implied for Greek banks due to the turbulence in the international financial markets in 2008-2009 and more importantly in the GGBs market in 2010. In other European countries, general government deficits and debts exploded in 2008-2009 because governments in these countries had to bail out their banking system and also to counter the deep recession in their economies, as a result of the international financial crisis. ***In Greece, toxic asset write-offs by banks related to the global financial crisis were almost nil and their capital base has remain relatively strong.*** Moreover, some banks proceeded with 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 11.7% and 10.6% respectively at the end of March 2010, from 11.8% and 10.6% respectively at the end of December 2009, and 9.4% and 7.9% respectively at end December 2008. Indeed, if Greek banks suffer is only due to the derailment of the country's public finances.

It is very important, for example, ***that leverage of domestic households and businesses in Greece is much lower than that in the Eurozone,*** with loans to GDP at 102% in Greece, compared with an average 135.4% in the Eurozone and above 170% in some overleveraged economies. See for example Diagram 3 showing household debt as a percent of GDP in 2008.




***Concerning the effect on Greek banks because of the turbulence in the GGBs market, the following considerations should be taken into account:*** a) Greek banks are primarily funded by customer deposits, with a loan to deposit ratio at the end of March 2010 reaching 111.5 for banks and 118.4 for banking groups. However, some moderate deposit outflows were noted during the turbulence in H1 2010. More specifically at end June 2010 household and business deposits were lower by -8.8% yoy (by € 21.0 billion), from their very high level at end-June 2009, when they had registered an increase by 13.3% yoy. Despite the fall, sight and time deposits reached 93% of total M3, while M3 reached 101.3% of GDP at end-May 2010, from 110% of GDP at end-December 2009.

b) During 2009 and in early 2010 the Greek banks continued using ECB funding (posting as collateral securitized loans and government bonds) to strengthen their liquidity. The banks have been negatively affected by the downgrades of the Greek State. 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 support liquidity in the economy in these difficult times, the government proceeded with fully allocating the € 28 billion original 2009 support package (of which Greek banks, as of the beginning of 2010 had only made use of € 9.3 billion) and making available two tranches of € 25 billion respectively in government guarantees to support the banks' resort to the ECB window.Finally, the government and the Bank of Greece have set up by the € 10 Financial Stability Fund, as provided for by the IMF agreement in order to preserve a sound position in the banking system, by providing capital to banks being hit from severe loan losses as a result of the deteriorating economic conditions.

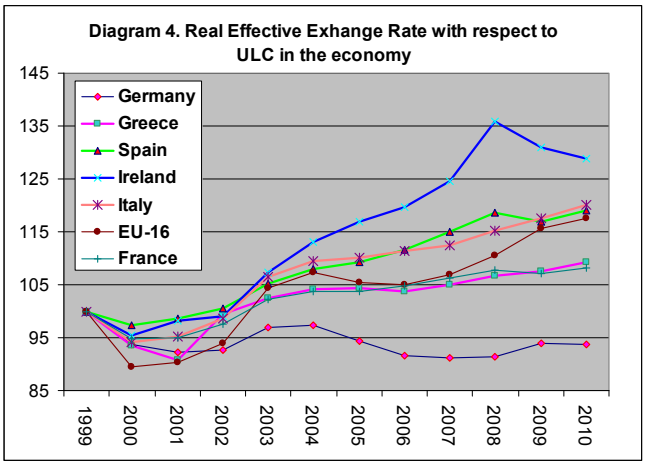
c) Concerning credit risk, the banks are faced with increasing NPLs in an economy experiencing negative growth conditions and an unfavorable external economic environment. As a result NPLs increased to 8.2% of total loans at end-March 2010, from 7.7% of total loans at the end of December 2009 and 5.0% at end December 2008. NPLs for mortgage loans have reached 8.2% (from 7.7% in December 2010), for consumer loans to 14.7 (from 13.4%) and for business loans 7.0% (from 6.7%). Nevertheless, bank credit growth stabilized to 2.5% yoy at end-June 2010, from 3.5% yoy at end March 2010, 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, a recovery of bank credit is rather unlikely before 2011. 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.

***Third, unit labour cost competitiveness of Greece is expected to improve further:*** From 2010 onwards, Greece's international competitiveness will benefit from a negative growth of nominal unit labour costs, in combination with the substantial devaluation of the effective exchange rate of the Euro for Greece, exerting a positive effect on growth from 2011 onwards.

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 data from the European Commission (Diagram 4.) show that Greece's ULC-based real effective exchange rate (REER) against the 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 rose by 6.2% in 2009, compared with 2005, while the appreciation of the Eurozone REERULC reached 9.2%. Therefore, Greek international competitiveness in 2006-2009 has actually improved against the Eurozone average, while it has worsened with respect to Germany and with respect to countries which are experiencing substantial exchange rate depreciation with respect to the Euro. Overall, the challenge for Greece to reign in domestic wage growth is now accepted by Greek authorities and constitutes one of the central

pillars of the process of fiscal adjustment in the GG–EU/IMF MOU.




In any event, in the period of drastic fiscal adjustment, Greece's REERULC will turn downwards, while at the same time Germany's and other developed country REERULC might turn gradually upwards. Greece will become more competitive and more export oriented. In this way, it can again have positive growth from 2012 onwards. The fall in domestic demand due to the persistent fiscal adjustment policies will be made up through the substantial increase of Greece's net exports.

***STRUCTURAL REFORMS, POTENTIAL INCOME GROWTH AND SOUND MEDIUM AND THE LONG TERM FISCAL FINANCES:*** The implementation of the fiscal adjustment and structural reforms endorsed by the Greek Government (GG) - EU/IMF MOU are now in full swing. Its main objectives are the following:

***a) The establishment of better governance and management of the public sector and public finances, providing for the reversal of the excesses of the 2000s,*** when high wage and employment growth, in combination with low (or even negative) productivity growth in the public sector, were the main contributors to the gradual erosion of Greece's competitiveness in terms of the unit labour cost (ULC) in the economy as a whole.

***b) The gradual withdrawal of the Greek state from activities that are better performed by the private sector.*** In particular, the Greek state owns a huge number of lucrative real estate properties, which have been either lying idle or badly managed, owing to inappropriate, or lack of, zoning arrangements. One of the great comparative advantages of Greece is tourism and the time is ripe for real estate development to become growth sector in the Greek economy.

***c) The rationalization of management of public sector entities.*** Corporate governance in this sector deteriorated substantially in the 2000s, a period in which government-controlled and local government entities have been operating with no regard to fiscal discipline. Their ever increasing deficits were duly covered by the General Government Budget without questions being asked. Strict budget constraints and cost recovery take increasingly center stage in their management operations. Of particular importance in this respect is ***the fundamental improvement of the management of the health sector in Greece*** and in particular of state hospitals, which have been between the main culprits of fiscal slippages in the 2000s. Also, ***the reorganization, privatization and better management of operations and properties of Greek railways*** could produce savings for the Greek state of more than € 1.0 billions per year, while at the same time upgrading the services offered to the public.

***d) The long overdue reform of the overgenerous Greek social security system,*** which is one of the main drivers 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.

Therefore, 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.*** In particular, a ***reduction in civil service employment*** will be effected through the freeze in public sector hiring in 2010 and the application of 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. Moreover, public sector rationalization includes the ***new reorganization scheme of local government (Kalikrates project),*** which has already been legislated and ***the rationalization, merging, or abolition of numerous public sector entities.*** The government is also in the process of implementing measures increasing transparency and enhancing accountability of the management of these entities.

**The Hellenic Privatization Programme:** The Greek government has announced its plans to privatize a number of state-owned companies as part of its attempt to promote their reorganization and effectiveness and fix the country's public finances.

The first move will be the reorganization of the Hellenic Railways Organization, or OSE, which is a fully state owned and overly underperforming business, recording a loss amounting to € 1.0 billion per year and a government-guaranteed debt of about € 10 billion. In fact, the company also owns real estate assets valued at much more than its debt. The Government intends: a) To proceed with the immediate restructuring of the company with the closure of loss-making lines, the streamlining of the management and the downsizing of its staff. b) To sell 49% of the trains operating subsidiary TRAINOSE to a strategic investor (e.g. a specialized foreign operator), transferring also the management of the company to this investor. c) To develop OSE railway stations and commercial real-estate via concession agreements and Special Purpose Vehicles or SPVs. d) Develop two large OSE freight centers in Thessaloniki and in Thriasio (Athens) via concession agreements. Unprofitable lines will be closed and profitable lines will be appropriately developed and further expended. In fact there are great

possibilities for expansion of TRAINOSE in the field of containers and other freight transport in combination with the development of its freight centers and Greek ports already under way.

The Government is also planning to go ahead with the privatization of state holdings in several casinos, and holdings of the Hellenic Tourist Real Estate (ETA). Also, it intends to develop the appropriate legal framework in order to regulate the gaming and internet betting industry, to issue new licenses and to regulate the monopoly of the Greek Gaming Lotteries (OPAP SA). But it will maintain the state's 34% holding in the company. Moreover, the Government plans to sell: a) a 39% stake in the Greek post office (ELTA) in which it holds a stake of 90%, b) a 23% stake the water supplying company of Thessaloniki (EYATH), in which it now holds 74% and c) a 10% stake of EYDAP, in which it now owns 61%. The government is also restructuring Greece's natural-gas monopoly (DEPA) to prepare it for privatization. In this company the state owns 65%, while another 30% is owned by the 51% state-owned Public Power Corporation (DEH).

Of particular interest is the Public Power Corporation S.A. (DEH), which holds an almost absolute monopoly in the electricity market in Greece. DEH and its subsidiaries engage in the generation, transmission, and distribution of electricity in Greece. It generates electricity from lignite, fuel oil, water, and natural gas, as well as from renewable energy sources. The company owns 63 power generating stations; transmits electricity through approximately 12,017 kilometers high voltage power lines; and distributes electricity to consumers through approximately 217,200 kilometers of distribution network. According to the current government plans, the State will maintain its controlling state in DESMHE, the grid network management company, and it will push through structural reforms for the retail and wholesale electricity markets, in line with EU directives. However, no concrete plans for the required liberalization of the electricity market have been announced.

Concerning the state-owned real estate companies, such as the State Real Estate Company (KED), the Hellenic Tourist Real Estate SA (ETA) and the Olympic Real Estate, the government has decided to merge all three into one company, including properties which are under the management of various ministries. Through the new holding company the Government wants: a) to design concession agreements using the existing privatization law, b) to manage portfolios of assets through new holding companies, c) to potentially float the company on the Athens Stock Exchange, maintaining 51%, or 34% state holding. The above developments require substantial changes in the existing legal framework in order to provide the tools for a fast track process.

In addition to the above, the Greek Government is also looking at other opportunities to privatize state assets, either through selling stakes or through privatized management contracts, including the country's ports, airports and state property holdings.

Over the next three years, the GG-EU/IMF MOU foresees privatization revenues reaching € 1 billion a year for the period 2011-13. However, the Greek Government expects that privatization proceeds will be definitely higher than those foreseen in the MOU.

**Improving labour market flexibility:** The government, in order to further improve Greece's international competitiveness has already passed through the Parliament measures providing for the following: a) The fundamental reform of the legal framework for wage bargaining and arbitration in the private sector. This will prevent situations in which an arbitration body chosen only by the trade unions could decide for wage increases which businesses could not afford. b) The introduction of entry-level wages for the young long-term unemployed workers below the current statutory minimum wage, which itself has been agreed by the social partners to remain virtual stable for the following three years. This will assist young workers to enter the labour market and improve their prospects thereafter. c) Employment protection legislation has been substantially rationalized, so that to facilitate entry and exit in the labour market. This is applicable also for part time workers, an area in which Greece has ample potential to boost employment. The above will give businesses a better opportunity to effectively manage their labour force improving employment, labour productivity and, in coordination with the already applied restrictive wage policy, international competitiveness.

**The pension system reform:** The budget funding of 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 this substantial increase was due to the surge of social security contribution evasion, which in 2009 meant lost revenue of € 8 billion. An additional part was advance payment for the needs of pension funds in 2010. Thus, the funding included in the 2010 budget was € 14.5 billion (6.0% of GDP). This item is expected to be contained further in the following years through a more effective crackdown on contribution evasion and the containment of pension funds health care expenditures (which have been increasing at more than 30% per year in the 2000s). 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 a 1.0% increase of contributions to the Farmer's Social Insurance Fund (OGA) has also been decided.

***The long overdue fundamental reform of Greece's unsustainable pension system has now been voted into law by the Greek parliament.*** The main target of this legislation is to reduce 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 no-reform baseline scenario. This will be achieved through restoring a balance between pension funds benefits and employer and employee contributions, so as to effectively contain budgetary transfers to the pension funds. To that end ***the main measures of the pension reform are as follows:***

**(1) Measures to increase the average effective retirement age limit starting from 2011.** This is implemented through the abolition of all early retirement provisions existing in many funds, the equalization of the retirement age in the public sector between men and women, the immediate raising of the retirement age from 58 to 60 for people with 40 (instead of 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 related measures.

***(2) Measures to align pension benefits to contributions. This is implemented through*** the institution of a basic pension for all at age 65 of € 360 (poverty level) from 2015 onwards, 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 fiscal 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 pension bonus payments from 2010, which are especially important for high income pensioners.

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. A pension freeze to 2010 levels has been decided for the following years 2011-2013 as well.

**The Reform of the Health Care System:** The government promotes measures aiming at a substantial improvement of operational and financial management of the Greek state hospitals and of the National Health Care system as a whole. It has already passed legislation under which all-day outpatient services at state hospital will be provided in competition with similar services offered by private hospitals and clinics. The new legislation aims to upgrade the National Health Care System and also to substantially increase state hospital revenues, as after official hours services will be provided at a relatively low cost to patients and social security funds and insurance companies. Moreover, the Greek Government has undertaken: a) to close budget loopholes in the state hospitals and force arrears to be reported as they develop, b) to immediately start the implementation of the double-entry accounting system in state hospitals, c) to publish periodically audited accounts of the state hospitals, and d) to establish procedures for better pricing and cost accounting mechanisms for hospital purchasing of supplies. Additionally, as part of the pension reform, health funds will be separated from pension funds, with the purpose to achieve a better delineation of tasks and accountability. ***Through these and other reforms, planned budgetary health care spending is set to be cut by € 0.9 billion in 2011 and by an even higher € 1.2 billion in 2012.***

***The above structural reforms and fiscal adjustment policies are estimated to have some very important implications for Greece's medium and long term public finances.*** First, the implementation of the reforms in the Greek public sector and state controlled businesses and entities and in the labour and product markets contribute to a substantial increase of labour productivity and of potential GDP growth. Second, the fundamental reform of Greece's pension and health care systems imply a substantial containment of the increase in public expenditure due to pension and health care payments in the future.

More specifically, the fundamental change that has occurred in the past five months, concerning the Greek medium-to-long term public finances, is better shown if we consider the following IMF (August 2009) exercise.

In this exercise, the IMF used the estimation of the European Commission (2009 Aging Report) that, on the assumption of no policy change in the Greek pension system as it existed in 2007, the ageing related increase of pension payments in the following 50-years would imply an increase in government expenditure by 12.4 percentage points (pps) of GDP. Also, ageing would imply additional increases in government expenditure due to the increasing health care expenses and the cost of long-term care, which in total implied an increase of this expenditure in the case of Greece by 15.9 pps of GDP.

Finally, the IMF assumed also an ageing-determined substantial falling trend in labour employment in the following decades, combined with a rate of growth of productivity much lower than Greece's 1995-2009 average. These assumptions implied the explosive trajectory of the general government debt/GDP ratio of Greece as shown in the following Diagram 5.

