ALPHA BANK

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Greece and Southeastern Europe Economic & Financial Outlook

Executive Summary

1. Greece

-With a collapse in business and consumer confidence following an unprecedented barrage of multiple downgrades by rating agencies and a concomitant erosion of the deposit base of the Greek banking system, a recovery expected as early as Q4 2011 is no longer likely to materialize, with expectations now shifting later into 2012.

-With substantial budgetary slippages in H1 2011 amidst a deteriorating economic environment, a new financial support package was put in place in July covering the period to mid-2014, including substantial debt relief from official and private sector creditors, as market access in early 2012 was deemed not to be any longer a credible option.

-In return, the Greek government adopted a medium-term fiscal consolidation plan aiming to bring the general government deficit to below 3% of GDP by 2014 and an ambitious privatisation and real estate development plan expected to raise € 50 billion by 2015.

-With structural reform and privatisation becoming more entrenched, and a strong performance in exports and tourism sectors already underway, solid conditions for sustainable growth from 2012 onwards have emerged and are now expected to take hold if confidence building continues on the back of achieving the 7.6% deficit target in 2011 bringing a primary surplus in 2012 within realistic reach.

- 2. Romania

- The economy continues to expand albeit at a slower pace. GDP grew by 1.4% yoy in Q2 2011 from 1.7% yoy in Q1 2011.
- The second IMF review of the economy under the terms of the new agreement was concluded successfully in July 2011.
- The budget deficit was 2.1% of GDP in H1 2011 from 3.5% of GDP in H1 2010. The government targets a reduction of the budget deficit to 4.4% of GDP in 2011 from 6.5% in 2010.
- The current account deficit narrowed to 2% of GDP in H1 2011 from 3% of GDP in H1 2010, as export growth continued to outstrip import growth and the current transfers balance kept on improving.

3. Bulgaria

- Economic growth remained positive but slowed to 1.9% yoy in Q2 2011 from 3.4% yoy in Q1 2011 and 3.8% yoy in Q4 2010. The outlook remains positive which is also confirmed by the recent upgrade by Moody's of the county's rating to Baa2 from Baa3.
- The budget deficit narrowed to 0.9% of GDP in H1 2011 from 2.1% of GDP in H1 2010, as expenses declined by 0.2% to BGN 12.7 billion, while revenues were up by 7.6% to BGN 12.
- In H2 1011 there was a surplus in the current account of 0.6% of GDP from a deficit of 1