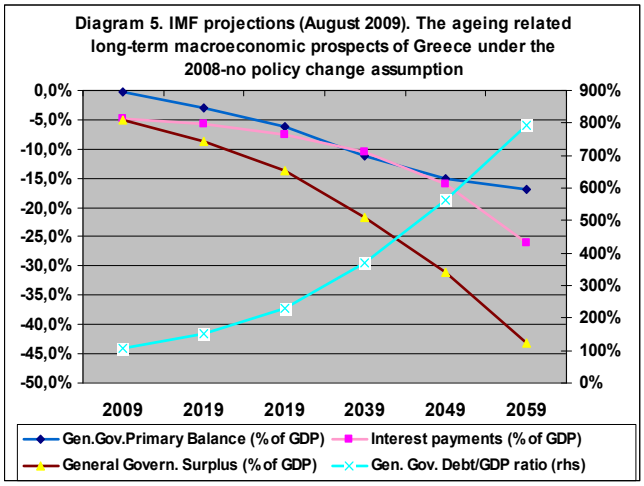


Diagram 5. IMF projections (August 2009). The ageing related long-term macroeconomic prospects of Greece under the 2008-no policy change assumption

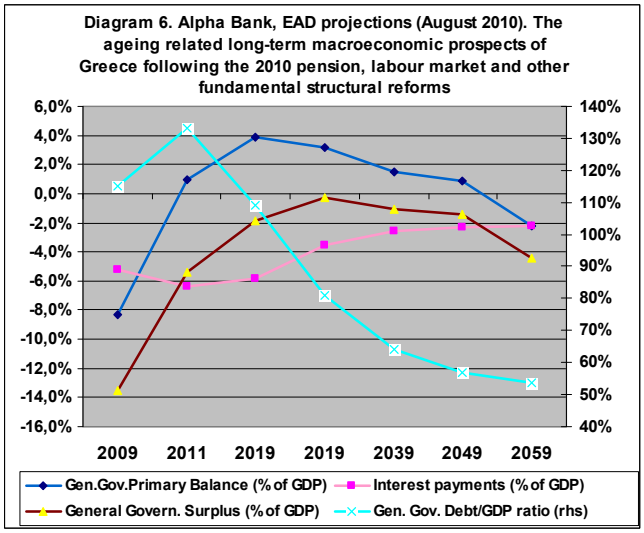


Diagram 6. Alpha Bank, EAD projections (August 2010). The ageing related long-term macroeconomic prospects of Greece following the 2010 pension, labour market and other fundamental structural reforms

Now, the already legislated pension reform in Greece implies that the most important of the above August 2009

IMF assumptions does no longer apply. There was a fundamental reform of the Greek pension system, which implies that the increase of government expenditure in the following 50 years due to pensions' payments will be no longer 12.4 pps of GDP but only 2.5 pps of GDP and in the worse case scenario 4.5 pps of GDP. Moreover, the initial conditions have also changed with the huge fiscal adjustment effort prescribed by the GG-EU/IMF MOU and applied successfully by the Greek Government. It is assumed that those adjustments will bring the general government deficit to a level below the 5.5% of GDP in 2011 and a fundamental change of Greece's long term macroeconomic prospects, as shown in Diagram 6.

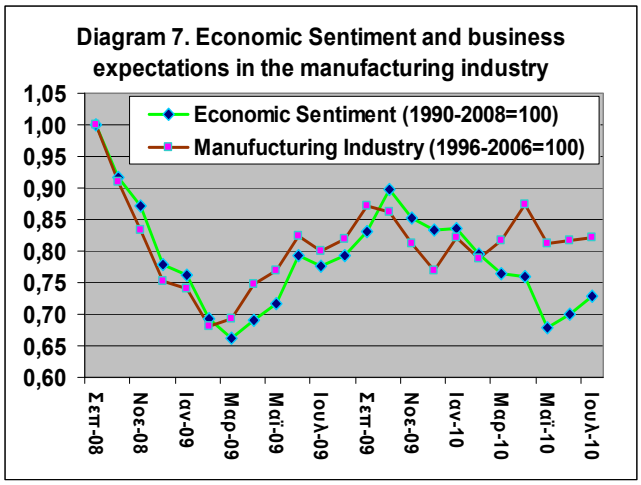
**RECENT ECONOMIC DEVELOPMENTS:** ***The fall of real GDP in H1 2010*** (a period of unprecedented turmoil and uncertainty in the Greek economy) was -2.9%, much lower than expected. This was mainly due to the substantial fall in fixed investment and government consumption both in Q1 and Q2 2010. In particular, GDP growth was -2.3% in Q1 2010 and this fall was mainly due: a) to the fall of fixed investment by -14.0% (contributing to the fall of GDP by 2.8 pps), b) to the fall in inventories contributing to GDP growth by -1.2 pps, c) to the 9.0% yoy fall of government consumption (contributing to the fall of GDP by -1.6 pps). On the other hand, private consumption registered unexpectedly a positive growth of 1.4% in real terms in Q1 2010, contributing a positive effect on GDP grow of the order of 1.1 pps. Also, net exports had a positive effect on Q1 GDP growth of the order of 2.2 pps, which was lower than expected. Finally, nominal GDP growth was slightly negative, -0.7%.

***The performance of the tourist sector in 2010*** has been unfavourably affected by minor riots that took place in Athens in H1 2010. In fact, social unrest was to be one of the factors that would undermine Greece's efforts for fiscal adjustment. Therefore, world media congregated in Athens in order to capture the expected super spectacle. Unfortunately, some minor incidents did happen, which the media exploited to the highest degree possible, with substantial negative effects on Greek tourism and on the Greek economy in general, especially in May and June 2010.

Nevertheless, ***arrivals of foreign tourist in the main Greek airports were only slightly down by -0.2% yoy in January –July 2010 (+2.7% in July),*** with international tourist revenues registering a -11.9% fall in H1 2010, that is in the very period in which Greece was in the forefront of the negative publicity internationally. For the year as a whole it is now expected that arrivals will register positive growth of the order of 3.5% in 2010, while international tourist revenues are expected to register a -5.5% negative growth from the low level of revenues of 2009. On the other hand, payments for travel by domestic residents abroad are also much lower in H1 2010, registering a substantial fall by -10.5% yoy. The fall of these payments is expected to contribute to an overall increase in the surplus of the external tourist sector in 2010 and to have an overall positive effect on GDP growth. Finally, it is important to note that turnover in the tourist sector was up 2.9% yoy in Q1 2010, from the very law level of Q1 2009, when it had registered a fall by -20.0%.

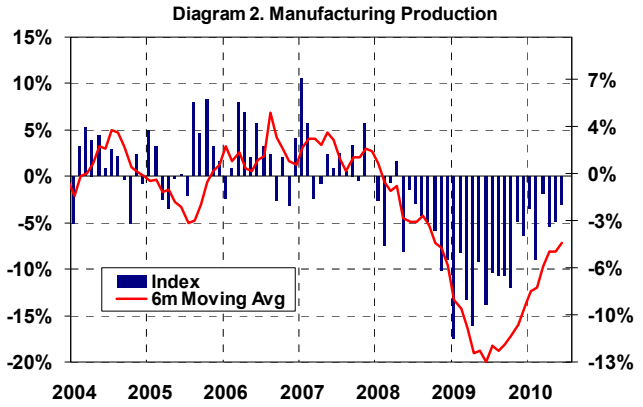
**Greece's net merchant shipping receipts *were substantially up by 14.8% yoy in H1 2010,*** reversing some of their fall by -28.4% yoy in H1 2009. However, outflows from the same source were also 20.2% yoy higher in H1 2010, implying that the net surplus revenue from shipping was robustly higher by 9.2% yoy in H1 2010 compared with its substantial fall by -30.9% in H1 2009. In 2009, revenues from this source fell by -34.4%, to € 6.48 billion, from their record level of € 9.9 billion in 2008. This was one of the factors which had affected negatively domestic consumption and housing investment in 2009. For 2010 as a whole we are expecting an increase by more than 15% in revenues and by 12% of net shipping revenues implying an important positive effect on domestic consumption and investment.

The substantial improvement of the world economy and international financial markets from Q3 2009 onwards, had contributed to a notable improvement ***in the Greek economic sentiment (ESI) and business expectations in industry indices*** until October 2009 (Diagram 7). However, economic sentiment and business expectations relapsed again to a rapid falling trend in November–December 2009, following Greece's entry into the fiscal and GGBs crisis. This deteriorating trend continued unabated in the first five months of 2010, which was a period of unprecedented crisis in GGBs market, with a small improvement showing only in June and July 2010. In particular, c***onsumer sentiment*** had improved substantially to -27.1 in October 2009, from -56.2 in March 2009, but fell sharply to -47.2 in Jan. 2010 and then to -67 in Apr. 2010, only to improve slightly to -66 in July 2010. Moreover, the substantial improvement in business expectations in services, construction and retail trade registered until October 2009 was also reversed brutally in the subsequent months.



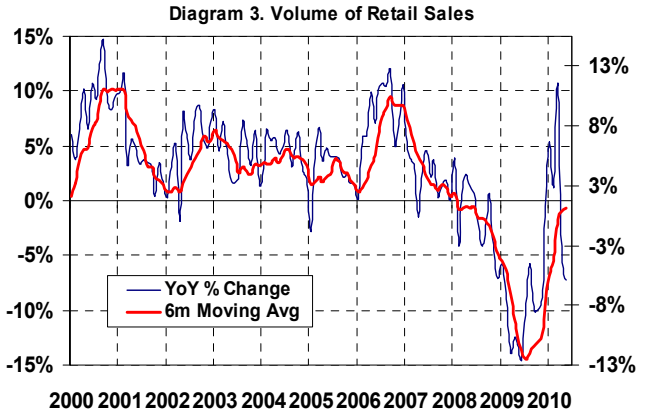

***In the manufacturing industry (accounting for about 8% of value added),*** the falling trend of production continues mainly due to the substantial fall on production of traditional industries, which are facing intensifying competition from low cost countries, as well as the fall of production of industries which are related to the domestic construction activity. ***Therefore, production fell by -4.4% yoy in Q2 2010, from -3.6% yoy in Q1 2010,*** -

8.3% Q4 2009, -10.6% in Q3 2009 and a substantial fall of -12.8% yoy in Q2 2009. ***For 2010 as a whole manufacturing production is now expected to fall further by -3.8%, after its fall by -11.0% and -4.5% in 2009 and 2008 respectively.***




***In 2009, 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 of -3.3%, -5.8% and -2.7% respectively. However, the performance of these sectors in H1 2010 was less promising, as they register a higher fall in their production of -2.1%, -7.8% and -18.0% respectively. In fact, beverages and tobacco industries are affected negatively by the substantial increase of the specific retail taxes imposed on sales. On the other hand, a positive growth in production in H1 2010 are registering some other important sectors of the Greek economy, as the chemical industry (H1 2010: 1.4%, H1 2009: -17.2%), the pharmaceutical industry (H1 2010: 7.0%, H1 2009: 14.1%), the basic metals industry (H1 2010: 11.1%, H1 2009: -24.2%) and other manufacturing activities (H1 2010: 0.3%, H1 2009: -16.6%). Still negative increase in production are registering the construction of metal products industry (H1 2010: -7.3%, H1 2009: -22%) and the motor vehicles industry (H1 2010: -6.0%, H1 2009: -29.3%) Finally, the fast falling trend of production of the textiles, clothing and footwear sectors continue unabated in H1 2010 as 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, only to fall in May and then recover in June and July. 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 and to 45.3 in July.

Concerning private consumption, ***the volume of retail sales has registered positive growth of 0.8% yoy in January-May 2010, compared with a fall of -10.7% in January-May 2009.*** Developments in April and May reflect the substantial deterioration of consumer confidence, falling to -61 in April 2010 and to -67 in May and June 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, 64.3 in May 2010, 53.3 in June and 50.8 in July 2010.




***The positive increase of the volume of retail sales in Jan.-May 2010 is due to the positive increase of the volume of sales of food-beverages and tobacco stores, as well as the positive increase of sales of big super markets. On the other hand, the big department stores have registered a fall in sales of -11.2%. Also, the sales of durable goods,*** including furniture, electrical appliances and electronics have recorded a small fall in sales of -1.3% in Jan.-May 2009 and a -10.4% fall in May 2010, compared with a substantial fall of -20.2% in January – May 2009. Finally, clothing and footwear registered a fall in the volume of sales of -4.4% in January-May 2010 and of -19% in May 2010, following an increase of 4.6% in January – May 2009. Moreover, ***new passenger car registrations*** have also registered a substantial fall of -27% yoy in January – July 2010, following a fall of -22.1% in January – July 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 € 1.22 in January-May 2010, which it was 11.6% down from the payments of € 1.38 billion in January – May 2009. In 2009 as a whole payments for passenger car imports reached the € 3.3 billion, from € 5.2 billion in 2008. Noone buys big and expensive cars in Greece any longer. These developments contributed to ***the substantial fall of imports of goods*** in H1 2010 and in 2009 and are expected to contribute to this fall even more in the following months of 2010.

***Concerning investment in housing, the falling trend of residential construction activity*** – as measured by the volume ($m^3$) of building permits – continues unabated, registering a new fall of -22.4% in Jan-May 2010, following its 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 H2 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 2.5% at end-June 2010, from 3.5% at end-March 2010, 3.7% at end-December 2009, 6.0% at end-

June 2009 and 11.5% at end-2008. ***The adverse impact of the substantial deterioration of Greece's fiscal position on consumer 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 expectations 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, to 39.7 in March 2010, to 44.6 in April 2010 and to 46.1 in July 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 threat of bankruptcy for the Greek economy fades away.

**GDP GROWTH DEVELOPMENTS AND PROSPECTS: Uncertainties and risks concerning economic growth in Greece in 2010 and 2011 remain high.**

The global economic crisis in 2008-2009 affected in particular the Greek shipping and international tourism earnings, as well as the exports of goods, with a fall in exports of goods and services of -18.1% in 2009. Moreover, it ***had substantial negative effects on economic sentiment in Greece.*** As is shown in Diagram 7, the economic sentiment index (ESI) and the index of business expectations in industry reached their lowest values, since their first publication by the European Commission, at 60.4 and -37 respectively in March 2009. Also, business expectations in services, construction and retail trade, as well as the consumer confidence index fell to very low levels in March-April 2009. These negative developments in exports and in the domestic economic sentiment implied a dramatic fall in Investment and in private consumption in 2009. Of particular importance was the substantial fall of investment in housing, which had started in 2007 and took unprecedented proportions in 2009 and in H1 2010. Also, government investment through the CSF 2007-2013, the incentives investment law and the PPPs fell in 2009 and this fall continued unabated in H1 2010. Finally, the dramatic deterioration of consumer confidence implied a substantial fall of private consumption, especially of durable goods items.

However, the fall in domestic demand until now has been greatly 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 in 2009 was mainly the result of the big fall in exports of goods and services in this year, which was cushioned only partially by the fall in imports. ***However, in 2010, there will be an even bigger fall of domestic demand and imports, but this time growth of exports of goods and services is expected to be positive.***

Developments in the Greek economy summarized in Table 1, indicate a possible equal fall of GDP in H2 2010, as in H1 2010, which will imply an overall -3.0% fall of real GDP in 2010. This GDP fall will be due to: a) an estimated -2.8% fall of private consumption (from +1.4% in Q1 2010), b) to the fall of government consumption by -10.5% (from -9.0% in Q1 2010) and c) the fall in fixed investment by -7.1% (-14.6% in Q1 2010). In the external sector we expect an increase in exports of goods and services by 1.8% (from -0.5% in Q1 2010) and another fall in imports of goods and services by -8.5% (from -6.6% in Q1 2010).

The above projection takes into account the observed so far delays in the implementation of the 2010 investment program and the fact that business and consumer confidence remain at very low levels until July 2010, despite their improvement in June-July 2010. A GDP fall by -3.0% is primarily the result of much bigger fall of domestic demand by -5.4% in 2010, from -2.4% in 2009, which, however, will be compensated to a great extent by the sizable fall of net exports deficit (-27.1%), implying a positive contribution on GDP growth of 3.0 pps in 2010, compared with only 0.7 pps in 2009. More specifically:

**Private consumption registered a fall of -1.8% in 2009,** despite the substantial increase of gross disposable income of the private sector by more than 5.1% (3.9% in real terms) in this year. As a result, in 2009 Greece registered a surge of the gross saving rate of the private sector to levels above 17%, from 12.9% in 2008. Therefore, the fall of private consumption in 2009 was mainly due to the negative impact of the weak consumer sentiment, which led to a substantial increase of precautionary household savings. For 2010, ***taking into account current developments, which are still indicating: a) a positive growth in the volume of retail sales in January-May, despite a substantial fall of the volume of retail sales in April-May 2010, b) an expected substantial fall by about -7.0% for real disposable income of households in 2010, c) an estimated improved consumer sentiment from Q3 2010 onwards and d) an estimated negative, -2.0% yoy, consumer credit growth in December 2010,*** we are projecting a -2.8% real private consumption growth, following its -1.8% fall in 2009. Moreover, real private consumption growth will remain negative to the order of -2.3% in 2011, with ***the gross saving rate*** increasing again to 17.3% in the following year from its fall to 14.8% in 2010.

**Growth in government consumption:** For 2010, fiscal adjustment entails that government consumption growth will be substantially negative, of about -10.5% in real terms, following its 9.6% increase in 2009. 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 below the 3.0% of GDP in the year 2013. This will constitute a substantial withdrawal of the public sector from the economy, allowing more room for the private sector.

**Total fixed investment:** Under the current economic conditions, we are projecting an additional negative growth of fixed investment of -7.1% for 2010, following their fall by -13.9% in 2009 and by -7.4% in 2008. This will be mainly due to the following developments:

a) To ***the estimated new fall of housing investment in the current year*** by -19.5%, from -21.7% 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 1.5% in 2008, from 6.2% in 2007 and 13% in 2006, and has now turned negative, falling by –4.4% in 2009 and by -2.3% yoy in Q1 2010.

Table 7. Greek GDP developments 2008-2013

| | %Δ'08 | %Δ'09 | %Δ'10 | %Δ'11 | %Δ'12 | %Δ'13 |
|---|---|---|---|---|---|---|
| **Final Consumption** | 2,0% | 0,3% | -4,3% | -2,8% | 0,5% | 1,4% |
| ***Private Consumption*** | 2,3% | -1,8% | -2,8% | -2,3% | 1,5% | 2,1% |
| ***Government Consumption*** | 0,6% | 9,6% | -10,5% | -5,0% | -4,0% | -2,0% |
| ***Investment*** | -7,4% | -13,9% | -7,1% | -1,5% | 6,8% | 9,1% |
| ***Housing*** | -29,1% | -22,0% | -19,5% | -7,0% | 9,5% | 10,2% |
| ***Other Construction*** | 2,2% | 1,8% | -1,0% | 6,0% | 7,5% | 11,5% |
| ***Equipment*** | 6,3% | -15,9% | -6,1% | -3,0% | 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% | -42,2% | -25,0% | -9,1% | -10,0% |
| **Final domestic demand** | 1,0% | -2,5% | -5,4% | -2,8% | 1,6% | 2,8% |
| ***Exports of goods and services*** | 4,0% | -18,1% | 1,8% | 3,5% | 4,1% | 5,1% |
| ***Imports of goods and services*** | 0,2% | -14,1% | -8,5% | -4,5% | 2,8% | 4,0% |
| **External balance** | -6,7% | -6,0% | -27,1% | -24,6% | -1,8% | -0,1% |
| **GDP, 2000 prices** | 2,0% | -2,0% | -3,0% | -1,0% | 1,8% | 2,9% |
| **GDP components as % of GDP** | | | | | | |
| Final Consumption % of GDP | 88,8 | 90,8 | 89,6 | 87,9 | 87,0 | 85,9 |
| Private consumption % of GDP | 72,8 | 72,9 | 73,1 | 72,1 | 72,0 | 71,7 |
| Gross savings % of GDP | 11,2 | 9,2 | 10,4 | 12,1 | 13,0 | 14,1 |
| Investment % of GDP | 21,0 | 18,4 | 17,7 | 17,6 | 18,3 | 19,2 |
| Exports of goods and services % of GDP | 24,0 | 20,1 | 21,0 | 22,0 | 22,5 | 23,0 |
| Imports of goods and services % of GDP | 35,6 | 31,2 | 29,4 | 28,4 | 28,5 | 28,7 |
| External balance % of GDP | -11,6 | -11,1 | -8,4 | -6,4 | -6,0 | -5,7 |
| Change in stocks and stat. descrepances % of GDP | 1,8% | 1,8% | 1,1% | 0,9% | 0,7% | 0,6% |
| **7** | | | | | | |
| ***Net exports*** | 0,85 | 0,69 | 3,01 | 2,06 | 0,28 | 0,15 |
| ***Private consumption*** | 1,67 | -1,30 | -2,04 | -1,68 | 1,15 | 1,73 |
| ***Government consumption*** | 0,09 | 1,53 | -1,87 | -0,82 | -0,63 | -0,30 |
| ***Investment*** | -1,71 | -2,92 | -1,30 | -0,26 | 1,04 | 1,41 |
| ***Housing investment*** | -2,35 | -1,23 | -0,87 | -0,26 | 0,33 | 0,34 |
| **Chnange in stocks and Stat. descrepances** | 1,11 | -0,04 | -0,80 | -0,28 | -0,11 | -0,11 |
| ***GDP, 2000 prices*** | 2,0 | -2,0 | -3,0 | -1,0 | 1,7 | 2,9 |

In fact the fall in the Athens area reached -4.6% in 2009 (Q1 2009: -4.3% yoy, Q2 2009: -4.7% yoy, Q3 2009: -5.2% yoy and Q4 2009: -4.1% yoy) and -2.0% yoy in Q1 2010. 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 did 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 from 2010 onwards.

***b) To the expected fall 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 of 4.0% in 2009 and 2.2% in 2008 and it was expected that its rate of growth would accelerate in 2010 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 -8.5% in real terms in 2010,*** following its increase by 3.3% in 2009 and its fall by -5.2% in 2008. This will be mainly due to the expected fall in spending under the Public Investment Budget (PIB) by -7.2% in real terms. 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.

***c) To the expected new fall by -6.1% of investment in equipment,*** following its fall by -19% in 2009 and its increase by 6.3% in 2008. It is now evident that various categories of investment projects were delayed or postponed on the back of the unprecedented uncertainty due to the global economic and financial crisis and the domestic political turmoil in 2009 and the GGBs crisis in H1 2010. For example, it appears that only a minimum of activity is taking place currently in the field of Public Private Partnerships (PPP). Following a relatively long gestation period, 52 PPP 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 beyond. However, the implementation of these PPP projects did not start in 2009 due mainly to government paralysis in a year of two election campaigns. Moreover, the government announced in June 2010 that they are to proceed with about half of these projects, budgeted at € 2.1 billion, which have been judged as mature and worthy of implementation. The rest of the projects remain under examination. ***Business investment*** was also expected to be boosted by the PPPs on the one hand and by 12,050 investment projects under the investment incentives law (3299/2004 and 3522/2006) in the period 2005-28.1.2010. About 12,050 projects of € 31.2 billion were submitted, of which, 7,080 projects of € 14.5 billion were approved. These projects are already under gradual implementation, but delays in government financing have reduced to a minimum the relevant investment activity in H1 2010. On the other hand the apparent increased availability of government funds for the subsidization of these investments from H2 2010 may contribute to a higher business investment in H2 2010 and in 2011 onwards. Moreover, the government has already published the new investment incentives law, which is soon going to be passed through parliament and it is expected to be applied from the beginning of 2011.

The above assumptions concerning final consumption and fixed investment, with the assumption of a fall in stocks by an estimated -42.2% in 2010, imply that **the overall domestic demand will register a negative growth of -5.4% in 2009,** contributing to a sizable improvement of the external goods and services deficit (national accounts basis) to 8.4% 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 **in total imports of goods and services,** which are expected to register a -8.5% fall, following a -14.1% fall in 2009 (when the fall in domestic demand was -2.5%). On the other hand, **exports of goods and services** are expected to recover, by 1.8% ın 2010, on the back of the recovery of the European economies, as well as of the recovery of the volume of the international trade (2010: +9.0%, 2009: -11.3%) affecting Greek shipping. On these grounds, overall, net exports are expected to have a substantial positive impact on GDP growth of 3.0pps in 2010 and 2.1pps in 2011, from 0.7pps in 2009.

**THE IMPLEMENTATION OF THE 2010 BUDGET:** The implementation of the 2010 Budget during January – July 2010 point to 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:

***The increase in net current revenues by 4.1% to € 28.67 billion,*** compared with their fall by -2.7% in January-July 2009 and a targeted increase of 13.7% for the year as a whole. This outcome is less than expected, as it does not appear to incorporate any gains in the government's effort to combat tax evasion as of yet. However, a better performance in the tax collection effort may be expected for the remaining 5-months of the year for the following reasons: (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 -6.2%. (2) The functioning of the tax administration in the seven months of 2010 was still problematic. In fact, the revenues from taxes assessed in previous years and from overdue tax liabilities were lower by -29.1% yoy (at € 1.17 billion) in January-July 2010. There are indications that the tax administration has picked up speed. Therefore, the collection of tax revenues assessed in previous years is expected to reach in 2010 their level in 2009 (€ 2.45 billion) and to be much higher in 2011. (3) Most of the basic measures for net current revenue boost taken in 2010 were not in effect until July 2010. For example, direct income tax was -7.8% lower in the seven months of 2010, but the new tax bill and the broadening of the tax base is applicable only from June 2010 and there is a substantial delay in the processing of tax returns in 2010. Moreover, revenues from VAT registered a small 1.5% increase in H1 2010, with a 2 pps hike in VAT rates not applied until May 2010 while another 2 pps hike until July 2010, with additional revenues expected from August 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 is now expected to reach 11.0%, compared with a budgeted increase, following the additional May 2010 tax measures, of 13.7%. In fact, most of the additional tax revenues expected to arise from the application of the new tax law, the property taxes and the broadening of the tax base, are now expected to be captured from 2011 onwards.

**(b)** Current primary expenditure reached € 28.92 billion in January-July 2009, down by -12.6% yoy, following its increase by 13.9% in January-July 2009 and a projected fall, following the expenditure cut measures of May 2010, of -5.8%. This is a spectacular achievement in the field of fiscal adjustment, compensating for any shortfall in net current revenues. In fact ***current primary expenditure is expected to fall at the same high rate in the following months of 2010.*** Budgetary implementation will benefit substantially in this period from the recent additional cut of € 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 high pensions. Also, most of the cuts in intermediate consumption, estimated at € 0.7 billion will be registered in the remainder of 2010. Overall, a conservative estimate is for current primary expenditure to reach € 53 billion in 2010, registering a fall of about -10.9%.

**(c)** Interest payments in January – July 2010 reached € 8.91 billion, compared with € 8.93 billion paid in Jan.-July 2009. 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 2010-2013.

**(d)** In the Public Investment Budget (PIB), expenditure reached € 4.2 billion in Jan.-July 2010, down from the € 6.59 billion absorbed in Jan.-July. 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 € 9.2 billion. On the other hand, PIB revenues reached € 1.28 billion in Jan.-July 2010, up from € 1.03 billion in Jan.-July 2009. It is now projected that PIB revenue will reach at the end of 2010 the € 3.2 billion, which will be less than the targeted level of € 3.86 billion.

The above developments indicate that the implementation of the B2010 in the period Jan.-July 2010 is more than satisfactory and much within the targets set by the Greek government-European Commission-ECB-IMF MOU. It is now more certain that with a better performance in the field of revenue collection, the Greek general government deficit will be significantly lower than the targeted 8.1% of GDP for 2010.

**INFLATION:** Debt dynamics in a country become explosive if one is able to assume an extensive period of recession and deflation. An assumption that fiscal adjustment will bring the country in the brink of deflation, may easily lead to assumptions as absurd as the one made by S&P that "Greece's nominal GDP will not exceed its level in 2008 before 2017".

Nevertheless, inflation in Greece reached 5.5% in July 2010 and is expected to fall back to around 4.5% in December 2010. 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 price hikes of services provided by deficit ridden public sector entities. Therefore, inflation surged in 2010 and is expected to remain above 1.5% in 2011 as well, despite the expected substantial fall of domestic demand. ***Average inflation for 2010 is now expected at 4.5%***. It should be noted that ***the Greek GDP deflator is wisely estimated by the European Commission to increase by 2.9% in 2010 and by 1.7% in 2011.*** More recently the IMF has also changed its projections for the CPI inflation in Greece to 4.75% in 2010 (from 1.9%) and to 1.5%-2.0% in 2011 (from -0.4%).

**BALANCE OF PAYMENTS:** The current account deficit (CAD), which includes net capital transfers, reached € 14.4 billion in H1 2010, up 5.9% yoy, following its substantial fall by -19.3% in H1 2009 and by -19.6% in 2009 as a whole. Developments in the Greek BoP in 2009 and in H1 2010 reveal the effect of the substantial fall of domestic demand in Greece due to the international economic crisis and the extensive fiscal adjustment measures applied in 2010.

Of particular importance is the new fall of the deficit of the trade balance by -0.6% in H1 2010, following its

substantial fall by -32.6% in H1 2009. Exports of goods have registered a healthy increase by 4.74% in H1 2010, following their fall by -21.8% in H1 2009. On the other hand, imports of goods registered an 1.1% increase in H1 2010, mainly due to the excessive increase by 32.1% of payments for imports of fuels (H1 2009: -38%). Imports of goods excluding fuels and ships fell in H1 2010 by -8.74% yoy, following their fall by -25.4% in H1 2009. Exports of goods excluding fuels and ships were also lower by -4.9% in H1 2010, following their fall by -14.3% in H1 2009. Therefore, the trade balance excluding fuels and ships, registered a new fall by -10.9% in 2010, following its substantial fall by -30.9% in H1 2009.

A second important development was the small increase by 3.1% of the surplus of the balance of services in H1 2010, following its sizable fall by -30.4% in H1 2009. More specifically, in H1 2010 there was a new fall by -11.9% of earnings from external tourism, following their fall by -13% in H1 2009, while revenues from shipping and from other services registered substantial increases by 14.8% and 11.5% respectively, following their fall by -28.4% and -7.7% in H1 2009. Finally, payments for imports of services were also higher, by 9.3% in H1 2010, compared with -16.3% in H1 2009.

Thirdly, the deficit of incomes balance was lower in H1 2010 on a yearly basis, mainly due to the fall of payments for interest, dividends and profits to foreign investors in Greek government bonds and shares by –7.7% in H1 2010, from -5.9% in H1 2009.

Finally, the surplus of the balance of current and capital transfers was substantially lower on a annual basis, reaching only € 1.22 billion in H1 2010, from € 2.36 billion in H1 2009 and € 4.6 billion in H1 2008. This development has prevented a bigger fall of the current account deficit in 2009 and in h1 2010. Nevertheless, a further improvement of the CAD is expected for 2010 as a whole, where the deficit is estimated to fall to 8.5% of GDP, compared with 10.4% of GDP in 2009, 12.7% of GDP in 2008 and 12.3% of GDP in 2007.

Table 8. Greek Balance of Payments (€ Billions)

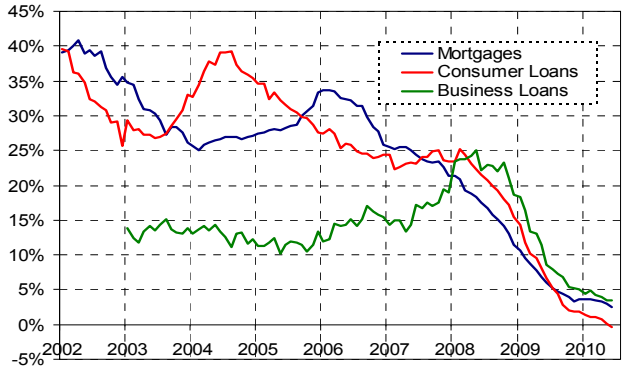
| | 2007 | 2008 | 2009 | H1 2009 | H1 2010 |
|---|---|---|---|---|---|
| Trade Balance (TB) | -41,50 | -44,05 | -30,76 | -15,36 | -15,27 |
| Exports | 17,45 | 19,81 | 15,32 | 7,44 | 7,79 |
| Imports | -58,94 | -63,86 | 46,08 | -22,80 | -23,06 |
| Services Balance | 16,59 | 17,14 | 12,57 | 4,37 | 4,50 |
| Tourism Receipts | 11,32 | 11,66 | 10,37 | 3,16 | 2,78 |
| Shipping Receipts | 16,94 | 19,19 | 13,55 | 6,73 | 7,72 |
| Income Balance | -9,29 | -10,64 | -9,80 | -4,95 | -4,85 |
| Payment of Interest, Divid. & Profits | -13,51 | -15,81 | -13,52 | -7,02 | -6,48 |
| Transfers' Balance | 5,92 | 6,85 | 3,31 | 2,35 | 1,22 |
| Current Account (CA) | -28,27 | -30,71 | -24,69 | -13,59 | -14,40 |
| CA (% of GDP) | -12,4% | -12,8% | -10,4% | -5,72% | -6,02% |
| Capital Account | 27,89 | 29,94 | 24,56 | 14,37 | 14,99 |

Source: Bank of Greece

In ***the capital account*** of the Greek balance of payments, net capital inflows reached again to € 14.99 billion in H1 2010, from € 14.37 billion in H1 2009. ***Net capital inflow through foreign direct investment (FDI)*** reached € 891.8 billion from € 1.08 billion in H1 2009. This was mainly due to lower FDI by foreign firms in Greece of € 1.25 billion (H1 2009: € 1.5 billion), as well as to the fall of FDI by Greek firms abroad to € 0.36 billion (H1 2009: € -0.43 billion). ***Net Capital outflows for portfolio investment abroad by Greek residents*** reversed to substantial inflows of € 8.6 billion in H1 2010 (outflows of € 1.71 billion in H1 2009). On the other hand the H1 2010 period witnessed a substantial reversal of net capital inflows from foreign residents for portfolio investment in Greece, which turned into outflows of € 13.6 billion in H1 2010, from inflows of € 20.68 billion in H1 2009. Finally, there was a substantial net inflow of other investments (primarily bank and Government borrowing and lending) of € 19.1 billion in H1 2010, from a substantial net outflow of € 5.7 billion in H1 2009. This net inflow in 2010 comprises an inflow of € 35.3 billion, of which € 19.3 billion to the Government from the EU/IMF financial mechanism and the remainder to the Greek banks, and an outflow of € 16.3 billion which includes outflows from Greek banks.

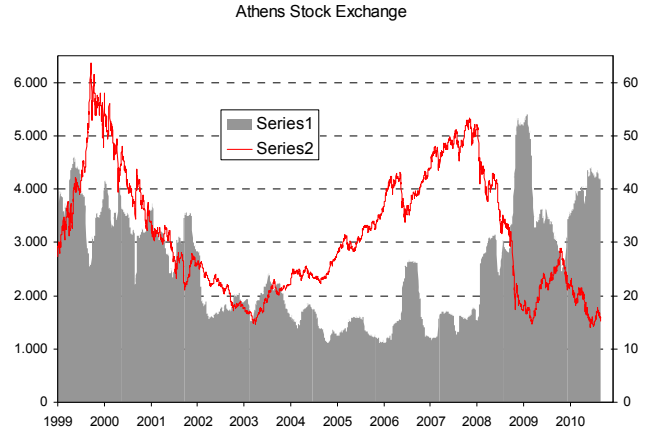
**MONEY & FINANCIAL MARKETS:** Credit expansion to businesses and households decelerated further to 2.5% at end-June 2010, from 3.5% at end March 2010, 4.2% at end- Dec.'2009, and 7.6% at end-June 2009. In particular, mortgage and consumer lending growth reached 2.5% and -0.4% respectively at and June 2010, from 3.5% and 1.1% respectively at end March 2010, 3.7% and 1.8% respectively at end-Dec.'2009, from 4.4% and 2.9% respectively at end September and 6.0% and 6.6% at end June 2009. Loans to domestic households reached 50.4% of GDP in end-June 2010 (49.9% of GDP in end Dec 2009), compared to 66.6% of GDP in the Eurozone in end- June 2010.

Diagram 6. Credit Expansion




Moreover, lending growth to businesses decelerated to 3.4% at end June 2010, from 4.3% at end March 2010, 5.1% at end-Dec.'2009, 6.2% at end-September 2009 and 8.8% at end June 2009. Overall, credit expansion to the private sector is expected to decelerate further to about -1.5% by year-end 2010, which is in line with an expected nominal GDP growth of about 0.0%. 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 in Greece, as domestic demand is expected to remain subdued due to the effort for fiscal adjustment. The problems of liquidity and capital adequacy structures that banks face may increase in following months, given the expected low pace of activity in the Greek economy.

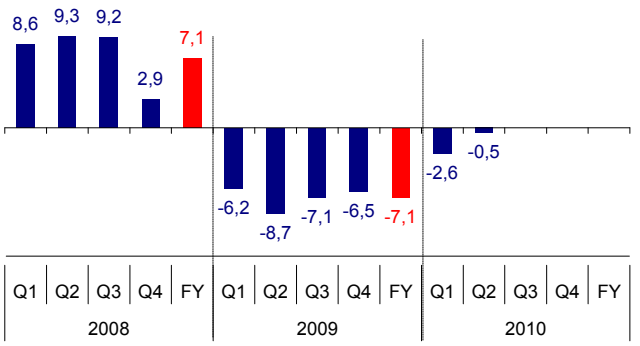
By the end of July 2010, the main ASE composite index was down -28.8% on a yoy basis (FTSE-20 stocks: -32.0%, mid-cap FTSE-40: -30.5% and small caps FTSE-80: -31.2%), from 22.9% at end-2009. Following these developments, at the end of July 2010 48.5% of the total stock exchange value of listed firms was in the hands of foreign investors (€ 31,654 billion), almost the same as of the end of 2009.



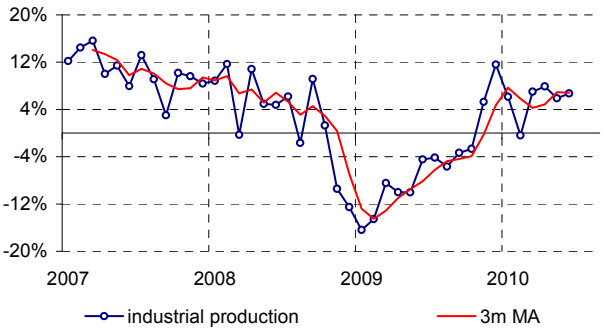

# ROMANIA

**ECONOMIC OVERVIEW:** In a sharp reversal of fortunes, in 2009 GDP fell considerably by -7.1% versus an average 5.9% during the period 2000-2008. High external imbalances and reliance on capital inflows precipitated a balance of payments adjustment in 2009, which shocked the economy and necessitated the agreement on a loan-deal with multilateral lenders led by the IMF and the EU. The IMF-EU led loan-program, amounting to a € 20 billion stand-by arrangement with a time horizon of 24 months, was successfully negotiated and agreed in May of 2009. More than one year following the agreement of the loan-program, considerable adjustments have taken place in the Romanian economy. The substantial fall in domestic demand and GDP has resulted to a significant correction of the country's external imbalances, but also to a disturbing widening of its general government deficit. The effort to contain and reduce this deficit has now become the focus of the government's reform efforts.

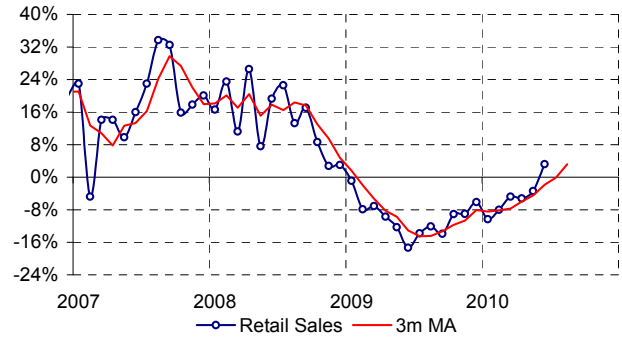
Real GDP (%Δ YoY)




Industrial Production - January (%Δ YoY)




Retail Sales (%Δ YoY)




The 2009 recession was marked by steep declines in private consumption (-10.5%) and investment (-25.3%), which affected output in manufacturing industry and construction and as well as wholesale and retail trade. In Q1 and Q2 2010 GDP continued to decline by -2.6% yoy and -0.5% yoy respectively, following its fall by -6.5% in Q4 2009. Overall, in H1 2010 the falling trend of consumption and fixed investment has decelerated, while, growth of public consumption has turned negative. Moreover, partly due to the existing substantial base effects and also due to increased external demand, exports surged by 21.6% yoy in Q1, while imports increased by 16.1%. Similar trends are projected for Q2 2010, while imports may revert to negative growth from Q3 2010 due to the renewed weakness in domestic demand. Overall the Q1 GDP performance disappointed and many analysts, including the IMF, revised their GDP forecast downwards, from 0.8% growth at the beginning to -0.5% latter and then, following the substantial increase to the VAT rates by 5.0pps (see below), the consensus is for a -2% GDP fall. The -0.5% drop of GDP in Q2 2010 is now considered as a prelude to even bigger fall of GDP in Q3 and Q4 2010, mainly because of the newly applied aggressive fiscal adjustment measures. In fact, the falling trend of GDP is now expected to accelerate despite the substantial recovery of industrial production and exports.

**FISCAL POLICY:** The downward revision of the 2010 GDP forecast also led to an upward revision of the fiscal deficit target in the context of the loan-accord, to 6.8% of GDP in 2010, from 5.9% of GDP initially, while the deficit reached 7.4% of GDP in 2009. In order to achieve the required 2.6 pps of GDP fiscal adjustment (the deficit would be much higher in 2010 without additional expenditure reducing and revenue raising measures), the authorities agreed with the IMF to adopt additional public expenditure cutting measures, including a -25% cut in salaries of the

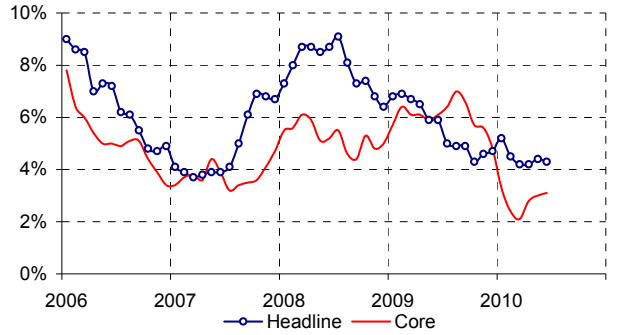
public sector employees and a -15% cut in pensions. In mid-June of 2010 the government was able to bring together a thin majority in the Parliament and fended off a no confidence vote from the main opposition party. Therefore, the above fiscal measures were passed through the Parliament. However, soon after, the Constitutional Court of the country judged that the proposed cuts in pensions (including the pensions of the Judges themselves) were not compatible with the Constitution, thus raising concerns in the markets that the IMF-EU deal may be derailed. Putting on the one side the loss in credibility over its ability to push forward with tough measures in order to achieve the needed fiscal adjustment, the government immediately went ahead with an increase of the VAT by 5.0 pps to 24%, effective from 1st of July 2010, as a compensatory measure for the withdrawal of the proposed -15% cut in pensions.

The government's bold response was duly recognized by the IMF, which on 2 July 2010 announced the successful completion of the 4th review of Romania's economic policies under the IMF loan arrangement. The new focus on aggressive indirect tax measures, in order to achieve the required fiscal adjustment, will inevitably have a substantial negative impact on domestic demand and will prolong the deep 2009 recession into 2010, putting off expectations for an early recovery of the economy well into 2011. Therefore, the new fiscal adjustment strategy of the government is widely questionable. For example, the expectation that inflation will accelerate (due to the VAT hike) have raised interest rates at which commercial banks lend money to the government in its local currency issues, leading the government to reject lately most bids in its auctions and under-sell debt across maturities.

It is estimated that from the beginning of 2010 and until the 9 August 2010 Romania had issued about RON 24 billion in debt securities plus a Eurobond of € 1 billion. Also, according to the same projections, Romania needs to raise a further RON 11 billion in the last five months of the year in order to cover fully its borrowing needs, provided that the disbursement of the € 1.1 billion EU aid will be delivered in time in order to enable Romania to repay a T-bill issue worth € 1.4 billion, which expires in November 2010. On 19 August 2010 the Ministry of Finance rejected all bids of yet another 5-year bond issue as the interest rate demanded by the lenders was higher than the 7.0% capped rate set by the ministry. On a compensatory move the Finance Ministry has appointed two international banks to arrange the sale of euro medium-term notes (EMTNs) of € 7.0 billion.

According to the Ministry of Finance the budget deficit was RON 18.1 billion or 3.35% of GDP at the end of June 2010 marginally below the IMF-agreed ceiling of RON 18.2 billion. This was the result of a marginal 0.1% increase in public revenues (less than the targeted increase) and a 4% increase in public expenses. Of course there are accusations that the government has been postponing payments, in order to ease expenditure increases recorded on a cash basis. This practice is considered as deepening the existing recession in the economy by reducing the flow of funds to businesses and households. However, the adoption by Parliament of the fiscal responsibility law in March 2010 bodes well for the implementation of the budget going forward. Also, the pension reform and the unified public pay law are scheduled to be adopted by Parliament in September 2010. Finally, the government has to eliminate gradually government arrears by April 2011, especially concerning VAT returns, which until today are said to be delayed for more than 45 days. This is an obligation, which Romania has undertaken under the EU/IMF loan arrangement, but its implementation has been substantially delayed. Finally, apart from its fiscal reform schedule, the government was reminded by a European Commission communication on 20 July 2010 that it needs to seriously pick up the pace of judicial reform and of the fight against corruption.

HICP Inflation (%Δ YoY)




**INFLATION:** The recession dissipated inflationary pressures. However, the recent VAT hike will most certainly push inflation up. CPI Inflation fell to 5.6% in 2009 from 7.9% in 2008 and its falling trend continued in H1 2010. However, the 5 pps VAT hike from July will lead to a temporary increase in inflation to around 8.0% in H2 2010. Therefore, the Bank of Romania inflation target of 2.5% to 4.5% at end 2010 will have to be revised upwards. On the other hand inflation will be lower in 2011, perhaps even lower than the BoR target of 2% to 4% by the end 2011.

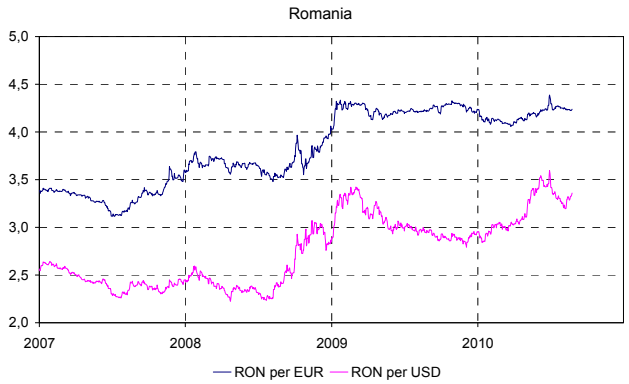
**BALANCE OF PAYMENTS:** The current account deficit (CAD) fell to –4.4% of GDP in 2009 after swelling to an extraordinary -13.4% of GDP in 2008. In H1 2010 the CAD reached € 3.65 billion and it was 50% yoy higher due to lower current transfers (See Table), which are comprised mostly of remittances, and a widening of the deficits in services and income balances. Net direct investment was € 1.77 billion in H1 2010 and covered 48.6% of the CAD from € 2.59 billion and 106% coverage in H1 2009.

**Romania: Developments in the Balance of Payments in H1 2010**

| | H1 2010 | H1 2009 | %Δ |
|---|---|---|---|
| Exports | 17.161 | 13.642 | 25,8% |
| Imports | 20.185 | 16.913 | 19,3% |
| Trade Balance | -3.024 | -3.271 | -7,6% |
| Services Balance | -414 | -90 | 360% |
| Income Balance | -1.274 | -1.195 | 6,6% |
| Current Transfers Balance | 1.065 | 2.125 | -49,9% |
| Current Account Balance | -3.647 | -2.431 | 50,0% |

**EXTERNAL DEBT**: By end-June 2010 total external debt stood at € 87 billion from € 80.3 billion at end-December 2009. Both short-term and 'medium to long-term' external debt increased by around 8.35% in the same period. The

increase in short-term external debt (from a decrease of -35.6% in 2009) reflects the amelioration of external financing conditions. The increase in medium to long-term debt reflects borrowings of the public sector from the markets and the multilateral lenders. Foreign exchange reserves with the Bank of Romania stood at € 31.58 billion at the end of July 2010 from € 28.303 at the end of 2009.




**MONEY & FINANCIAL MARKETS:** The adjustment process and the slowdown of capital inflows due to the global recession entailed a depreciation of the local currency against the major currencies. Against the Euro the Lei depreciated by around 39% over the period from August 2007 until January 2009. The currency has kept fluctuating since, amid continued re-assessment of emerging market risks, presidential elections and political turmoil over the reform process. The exchange rate traded at a low of 4.052 RON/EUR on 25.3.2010 but then depreciated to 4.3835 RON/EUR on 29.6.2010, in order to recover some of its strength since and trade at 4.226 RON/EUR on 12.8.2010.

The Bank of Romania undertook a series of policy interest rate cuts reducing the basic rate from 8% in December 2009 to 6.25% in May 2010. It has since kept it there until its latest Board meeting on 4.8.2010. However the expected increase in inflation in the months ahead is likely to induce a policy shift.

Bank credit to the private sector reached a substantially negative rate of -11.2% yoy in October 2009, from 18.6% at the end of 2008 (Euro basis). Then there was a gradual recovery of credit growth reaching 2.7% yoy growth in June 2010, a 14-month high. Credit growth to businesses and households was 4.3% and 1.1% respectively in June 2010. In a recent statement, the IMF mission chief for Romania (4.8.2010) reports that the "capital adequacy ratio [of the banking system] at end-June was 14.3% and all banks had a ratio exceeding 10 percent compared to the mandatory ratio of 8 percent". This development is especially positive as the share of non performing loans (past due 91 days and over) to total loans has kept increasing to 14.4% in June 2010 from 11.8% in December 2009 and 8.3% in June 2009.

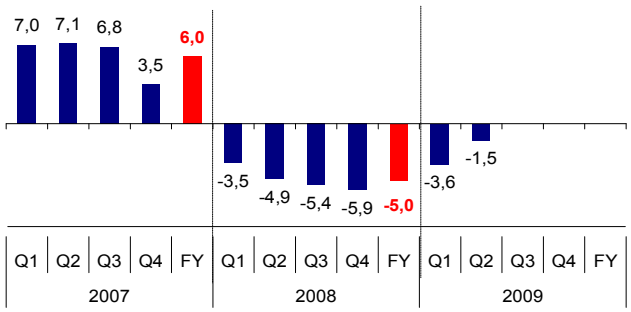
# BULGARIA

**ECONOMIC OVERVIEW:** Under the impact of the global financial economic crisis, GDP declined by -5.0% in 2009 following an annual average growth of 5.6% during 2000-2008. GDP growth is expected to be around 0% in 2010 and to turn positive from 2011. Notwithstanding the acute external imbalances, exemplified by a huge current account deficit that reached -26.9% of GDP in 2007 and again -24.2% of GDP n 2008, before narrowing to -9.4% of GDP in 2009, Bulgaria did not request external financing support from the IMF. The economy's resilience in the face of the recession and its ability to go it alone reflects partly the good record of its public finances. However as a result of the economic downturn the fiscal balance turned negative in 2009 and is expected to deteriorate further in 2010 before registering improvement in 2011 as the economy resumes positive growth. In the on going domestic structural reform front, a July 2010 report by the European Commission praises Bulgaria for progress made in the field of judicial reform and fighting corruption, indicating the existence of "a strong momentum on reform" in this Balkan country.

The 2009 GDP decline was driven by a sharp contraction in domestic demand of -13.0%, which was mitigated by a -48.3% decrease in the external goods and services deficit. These trends have continued in H1 2010 but to a lesser degree. According to the flash estimates, in H1 2010 individual final consumption expenditure decreased by -6.7% yoy, gross fixed capital formation by -7.2% and the goods and services deficit decreased by -28.6% (exports increased by 8.9% and imports fell by -1.9%). Therefore, GDP fell again in H1 2010 by -2.5% yoy, but the falling trend is decelerating to -1.5% in Q2 from -3.6% in Q1, -5.7% in H2 2009 and -4.2% in H1 2010. It is important to note that retail sales are still registering substantially negative growth rates (see diagram), while a positive effect on H2 GDP growth is expected from net exports. In fact, as the global economy is recovering, Bulgaria's exports have increased by 26% yoy in H1 2010, while imports were up by 8.5%.

In terms of gross value added, the recession in H1 2010 is due mainly to the services sector, as the recession in industry is estimated to have bottomed out and there was a small pick up of growth in agriculture.

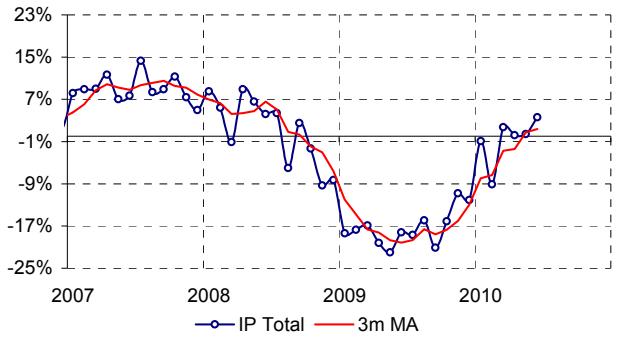
Real GDP (%Δ YoY)



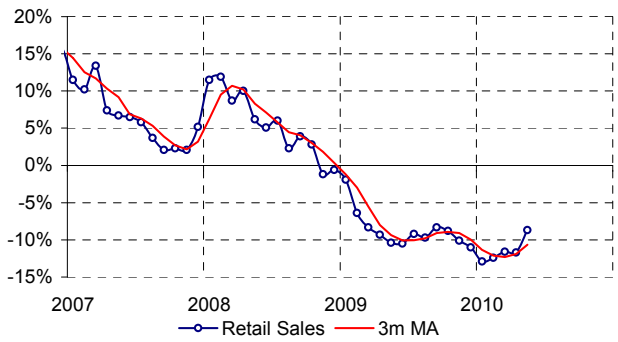

While it is expected that the recession will end in 2010 and positive growth will resume from 2011, a return to the high annual average growth rate experienced during 2000-2008 is unlikely in the medium term as world flows of capital remain subdued and international investors retain a more cautious approach to emerging market assets. In this environment the challenge for Bulgaria, which is a currency board is to verify the stability of its economy and maintain its international competitiveness in

a period in which other neighbouring countries have the ability to devalue their currencies. It should be noted that Bulgaria's exports of goods and services were already 60.5% of GDP in 2008, compared with 23.1% in Greece and 30.4% in Romania. Therefore, maintaining international competitiveness is of key importance.

Industrial Production - (%Δ YoY)




Retail Sales - (%Δ YoY)



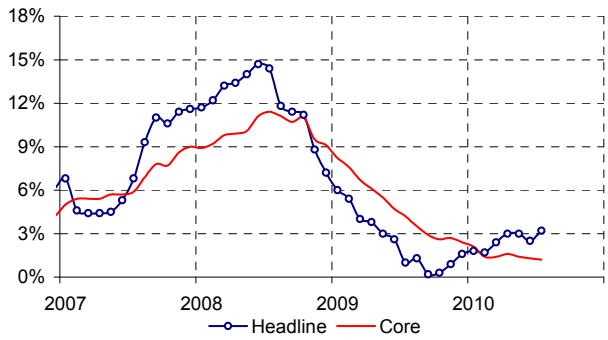

**FISCAL POLICY:** The fiscal balance turned negative in 2009 (annual average surplus during the period 2000-2008 was 1.4% of GDP) as the recession reduced budget revenues and boosted demand for public expenditures. The budget deficit came to (an upwardly revised) -3.9% of GDP in 2009 from a surplus of 1.8% of GDP in 2008. On a cash basis it came to -0.8% of GDP in 2009 from a surplus of 3.0% of GDP in 2008. The widening difference between the two ways of calculating the budget balance, accrual and cash basis, reflects the accumulation of government arrears to the private sector. The European Commission estimates that the 2010 budget deficit will widen to -2.8% of GDP (accrual basis) and the IMF to reach -2.5% of GDP (cash basis). The expected scaling back of the difference in 2010 is an indication that part of the cash deficit in 2010 will reflect payment of government arrears.

In H1 2010 the budget deficit came to -2.22% of the 2010 GDP from a surplus of 0.3% in H1 2009 and versus a government target 2010 deficit of -4.8% of GDP (accrual basis). The deterioration of the fiscal finances is due primarily to the drop in budget revenues by -13.6% yoy in H1 2020 to € 11.2 billion, while expenditures decreased marginally by -0.1% yoy. The overall budget performance in Q2 2010 (budget surplus of 0.23% of GDP) was notably improved from Q1 2010 (budget deficit of -2.45% of GDP). However, the slow GDP growth expected for the foreseeable future will constrain its budget revenues growth implying new challenges for maintaining needed equilibrium in public finances. In fact, the government will have to figure out a way to support tax receipts growth through structural reforms that strengthen competitiveness (including increasing the capacity to absorb EU structural funds). Pressing ahead with pension, health care reform and measures to increase the efficiency of the public sector will be instrumental to alleviating pressures on the expenditure side. The low consolidated general government debt of Bulgaria, of 15.1% of GDP at end-May 2010 (expected to reach the 17.5% at the end of 2010), continues to provide assurance against what is likely to be rather temporary fiscal slippages.

On the other hand, the fiscal reserve stood at BGN 6.029 billion at the end of H1 2010, from BGN 7.773 billion at the end of 2009 and BGN 8.265 at the end of H1 2009. The decline in the fiscal reserve, which the government maintains to support the currency board, has raised underline risks and indicates the need to contain the fiscal deficit and return to a surplus position in the medium-term.

**INFLATION:** The CPI inflation averaged at 2.8% in 2009 from 12.3% in 2008. In the first 7-months of 2010, inflation increased to 2.4% in July from 0.4% in January, due, primarily, to increases of prices within the group "housing, water, electricity, gas and other fuels". Moreover, increasing international energy and food prices and the unfavourable weather conditions locally may upwardly affect the prices of products in these groups in the months ahead. However, inflation is now under control in Bulgaria, while there is also a great effort to put also wage growth under control. In an economy with an exchange rate fixed to the Euro, unit labour cost growth 14.2% in 2007, 16.2% in 2008 and 11.1% in 2009 was obviously unsustainable. Nevertheless, in Q2 2010 average monthly wages and salaries grew by 3.4% q/q and 8.8% yoy, driven by increases in wages and salaries paid in "financial and insurance activities", "construction" and "real estate activities". In the public sector Q2 2010 average monthly wages and salaries grew by just 1.8% q/q and 0.5% yoy. The fiscal consolidation plans of the government in 2010 include a freeze in public wage and pensions. Overall, incomes policies followed in 2010 are expected to slow down the rate of growth of ULC to 2.5% in 2010 and to even lower rates in the following years.

HICP Inflation - (%Δ YoY)




**BALANCE OF PAYMENTS:** The current account deficit increased precipitously from -6.6% of GDP in 2004 to an

extraordinary high of -26.9% of GDP in 2007 and remained very high at -24.2% of GDP in 2008. This development reflects the increase of domestic demand at a higher average annual rate than the increase in GDP throughout this five year period (9.5% versus 6.2%).

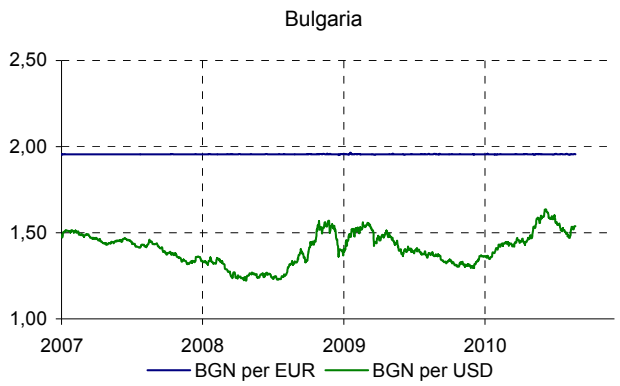
In 2009 the above trend was reversed, as domestic demand contracted by -13.0% and GDP by -5.0%, leading to an adjustment to the current account deficit, which was more than halved to 9.4% of GDP. This trend continued in H1 2010 when domestic demand fell by an estimated -7.5% versus a -2.5% decline in GDP. Reflecting this, the current account deficit was just -1.8% of GDP in H1 2010 from a deficit of -7.8% in H1 2009. As the global economy is slowly recovering, exports grew by 26% yoy in H1 2010, while imports also increased by 8.5%. Despite the substantial drop in the current account deficit its coverage by net FDI decreased to 48% in H1 2010 from 59% in H1 2009 as net inflows of FDI fell by almost -78% yoy in H1 2010 to € 358.5 million. The net inflow of portfolio investment was again negative in H1 2010 but less (by around -40%) than in H1 2009. Residents scaled back the pace of increase of their portfolio investment abroad. The net inflow of other investment was also negative in H1 2010 and more (by around a factor of 3.5) than in H1 2009 mainly because foreign investors accelerated the pace of reduction of their domestic liabilities.

**Bulgaria: Developments in the Balance of Payments in H1 2010**

| | H1 2010 | H1 2009 | %Δ |
|---|---|---|---|
| Exports | 6.808 | 5.419 | 25,6% |
| Imports | 8.206 | 7.812 | 5,0% |
| Trade Balance | -1.399 | -2.393 | -41,6% |
| Services Balance | 544 | 259 | 110% |
| Income Balance | -597 | -1.041 | -42,7% |
| Current Transfers Balance | 828 | 528 | 56,9% |
| Current Account Balance | -624 | -2.647 | -76,4% |

**External Debt & Int. Reserves:** Total gross external debt was € 36.5 billion at the end-May 2010, from € 37.7 billion at end-2009 and € 37.1 billion in 2008. In 2009 inter-company lending increased whereas long- and short-term debt decreased. At the end of May 2010 relative to the end of 2009 the level inter-company lending was marginally decreased, long-term external debt increased by 1.3% and short-term external debt decreased by -9.8%. As a percent of GDP, long- and short-term external debt stood at 30% and 33.4% respectively. The ratio of foreign reserves with the Bank of Bulgaria to short-term debt was 104.9% at end-May 2010 versus a low of 90% at end-May 2009. Total reserve assets with the Bank of Bulgaria stood at € 12.3 billion at end-July 2010 from € 12.03 billion at end-April 2010 and € 12.9 billion at end-2009.

**Money & Financial Markets:** Bulgaria maintains a currency board linking 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. However, the entry dates of Bulgaria into the ERM II or into the Eurozone are not now visible into the foreseeable future. In any event, the recent depreciation of the Euro with respect to the dollar and the other major currencies is a favourable development for Bulgaria.




Following very high growth rates during the years preceding the recession, credit expansion to the private sector slowed in 2008 and especially in 2009. In 2010 the deceleration of credit growth to the private sector shows signs of bottoming out, but it remains at historically lows. A the end of June 2010 credit to the private sector grew by 2% yoy as credit to businesses and households grew by 1.1% and 3.7% respectively.

## Cyprus

**Economic Overview:** The progress recorded in fiscal consolidation in neighbouring Greece is supportive of a positive outlook for the Cyprus economy due to its close economic and social links. At the same time economic recovery remains reliant on fiscal consolidation of its own public finances and on the rate of recovery in major European countries, notably the United Kingdom.

In 2009 GDP fell by -1.7% following almost three decades of strong growth (annual average GDP growth of 5.2% between 1980-2008). The economy looks on track to exit recession in 2010. Already in Q1 and Q2 2010 GDP grew on a quarterly basis by 0.3% and 0.4% respectively (seasonally and working days adjusted) after five consecutive quarters of negative q/q growth. On an annual (unadjusted) basis GDP grew marginally by 0.1% in Q2 2010 following a fall by -1.4% in Q1 2010. The substantial decline in private consumption and investment were the main negative contributors to yoy Q1 GDP growth. Also, net exports had a negative effect on GDP growth in Q1 2010, mainly due to the fall in exports of goods and services by -3.3% (Q1 2009: -1.1%) and the recovery in imports by 0.9% (Q1 2009: -18.1%). Public consumption contributed also positively to GDP growth in Q1 2010, as it registered a positive growth of 1.7% (Q1 2009: 10.6%).

The sectoral accounts for yoy Q1 2010 GDP growth show a shift to positive growth in agriculture, and financial intermediation. In manufacturing, construction and wholesale/retail trade the recession decelerated, notably so in manufacturing. The tourism sector was reported to have contributed positively to GDP growth (revenue from tourism in H1 of 2010 grew by 2.2% yoy). The unemployment rate increased to 7.2% in July of 2010 from 6.3% at the beginning of the year and 5.5% a year ago. As the recession is expected to bottom out in 2010 and a mild recovery is forecast in 2011, unemployment is also expected to ease, albeit with a lag.

**FISCAL POLICY:** Cyprus' fiscal position deteriorated significantly in 2009 following considerable improvement during the period 2004 – 2008. In 2009 the fiscal deficit widened to 6.1% of GDP from surpluses of 0.9% in 2008 and 3.4% in 2007, following increased spending aimed at protecting the economy from the worst of the economic downturn and lower revenues. Having stabilised at just over 48% of GDP in 2008, public debt also rose, to around 56% of GDP in 2009. The government expects the 2010 fiscal deficit as a percent of GDP to remain largely unchanged. Doubts over the government's commitment to pursue fiscal consolidation reforms led S&P in late July to place Cyprus under review for possible downgrade from its current A+ long-term foreign currency sovereign credit rating. This followed a confirmation by Fitch of its AA- long-term foreign currency rating a month earlier. Moody's rates Cyprus Aa3. In H1 of 2010 the public deficit declined to 1.9% of GDP from 2.5% of GDP in H1 of 2009, on the back of an increase of 6.6% in public revenues and 4.1% in public expenditure, versus government set targets for increases of 5.5% and 4.9% respectively. However the increase in public revenues is largely due to temporal factors.

**INFLATION:** CPI inflation averaged 2.3% in the first seven months of 2010 and reached 2.6% in July 2010. This development is due to the increase in international energy prices, especially as Cyprus is highly dependent on oil imports. Unit labour cost for the economy surged by 6.6% in 2009, but is expected to return to trend growth of around 1.5% from 2010 inwards.

**BALANCE OF PAYMENTS:** The budget deficit is coupled with a deficit in the current account. The occurrence of twin deficits is considered to have potentially destabilising effects on the macro-economy and has been flagged as a policy issue of importance by the IMF, the EC and rating agencies such as Fitch. The global financial economic crisis has already produced a significant downward adjustment to the current account deficit to 8.56% of GDP in 2009 from 17.68% in 2008, while a surplus equal to 17.1% of GDP in 2008 in the financial account was reduced to 8.1% of GDP in 2009. In Q1 of 2010 the current account deficit increased by 27.2% yoy to 1.78% of GDP from 1.43% of GDP in Q1 2009 because of a 22.3% increase in the goods & services deficit. The financial account surplus also rose to 2.0% of GDP in Q1 2010 from 1.2% in Q1 2009, as net inflows of portfolio investment narrowed to € 1.5 billion from € 7.7 billion, more than compensating the decrease in net direct investment and net other investment.

**MONEY & FINANCIAL MARKETS:** Credit conditions tightened in 2009, when growth of credits to the private sector eased to 6.9% in December 2009, from 34.3% a year ago. During 2010, the yoy growth rate of bank credit to the private sector has exhibited a gradual upward trend reaching 8.2% in June of 2010, with credit to businesses of 5.8% yoy and credit to households at 11.8%, driven mainly by the pick up in mortgages.

## SERBIA

**ECONOMIC DEVELOPMENTS:** During the years 2000-2008 GDP exhibited annual average growth of 5.4% as the economy capitalised on its catching up potential which attracted the interest of foreign investors and mobilised the productive forces of the economy. The global financial and economic crisis generated an ongoing re-assessment of risk from international investors. Serbia's GDP contracted by -3.0% in 2009 as industry, construction, tourism and domestic trade all took a heavy blow from dwindling demand.

In 2010 the economy is poised to return to positive growth. However, the slow recovery in the EU, which accounts for almost 60% of the economy's foreign trade activity, and fiscal troubles in neighbouring Greece, an important source of capital coming into the country, will restrict recovery making it harder to raise living standards and to reduce the unemployment rate which reached 19.2% in April of 2010. After four quarters of negative yoy growth, GDP grew by a moderate of 0.6% in Q1 of 2010, downwardly revised from an earlier estimate of 1%. Sectoral GVA annual growth in Q1 of 2010 was highest in 'transport' (8.6%), 'financial intermediation' (6.3%), 'mining and quarrying' (4.0%) and 'manufacturing' (2.0%). It registered negative growth in 'hotels and restaurants' (–14.1%), in 'construction' (–12.0%), in 'trade' (–6.8%), in 'electricity, and gas and water supply' (–4.1%). Moreover, GDP grew by 1.6% yoy in Q2 2010 supporting a forecast for a 2.0% 2010 GDP growth.

After the unblocking, in December 2009, of the interim agreement which pertains to the trade aspects of the Stabilization and Association Agreement signed in April 2008, the European Council decided on June 2010 to proceed with the ratification process following Serbia's intensified efforts to cooperate with the International Criminal Tribunal. This development is expected to increase the inflow of EU structural funds in support of economic convergence. However EU-membership may take longer as appetite for further enlargement wanes. The recent ruling of the International Court of Justice that Kosovo's 2008 declaration of Independence was legal may further delay the process.

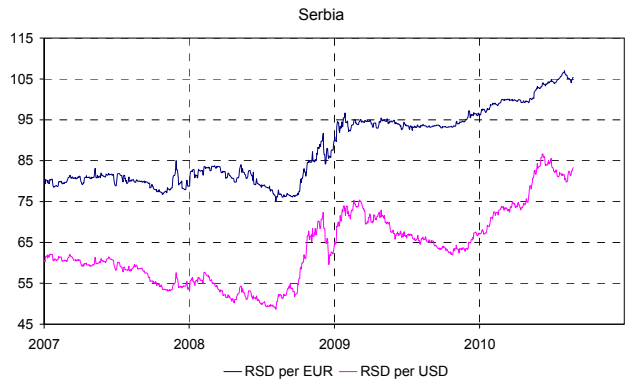
**FISCAL POLICY:** Fiscal consolidation is a central component of the May 2009 loan-agreement with the IMF and the EU, worth € 3.1 billion, with horizon to mid-April 2011. Applying this agreement, disbursements so far amount to € 1.8 billion. Key quantitative conditions for future disbursements include a fiscal deficit of -4.75% of GDP in 2010, revised upwards from -4.25% of GDP following a revision of the 2010 GDP growth forecast to 1.5% from 2%. For 2011 the GDP growth forecast is 3% and the fiscal deficit target -3.9% of GDP. Fiscal adjustment in 2009-2010 relied heavily on a freeze in public wage and pension growth. In the context of the 4th review of the IMF loan program it has been agreed that public wages and pensions "will be adjusted semi-annually, indexed to CPI inflation plus one-half of the real GDP growth rate in the previous year". In H1 2010 the budget deficit was RSD (national currency) 54.6 billion, having decreased by -19% yoy, versus a government target of RSD 102.25 billion for the year. In H1 2010 budget revenues increased by 7% yoy driven mainly by higher VAT and excise receipts, budget expenditures increased by 2%.

**INFLATION:** The 2009 recession dissipated the force of inflationary pressures. CPI inflation averaged at 8.8% in 2009, from 13.5% in 2008. Also, inflation was below 4.8% in every month during H1 2010, undershooting the Bank of Serbia's inflation tolerance band (7.0% plus or minus 2%). However the depreciating trend of the national currency (see Diagram below), in combination with higher international commodity prices and a pick-up in domestic demand is likely to push inflation higher in H2 2010. Already in July 2010 CPI inflation reached 5.1%. In its August inflation report, the Bank of Serbia states its expectation for inflation to "return within the tolerance band in H2 2010 and to the target by year-end (6%)".

**BALANCE OF PAYMENTS:** Current account imbalances exacerbated by rapid domestic demand growth, increased the vulnerability of the economy to the global financial and economic crisis. The recession provided a mechanism for partial redress of these imbalances, as the deficit in the current account fell to -5.6% of GDP in 2009 from -17.6% of GDP in 2008. Balance of payments support from the IMF but also the EU and the World Bank underpin the favourable prospects for the financing for the current account deficit. The fall in net FDI has been relatively contained, as it reached € 1.37 billion in 2009 and covered 78.7% of the CAD, from € 1.81 billion and 30.8% coverage in 2008. The IMF projects that the coverage of the CAD by net FDI will reach 51.5% in 2010. In H1 of 2010 net FDI was € 419.5 million and the current account deficit € 1.3 billion, following an increase in exports of goods and services by 13% yoy and of imports of goods and services by 3%.

**EXTERNAL DEBT & INT. RESERVES:** By end-June 2010 the stock of external debt increased by 4.57% from its end-December 2009 level to € 23.8 billion or 72.2% of the 2010 government GDP estimate. By end-June 2010 the split between short- and long-term debt and between public- and private-sector debts, as a percent of the total, was 92.5% to 7.5% and 35% to 65% respectively.

The Bank of Serbia's foreign exchange reserves were € 10.09 billion at end-July 2010 having decreased by almost € 511 million since the start of the year. Including reserves of commercial banks, total foreign exchange reserves were € 11.36 billion at end-July 2010.




**MONEY & FINANCIAL MARKETS:** The Bank of Serbia has recently ended its monetary policy easing cycle which started in 2009 and included a lowering of the key policy rate by 975 basis points. Considerations of inflationary pressures and the depreciation of the exchange rate may have played a part in the Bank of Serbia's decision to raise its key policy rate to 8.5% on 5.8.2010. The national currency has depreciated considerably since around October 2009 both against the Euro (by around 13%) and the US Dollar (by around 26%). The Bank of Serbia has repeatedly intervened in the foreign exchange market to ensure the smooth functioning of the market in the context of a floating exchange rate regime. In the last couple of months there has been a small appreciation of the national currency against the US Dollar by nearly 7% since June and more recently against the Euro, by 1.6% since the start of August.

Growth of credit to the private sector decelerated substantially to 1.4% yoy in September 2009 from 18.5% at the end of 2008 and 41% end of 2007 (Euro basis). It has since recovered somewhat to 11.5% in June 2010. The growth rate of deposits of the private sector also decreased to -7.5% yoy in March 2009, it recovered to 16.8% in March 2010 and stood at 11.5% in June 2010.

# ALBANIA

**ECONOMIC OUTLOOK:** The economy withstood the global financial economic crisis better than most, as GDP grew in 2009 by 2.8% according to a July 2010 IMF estimate. The annual average GDP growth in 1999-2009 was 6.3%. The limited impact of the crisis on Albania's economy is attributed to the low integration of the economy with the international financial markets and to increased public expenditure in infrastructure and wages/pensions during 2008-2009. At the same time there were some spill-over effects which manifested mainly through deposit withdrawal, currency depreciation and lower emigrant's remittances. The overall outlook for the Albanian economy continue to be positive in 2010 onwards, despite the fact that low growth in the economy's main trading partners may slow the recovery to GDP growth rates much lower than trend.

In Q1 2010 GDP grew by 2% yoy and by 1.8% q/q. On an annual basis the growth in Q1 2010 was mainly the result of growth in industry (27.5%), transport (11.4%), 'trade, hotels, restaurants' (4.8%) and agriculture (2.3%), while construction went in the opposite direction (-21.1%). The deceleration of economic growth had led to an increase in the unemployment rate to 13.8% in Q1 2010 from 12.7% in Q1 2009. The government is projecting 4.1% GDP growth in 2010 (revised down from 5.5%) while the EBRD holds a relatively pessimistic view that GDP will slow further to 1.4% in 2010. The IMF projects GDP growth of 2.3% in 2010 (revised upwards from 2.2%). The World Bank forecasts that GDP will grow by 3% in 2010, highest in the region, however it stresses (in its July 2010 Country Partnership Strategy report) that GDP growth in the next few years will be lower than in the past because of the "slower recovery in Europe and difficulties in Greece – a major economic partner for trade, investment and remittances". In fact, emigrant's remittances have fallen to 10.7% in 2009, from 13.5% in 2008 and are expected to fall even more in 2010 and 2011 due to the recession in the Greek economy.

**FISCAL POLICY:** Fiscal policy has been relatively prudent during the period 2002-2007 helping reduce the public

debt to GDP ratio by 9 pps from 62% in 2003 to 53% in 2007. Partly as a result of the operation of automatic stabilizers which reduced revenues but also because of the undertaking by the government of major infrastructure projects, a cut in social security contributions and privatization of the electricity distribution system a significant fiscal stimulus was engineered in 2008 and 2009, widening the budget deficit to 5.6% and 7.0% respectively (World Bank data). Both the World Bank and the IMF view fiscal consolidation as a key challenge in the coming years. The IMF projects that under current policies public debt will rise to 68.1% of GDP in 2013, which contrasts sharply with the projection of the government for a debt/GDP ratio of 54%. This discrepancy stems mainly from higher revenue growth projections by the government. The government targets a budget deficit of 3.1% of GDP in 2010 revised down from 3.9% of GDP following consultations with the IMF. In fact in H1 2010 the budget deficit narrowed to 1.8% of GDP from 2.7% in H1 2009, following a fall in public expenditures by -4% yoy and an increase of budget revenues by 3.4% yoy. The IMF commended the government for its performance in the field of fiscal adjustment in H1 2010, taking the view that it is of utmost importance for Albania for this decisive fiscal adjustment effort to continue for 2010 as a whole and in the following years.

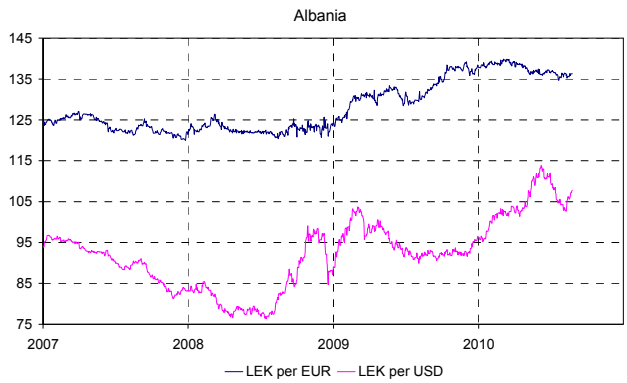
**INFLATION:** Inflationary pressures have been contained over the past decade when CPI inflation averaged 3.0%. In 2009 CPI inflation decelerated to 2.2% from 3.4% in 2008 as GDP and domestic demand growth decelerated. In 2010 CPI inflation accelerated to 4.7% in February 2010 and from then on it fell in four consecutive months to 3.2% in June 2010 and reached slightly up to 3.4% in July 2010. Food price inflation peaked at 7.6% in February 2010 and decelerated in the following months reaching 4.2% in July 2010. Regulated prices, such as electricity and fuels, increased by 8.9% yoy reflecting the implementation of a needed 13% hike in electricity prices in the beginning of 2010. The Bank of Albania has set a 3.0% inflation target, applicable throughout the period 2009-2011, with a tolerance band of plus/minus 1%.

**BALANCE OF PAYMENTS:** High GDP growth during the last decade led to a widening of external imbalances. The current account deficit widened to 10.4% of GDP in 2007 and then to 15.2% of GDP in 2008. In 2009 the current account deficit narrowed by a small margin to 14.0% of GDP due to the economic slowdown. It is notable that net FDI continued to increase over this period from € 597 million in 2008 to € 672 million in 2009, covering respectively 44.5% and 54.8% of the current account deficit. Net other capital inflows increased from € 206 million in 2007 to € 545 million in 2008 but turned to outflows of € 34 million in 2009. In Q1 2010 the current account deficit continued to narrow to 2.8% of GDP, from 3.7% in Q1 2009, as exports of goods and services increased by 6.0% yoy and imports fell by -7.0% yoy. Meanwhile remittances from expatriates, an important source of current revenues in Albania, have fallen from 13.5% of GDP in 2007 to the still high 10.7% of GDP in 2009. In Q1 2010 remittances from expatriates were € 170 million or 1.9% of GDP from € 183 million or 2.1% of GDP in Q1 2009. Net FDI was € 154 million in Q1 2010 from € 120 million in Q1 2009 and net other investment was again negative (outflows) to the order of € 38 million, from net inflows of € 128 million respectively.

**MONEY & FINANCIAL MARKETS:** In recent reports, both the World Bank and the IMF assess favourably the floating exchange rate regime of the country which is thought to have helped it weather the global financial and economic crisis better than many other countries. Moreover, the policy stance of the Bank of Albania in arresting rapid credit growth expansion in the previous years, especially un-hedged foreign currency lending, has been commended on its efficacy. The depreciation of the Albanian Lek (ALL) in 2009 reached 7.6% versus the Euro and 13.2% versus the USD and has supported the correction of the external imbalances in a period of falling emigrant's remittances and capital inflows. In 23 August 2010 the Lek had appreciated by a mere 1.3% against the Euro, but it had depreciated by 11.8% against the USD. The relatively high local currency interest rates are supporting the currency, while emigrant's remittances and net capital inflows are still on a falling trend.

The Bank of Albania has taken steps to inject more liquidity into the money market in an effort to mitigate the impact of the credit squeeze. The low inflation environment further enabled the Bank of Albania to cut its policy rate by 25 bps to 5% in July 2010.

Credit expansion to the private sector fell to a low -3.5% yoy in November 2009, but it has since accelerated to 5.2% in June 2010. Credit to business grew by 9.7% yoy in June 2010, while credit to households is still registering negative growth by -3.5%. Following negative annual growth rates from January 2009 through to January 2010, growth of deposits from the private sector has turned positive, accelerating to 11.3% in June 2010.




# 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% yoy growth in Q4 2009, bringing full-year growth to -0.7% in 2009. Underlying this outcome was the -1.0% yoy decline in private consumption, while investment declined by -6.0% yoy. A modest recovery with growth of around 1.5% is expected for private consumption in 2010, as growth will be limited by the lingering impact of the recession in 2009, and the

resultant increase in unemployment. Likewise, investment is expected to return to positive growth of around 2.0% in 2010, despite the fact that access to credit is likely to remain difficult in the current year as well, as local subsidiaries of foreign-owned banks continue to be affected by the aftermath of the global financial crisis as well as the Greek debt crisis. Government consumption declined -1.0% yoy in 2009 and is expected to increase by 0.2% yoy in 2010, restricted by the need to rein in the budget deficit. Exports of goods and services registered a substantial -32.3% decline in 2009, while imports declined by -26.4%. The relatively weak recovery in key export markets, namely the Eurozone and the Balkans, is expected to contain export growth in 2010 as well despite the substantial base effects. Therefore, exports of goods and services are forecast to expand by 2.5% in 2010 and imports of goods and services by just 2.0%, as domestic demand growth will be also subdued.

On the above assumptions, the IMF currently forecasts GDP growth for FYROM 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. Following similar reasoning, 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 GDP in 2009, in line with the government target. For the year, government revenues declined by 7.2% yoy to MKD 128.5 billion (€ 2.1 billion). The decline in revenues was driven by a 7.6% yoy drop in tax collection to MKD 70.8 billion. Despite various cost-cutting measures, government expenditure increase by 6.1% yoy to MKD 139.4 billion. The current parliament-approved a draft 2010 budget, which targets 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), from MKD 1.8 billion in Q1 2009. This negative development was due to both the decline in revenues by -6.0% yoy to MKD 29.5 billion and the increase in expenditures by 1.2% yoy to MKD 33.6 billion. In fact, tax revenues fell by 4.9% yoy to MKD 25.3 billion. These developments in Q1 2010 raise questions concerning the implementation of the 2010 budget which envisages a budget deficit of MKD 10.5 billion, equal to roughly 2.5% of the projected GDP.

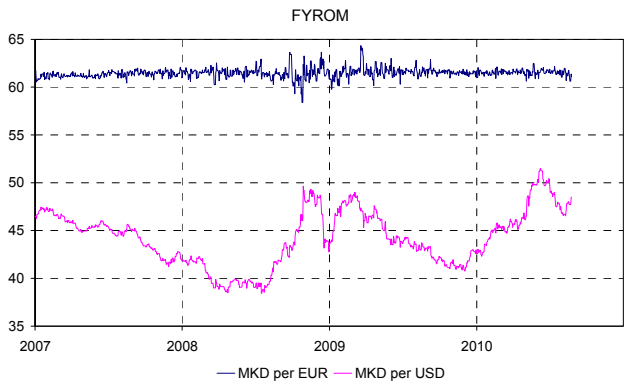
It should be noted that FYROM was considering issuing a Eurobond worth € 175 - € 250 million in mid-2010 in order to finance its borrowing needs, but decided to postpone these plans because of the Greek debt crisis, as did Albania and Montenegro (Reuters, 15 July 2010).

**INFLATION:** Peaking at more than 10.0% during the summer months of 2008, CPI inflation averaged 8.3% in 2008, before falling to -0.8% in 2009. In 2010 CPI inflation remains low, increasing to 0.7% in March from 0.6% in February. For 2010, CPI inflation is expected to reach 2.1% by year-end and average 1.5% for the year.

**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 from the high 13.4% of GDP in 2008, following the weakening domestic demand and low international oil prices. The trade deficit declined by -11% yoy on the back of the -28% yoy decline in merchandise exports, while merchandise imports declined by -22% yoy. The surplus on the Services account increased to € 28 million in 2009 from € 4 million in 2008, while the surplus on the current transfers account increased by 15% yoy to € 1.08 billion. The financial account declined by -48% yoy to € 446 million, with FDI declining by -58% yoy to € 172 million. Portfolio investment saw an outflow of € 51 million in 2008, but it turned into an inflow of € 104 million in 2009. 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. Exports increased by 17.7% y/y in January 2010 versus at -12.9% yoy fall in merchandise imports. Therefore, the current account deficit was down -72.7% yoy in January 2010 and 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 58.4 MKD/EUR in mid October 2008, it declined to 61.35 MKD/EUR 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% yoy in December 2008, credit expansion slowed to 3.5% yoy in December 2009 and now 2.5% yoy in March 2010. Credit expansion to businesses (which constitutes roughly 60% of total outstanding credit) has slowed from 32.6% yoy in December 2008 to 3.8% yoy in March 2010, while household credit expansion has slowed from 32.6% yoy in December 2008 to 0.6% yoy in March 2010.



## 8. UKRAINE

A new government and 2010 Budget, positive GDP growth in H1 2010, a brand new IMF deal and more neighbourly relations (and friendly gas rates) with Russia have materially improved the outlook of the economy. Fitch upgraded the government's long-term sovereign debt issue in July 2010 to 'B' from 'B-' and S&P to 'B+' from 'B'. There remain challenges ahead, such as the effective implementation of structural reforms necessary to meet IMF conditionality, including keeping a tight lid on incipient inflationary pressures which may threaten to resurface due to hikes of the price consumers pay for gas and detrimental effects of bad weather on the country's grain production.

In July 2010 the IMF approved a 29-month $ 15.15 billion "stand-by" loan program for Ukraine. Around $ 2 billion will be allocated to the budget and $ 13 billion to the central bank. Key conditionality provisions include the reduction of the general government deficit to 3.5% of GDP in 2011 and 2.5% of GDP in 2012, as well as stabilizing the public debt below 35% of GDP by 2015. Policy areas that will be targeted for reform include tax and expenditure, pension, energy, central bank independence and the banking system.

**ECONOMIC OVERVIEW:** Ukraine's economy was severely affected by the global economic financial crisis. In 2009 it plunged into a recession which resulted in a decline of -15.2% of its GDP following faltering global demand for steel and chemical products which revealed the economy's structural weaknesses. A stand-by loan-deal of $ 16.4 billion agreed in November 2008 with the IMF ushered in much needed reforms and helped restore, to a degree, macro-economic and financial stability. Aided by the recovery in global trade, GDP grew by 4.9% yoy in Q1 2010 and by 6% yoy in Q2 2010. The sectors which registered the most impressive turnaround in terms of yoy GVA growth in Q1 2010 were: 'manufacturing' (12.4%), 'electricity, gas and water supply' (12.6%) and 'agriculture, hunting, forestry' (6.1%). On the other hand, 'construction' and 'financial activities' fell by -19.2% and -1.3%. Demand for 'gross capital formation' surged on an annual basis in Q1 2010 whereas final consumption expenditure of households and general government grew only modestly. Demand from abroad led an increase in exports (mainly basic metals, chemicals and others) by 7% yoy in Q1 2010 versus a 2.4% growth in imports during the same period.

Overall the economy seems back on track to regain some of its earlier dynamism (annual average GDP growth of 7.5% in 2000-2007) though the pace of recovery is likely to be relatively slow as fiscal tightening and a rationalisation of the energy sector will likely constraint growth.

**FISCAL POLICY:** The 2009 budget deficit ballooned under the strain of burgeoning deficits in the social funds, the Naftogaz and other debt creating flows resulting to an overall deficit of 11.3% of GDP according to the IMF. The Bank of Ukraine provides data on the state budget and the consolidated budget which show that these came to 3.9% and 4.1% of GDP respectively in 2009. In the first five months of 2010 the state budget deficit was 1.4% of 2010 IMF GDP estimate from 0.3% in the corresponding 2009 period as expenditures surged by 21.1%.

| Ukraine: Public finance (percent of GDP) | | | | | | |
|---|---|---|---|---|---|---|
| | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 |
| General gov. balance (includes the central & local gov/s and social funds) | -2 | -3,2 | -6,2 | -5,5 | -3,5 | -2,5 |
| Overall balance (including Naftogaz operational deficit) | -2 | -3,2 | -8,7 | -6,5 | -3,5 | -2,5 |
| **Overall balance (including Naftogaz & other debt creating flows)** | **-2** | **-3,2** | **-11,3** | **-9,9** | **-3,5** | **-2,5** |
| Public debt (end of period) | 12,3 | 19,9 | 34,6 | 39,5 | 41,5 | 42,2 |
| Source: IMF | | | | | | |

The new government approved in July an amended 2010 Budget which envisages a fiscal deficit of 5.0% of GDP and incorporates a target reduction of the Naftogaz deficit to just 1% of GDP in 2010 and 0% in 2011. The government put into effect from August 2010 a 50% increase in gas prices for households. Earlier, it had negotiated a -30% reduction on the price that Naftogaz will pay on imported Russian gas in return to an extension of the use of Crimean naval facilities by the Russian Black Sea fleet.

**INFLATION:** Inflationary pressures peaked in 2008 exacerbated by high annual nominal wage growth (averaging 29% during 2000-2007), capital inflows and high regulated prices. In 2009 the global economic financial crisis and the accompanying decline in international commodity prices (the price of steel fell by around -45% in 2009) diffused inflationary pressures, a trend which continued during H1 2010. The annual growth in the consumer price index was 6.9% in June 2010 from 12.3% in December 2009 and an average 25.2% in 2008. The new IMF loan-accord will promote policies, such as a flexible exchange rate regime, geared towards establishing a low-inflation environment. In H2 2010 price increases may accelerate again on the back of higher gas prices and a bad harvest due to unfavourable weather conditions.

**BALANCE OF PAYMENTS:** The current account deficit escalated to 7.1% of GDP in 2008 but declined to 1.5% of GDP in 2009 under the impact of a significant exchange rate adjustment and plunging trade volumes.

The deficit in the current account was around 0.5% of GDP in Q1 of 2010 and in Q2 of 2010 there was a surplus of around 1.9% of GDP bringing the overall surplus in the current account for H1 of 2010 to an estimated 1.4% of GDP. In H1 of 2010 exports of goods and services increased by 29.2% yoy and imports by 24.4%. The financial account was in surplus of $ 3.9 billion in H1 of 2010 from a deficit of $ 6.9 billion in H1 of 2009 as the recovery from the global economic and financial crisis led to a partial recovery of capital inflows especially other investment flows.


**MONEY & FINANCIAL MARKETS:** Following a period of elevated turbulence from around August of 2008 to the end of 2009, the foreign exchange market is now experience a period of relative stability. The local currency (UAH) has stabilized at around UAH/USD 7.925 since the beginning of the year and is showing a modest trend towards appreciation.

Official reserve assets were $ 30.88 billion at the end of July 2010 from $ 26.7 at the end of May 2010, $ 26.5 at the end of 2009 and $ 31.54 at the end of 2008. The key policy rate remains was cut to 7.75% in August 2010 or by 250 basis points since the start of the year.

Credit growth to the private sector (euro basis) has recently turned positive. Following a year of negative annual growth rates, credit expansion reached 10.7% in June 2010. Private sector deposits have also recovered somewhat, since February of 2010 and have since gathered pace registering yoy growth rates of over 25% in both May and June of 2010. The loan-to-deposit ratio has also diminished in recent months, though it remains at the relatively high level of around 203% at the end of June 2010.

## 9. TURKEY

**ECONOMIC OVERVIEW:** The Turkish economy rebounded in Q1 2010 with GDP growth of 11.7% yoy, following a GDP decline of -4.7% in 2009 and marginal growth of 0.7% in 2008 (average annual growth rate of 6.8% during 2002-2007). After dipping into negative territory in Q4 2008 annual GDP growth was again positive in Q4 2009 sooner than in many other emerging and advanced economies. Notwithstanding the impressive comeback, the rebound reflected partly base effects as GDP in Q1 2009 declined by -14.5%. The Q1 2010 GDP breakdown showed that private consumption and investment experienced high annual growth rates of 9.9% and 14.4%. On the contrary the contribution to GDP growth from net exports was negative as exports recorded a lackluster performance decreasing by -0.1% yoy in Q1 2010 versus an increase of imports by 21.1%. The sectoral accounts further showed that the annual growth rate of GVA in Q1 2010 was highest in 'wholesale and retail trade' (22.4%), 'manufacturing' (20.6%), 'real estate, renting and business activities' (11.4%), 'transport, storage and communications' (11.3%) and construction (8%), while negative rates were registered in 'agriculture, hunting and forestry' (-3.8%) and 'hotels & restaurants' (-2.1%). In line with the economic recovery the unemployment rate fell to 11% in the April to June 2010 period from 13.6% during the same period in 2009.

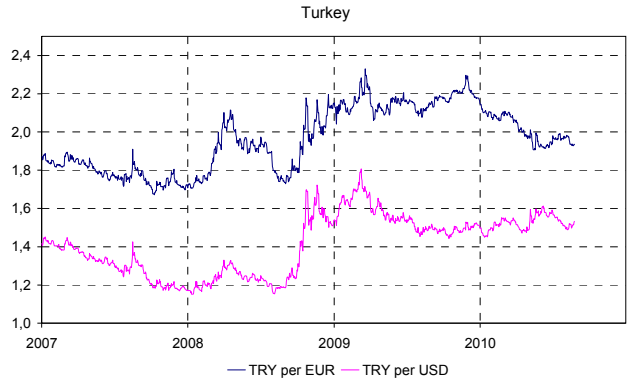
The outlook for the year is positive. Tourism revenues in Q2 of 2010 were up by 7.4% yoy from -2.2% in Q1 of 2010 and industrial production rose by 16.9% on an annual basis in the first five months of 2010. The European Commission in its spring forecasts projects that GDP will grow by 4.7% in 2010 and 4.5% in 2011, however it is likely to increase its projections in its interim forecasts next month. The EBRD forecasts GDP growth of 5.9% in 2010 and 4% in 2011. The 2010 GDP growth projection of the IMF is 6.1%. Factors that may yet constrain GDP growth in 2011 include a renewed widening of the current account deficit and consequent dependence on potentially volatile capital inflows, a worsening of fiscal finances, high inflationary pressures and slower growth of the global economy.

**FISCAL POLICY:** During a period of extensive policy reforms, the fiscal deficit was reduced to just 1% of GDP in 2007. The onslaught of the global financial economic crisis forced many countries to put into effect large-scale fiscal stimulus packages with a view to limiting the downturn. The widening of the fiscal deficit to 2.2% in 2008 and 5.5% of GDP in 2009 is explained in this context. In its July 2010 Article IV consultation the IMF urges the authorities to "step up the unwinding of fiscal stimulus in 2010 by saving all revenue over-performance in excess of mandatory spending increases". The government has recently announced that it is postponing the adoption of a much awaited new fiscal rule which envisaged reduction of the fiscal deficit and the public debt over the medium term to 1% and 30% of GDP respectively. Rating agencies Moody's and S&P have expressed concern that this may mean a loose fiscal policy during 2011, an election year. The delay by the government in tightening its fiscal regime is likely to further postpone agreement on a new loan-deal with the IMF. The finance minister has reported that the budget deficit accounted for 30.7% of the 2010 target and that it was by -33% decreased on an annual basis in H1 of 2010, following an increase of budget revenues by 19.1% and expenditures by 9.3%.

**INFLATION:** Inflationary pressures abated during 2009 after escalating in 2008 however incipient inflationary pressures remain and have re-appeared in the first half of 2010. The consumer price index increased by an average of 10.4% in 2008 and 6.3% in 2009. During the first half of 2010 the consumer price index increased by 9% yoy and by 7.6% yoy In July of 2010. The outlook for end of year inflation hinges on factors such as the developments in the international commodity market, the execution of the Budget and trends in the labour market. End of year inflation is almost certain to exceed the Bank of Turkey's

(BoT) target of 6.5%, though it may well hit its, downwardly revised, forecast of 7.5%.

**BALANCE OF PAYMENTS:** The current account deficit widened from $ 626 million in 2002 to nearly $42 billion or 5.65% of GDP in 2008. In 2009 the depletion of capital inflows that financed the burgeoning current account deficit in previous years (inflows of foreign direct investment fell by -57% and of other investments by -119%) and faltering demand led to a narrowing of the deficit to just bellow $14 billion or 2.27% of GDP. The economic recovery in 2010 is expected to lead to an increase of the current account deficit from its low 2009 level. Developments in this regard are closely watched by international investors and ratings agencies. In H1 2010 the current account deficit widened manifold to $ 20.7 from $ 7.4 billion in H1 2009 as exports of good and services increased by 12% versus an increase of imports by 32%. On the financial account inflows of direct investment continued to slow in annual terms in H1 2010 whilst inflows of portfolio investment and other investment increased markedly. The recent appreciation of the national currency contributed to the widening of external imbalances.




**MONEY & FINANCIAL MARKETS:** The Turkish Lira (TRY) appreciated against the Euro from TRY/EUR 2.135 on 31.12.1009 to TRY/EUR 1.93 on 18.8.1010 and more recently also against the Dollar from TRY/USD 1.6085 on 7.06.10 to TRY/USD 1.5014 on 18.08.2010 following higher than expected GDP growth in Q1. The Bank of Turkey increased its purchase of volume of dollars but has stopped short of more decisive intervention as it is supporting a floating exchange rate regime. It has left the one-week repo rate (the policy rate) at 7% and has announced its intention to keep it at this level “for some time” and at low levels “for a long period”.

## 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 | -3,0 | -1,0 |
| Gross Fixed Total Investments (including stocks) | -3,6 | 8,1 | 4,9 | -7,4 | -13,9 | -10,5 | -2,7 |
| - Residential Investment | 0,0 | 29,1 | -6,8 | -29,1 | -22,0 | -19,5 | -7,0 |
| - Equipment | -1,0 | 14,2 | 9,1 | 6,3 | -15,9 | -6,1 | -3,0 |
| 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 | 11,0 | 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 | 4,2 | 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 | -7,9 | -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 | 2007 | 2008 | 2009 | 2009 | 2009 | 2010 | |
|---|---|---|---|---|---|---|---|
| | | | | III | IV | (cumulative period) | |
| **Economic Activity (period average)** | | | | | | | |
| Retail Sales Volume | 2,3 | -1,4 | -9,3 | -8,6 | -6,0 | 0,8 | (5month 10) |
| Construction Activity | -5,0 | -17,1 | -27,6 | -32,6 | -21,3 | -22,4 | (5month 10) |
| Industrial Production (Manufacturing) | 2,2 | -4,2 | -11,2 | -10,6 | -8,3 | -4,8 | (5month 10) |
| PMI (manufacturing) | 53,7 | 50,4 | 45,3 | 49,0 | 48,0 | 45,3 | Jul-10 |
| Economic Sentiment Indicator | 107,9 | 93,4 | 70,6 | 72,9 | 78,5 | 66,3 | Jul-10 |
| Index of Business Expectations in Manufacturing | 102,8 | 91,9 | 72,1 | 76,6 | 75,0 | 75,8 | Jul-10 |
| Consumer Sentiment Index | -28,0 | -46,0 | -46,0 | -44,0 | -36,0 | -66,0 | Jul-10 |
| **Credit Expansion (end of period)** | | | | | | | |
| Private Sector | 21,5 | 15,9 | 4,2 | 5,4 | 4,2 | 2,5 | Jun-10 |
| Consumer Credit+Other | 22,4 | 16,0 | 2,0 | 3,3 | 2,0 | -0,4 | Jun-10 |
| Housing | 21,9 | 11,5 | 3,7 | 4,3 | 3,7 | 2,5 | Jun-10 |
| Business | 20,6 | 18,7 | 5,1 | 6,9 | 5,1 | 3,4 | Jun-10 |
| Tourism | 23,8 | 19,7 | 7,8 | 5,1 | 7,8 | 4,3 | Jun-10 |
| **Prices (end of period)** | | | | | | | |
| Consumer Price Index | 2,9 | 4,2 | 1,2 | 0,7 | 2,0 | 5,5 | Jul-10 |
| Core Inflation | 2,9 | 3,4 | 2,4 | 2,1 | 2,0 | 3,8 | Jul-10 |
| **Interest Rates (period average)** | | | | | | | |
| Savings | 1,14 | 1,17 | 0,56 | 0,45 | 0,37 | 0,38 | Jun-10 |
| Short-term Business Loans | 7,54 | 7,61 | 6,07 | 5,84 | 5,80 | 6,31 | Jun-10 |
| Consumer Loans (up to 1 year) | 10,39 | 11,03 | 11,53 | 11,44 | 11,32 | 11,02 | Jun-10 |
| Housing Loans (over 10 years) | 4,93 | 5,31 | 4,08 | 3,81 | 3,63 | 3,61 | Jun-10 |
| 3 month Euribor | 4,28 | 2,89 | 0,70 | 0,72 | 0,70 | 0,78 | Jun-10 |
| 10 year Bond Yield | 4,50 | 4,80 | 5,17 | 4,66 | 4,97 | 9,10 | Jun-10 |
| **National Accounts** | | | | | | | |
| Real GDP | 4,5 | 2,0 | -2,0 | -1,7 | -2,5 | -3,5 | (Q2/10) |
| Final Consumption | 3,9 | 2,0 | 0,3 | 1,1 | 0,3 | -0,7 | (Q1/10) |
| Investment | 4,9 | -7,4 | -13,9 | -18,6 | -25,8 | -18,4 | (Q1/10) |
| Exports | 5,8 | 4,0 | -18,1 | -21,7 | -15,5 | -0,5 | (Q1/10) |
| Imports | 7,1 | 0,2 | -14,1 | -16,5 | -18,0 | -6,6 | (Q1/10) |
| **Balance of Payments (in € mn - Cumulative)** | | | | | | | |
| Exports of Goods | 17,5 | 19,8 | 15,3 | 11,3 | 15,3 | 7,8 | (6month 10) |
| Imports of Goods | 58,9 | 63,9 | 46,1 | 34,5 | 46,1 | 23,1 | (6month 10) |
| Trade Balance | -41,5 | -44,1 | -30,8 | -23,2 | -30,8 | -15,3 | (6month 10) |
| Invisibles Balance | 13,5 | 13,2 | 6,1 | 6,4 | 6,1 | 0,9 | (6month 10) |
| Invisibles Balance / Trade Account | 32,5% | 29,9% | 19,8% | 27,5% | 19,8% | 5,8% | (6month 10) |
| Current Account | -28,1 | -30,9 | -24,7 | -16,8 | -24,7 | -14,4 | (6month 10) |
| Direct Investments | -2,5 | 1,7 | 1,1 | 1,6 | 1,1 | 0,9 | (6month 10) |
| Portfolio Investments | 17,4 | 16,4 | 27,1 | 23,1 | 27,1 | -5,0 | (6month 10) |
| **Athens Stock Exchange (end of period)** | | | | | | | |
| Composite Index | 5.123,4 | 1.786,5 | 2.196,2 | 2.661,4 | 2.196,2 | 1.682,0 | Jul-10 |
| % change | 17,9 | -65,5 | 22,9 | -6,8 | 22,9 | -28,8 | Jul-10 |
| Market Capitalization ASE (% of GDP) | 85,7 | 27,7 | 34,6 | 40,0 | 34,6 | 27,0 | Jul-10 |

Source: National Accounts, 2007 Official and Alpha Bank Research

## 10. Economic Data – Southeastern Europe

| Romania | 2006 | 2007 | 2008 | 2009 | 2010 (f) | 2011 (f) |
|---|---|---|---|---|---|---|
| **Real Economy** | | | | | | |
| Real GDP | 7,9 | 6,3 | 7,3 | -7,1 | -1,5 | 2,5 |
| Private Consumption | 12,7 | 11,9 | 9,5 | -10,5 | -2,9 | 2,4 |
| Government Consumption | -4,1 | -0,1 | 7,1 | 0,7 | -4,3 | 0,0 |
| Gross Fixed Investment | 19,9 | 30,3 | 16,2 | -25,3 | -1,9 | 3,9 |
| Exports (Goods & Services) | 9,8 | 7,8 | 7,7 | -5,2 | 12,0 | 8,4 |
| Imports (Goods & Services) | 22,7 | 27,9 | 7,0 | -21,3 | 7,4 | 6,4 |
| **Prices** | | | | | | |
| HICP Inflation (Avg) | 6,6 | 4,9 | 7,9 | 5,6 | 8,0 | 3,0 |
| **General Government** (%GDP) | | | | | | |
| Overall Balance | -1,4 | -3,1 | -4,8 | -7,4 | -6,8 | -4,4 |
| **Balance of Payments** (% GDP) | | | | | | |
| Current Account Balance | -10,6 | -13,4 | -11,6 | -4,4 | -6,0 | -6,0 |

| Bulgaria | 2006 | 2007 | 2008 | 2009 | 2010 (f) | 2011 (f) |
|---|---|---|---|---|---|---|
| **Real Economy** | | | | | | |
| Real GDP | 6,3 | 6,2 | 6,0 | -5,0 | 0,0 | 2,3 |
| Private Consumption | 9,5 | 5,3 | 4,8 | -6,3 | -3,9 | 1,6 |
| Government Consumption | -2,5 | 3,4 | -1,4 | -5,7 | -2,8 | 0,6 |
| Gross Fixed Investment | 14,7 | 21,7 | 20,3 | -26,9 | -3,3 | 3,3 |
| Exports (Goods & Services) | 8,7 | 5,2 | 2,9 | -9,8 | 5,4 | 4,8 |
| Imports (Goods & Services) | 14,0 | 9,9 | 4,9 | -22,3 | -1,7 | 2,5 |
| **Prices** | | | | | | |
| HICP Inflation (Avg) | 7,4 | 7,6 | 12,0 | 2,5 | 2,3 | 2,9 |
| **General Government** (%GDP) | | | | | | |
| Overall Balance | 3,5 | 3,5 | 3,0 | -0,8 | -1,8 | -1,5 |
| **Balance of Payments** (% GDP) | | | | | | |
| Current Account Balance | -18,4 | -26,8 | -24,0 | -9,4 | -6,3 | -5,8 |

| Cyprus | 2006 | 2007 | 2008 | 2009 | 2010 (f) | 2011 (f) |
|---|---|---|---|---|---|---|
| **Real Economy** | | | | | | |
| Real GDP | 4,1 | 5,1 | 3,6 | -1,7 | 0,0 | 1,5 |
| 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 | 1,3 |
| 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 | 3,5 |
| 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 | -6,0 | -5,5 |
| **Balance of Payments** (% GDP) | | | | | | |
| Current Account Balance | -7,0 | -11,7 | -17,7 | -8,5 | -7,1 | -7,5 |

| Serbia | 2006 | 2007 | 2008 | 2009 | 2010 (f) | 2011 (f) |
|---|---|---|---|---|---|---|
| **Real Economy** | | | | | | |
| Real GDP | 5,2 | 6,9 | 5,5 | -3,0 | 2,0 | 3,5 |
| Private Consumption | 6,9 | 4,0 | 7,6 | -2,7 | -2,0 | 3,0 |
| Government Consumption | 4,3 | 18,2 | 1,6 | -5,0 | -3,5 | -3,0 |
| Gross Fixed Investment | 14,5 | 25,6 | 1,9 | -3,3 | 2,0 | 6,0 |
| Exports (Goods & Services) | 4,9 | 17,2 | 8,9 | -11,0 | 5,0 | 9,0 |
| Imports (Goods & Services) | 7,8 | 26,0 | 9,3 | -18,3 | 3,0 | 5,0 |
| **Prices** | | | | | | |
| Consumer Price Inflation (Avg) | 12,7 | 6,5 | 11,7 | 8,4 | 4,6 | 4,4 |
| **General Government** (%GDP) | | | | | | |
| Overall Balance | -1,6 | -1,9 | -2,6 | -4,1 | -4,8 | -3,9 |
| **Balance of Payments** (% GDP) | | | | | | |
| Current Account Balance | -10,2 | -15,9 | -17,6 | -5,6 | -8,5 | -8,0 |

| Albania | 2006 | 2007 | 2008 | 2009 | 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 | 2,5 | 3,0 | 3,0 |
| **General Government** (%GDP) | | | | | | |
| Overall Balance | -3,2 | -3,9 | -5,5 | -7,4 | -5,2 | -6,1 |
| **Balance of Payments** (% GDP) | | | | | | |
| Current Account Balance | -5,6 | -10,3 | -15,2 | -14,0 | -12,6 | -11,3 |

| FYROM | 2006 | 2007 | 2008 | 2009 | 2010 (f) | 2011 (f) |
|---|---|---|---|---|---|---|
| **Real Economy** | | | | | | |
| Real GDP | 4,0 | 5,9 | 4,8 | -0,7 | 2,0 | 3,0 |
| Private Consumption | 5,2 | 8,0 | 7,4 | | - | - |
| Government Consumption | 6,0 | 9,8 | 6,9 | - | - | - |
| Gross Fixed Investment | 1,8 | 0,4 | 9,7 | - | - | - |
| Exports (Goods & Services) | 8,4 | 14,3 | -4,3 | - | - | - |
| Imports (Goods & Services) | 11,0 | 17,4 | 5,7 | - | - | - |
| **Prices** | | | | | | |
| CPI Inflation (Avg) | 3,2 | 2,3 | 8,3 | -0,8 | 1,9 | 3,0 |
| **General Government** (%GDP) | | | | | | |
| Overall Balance | -0,5 | 0,6 | -0,9 | -2,6 | -2,8 | -1,7 |
| **Balance of Payments** (% GDP) | | | | | | |
| Current Account Balance | -0,9 | -7,2 | -13,4 | -7,4 | -4,7 | -5,1 |

| Ukraine | 2006 | 2007 | 2008 | 2009 | 2010 (f) | 2011 (f) |
|---|---|---|---|---|---|---|
| **Real Economy** | | | | | | |
| Real GDP | 7,3 | 7,9 | 2,1 | -15,2 | 3,7 | 4,3 |
| Private Consumption | 15,4 | 17,0 | 10,0 | -12,3 | 0,5 | 2,0 |
| Government Consumption | 4,0 | 1,8 | 0,8 | -4,8 | 0,5 | 1,5 |
| Gross Fixed Investment | 20,9 | 24,4 | 1,9 | -46,6 | 3,5 | 14,0 |
| Exports (Goods & Services) | -5,8 | 2,8 | 5,5 | -26,1 | 10,0 | 13,0 |
| Imports (Goods & Services) | 8,3 | 23,9 | 16,8 | -41,2 | 10,5 | 14,0 |
| **Prices** | | | | | | |
| CPI Inflation (Avg) | 9,1 | 12,8 | 25,2 | 15,9 | 9,5 | 10,0 |
| **General Government** (%GDP) | | | | | | |
| Overall Balance | -0,7 | -1,1 | -1,8 | -4,1 | -5,0 | -3,5 |
| **Balance of Payments** (% GDP) | | | | | | |
| Current Account Balance | -1,5 | -3,7 | -7,1 | -1,5 | 0,5 | 0,1 |

| Turkey | 2006 | 2007 | 2008 | 2009 | 2010 (f) | 2011 (f) |
|---|---|---|---|---|---|---|
| **Real Economy** | | | | | | |
| Real GDP | 6,9 | 4,7 | 0,7 | -4,7 | 6,0 | 5,3 |
| Private Consumption | 4,6 | 5,5 | -0,3 | -2,3 | 6,0 | 4,5 |
| Government Consumption | 8,4 | 6,5 | 1,7 | 7,8 | 2,5 | 1,5 |
| Gross Fixed Investment | 13,3 | 3,1 | -6,2 | -19,2 | 15,0 | 13,0 |
| Exports (Goods & Services) | 6,6 | 7,3 | 2,7 | -5,4 | 6,0 | 7,2 |
| Imports (Goods & Services) | 6,9 | 10,7 | -4,1 | -14,4 | 9,5 | 10,0 |
| **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 | -4,0 | -3,5 |
| **Balance of Payments** (% GDP) | | | | | | |
| Current Account Balance | -6,1 | -5,9 | -5,7 | -2,2 | -4,5 | -5,4 |

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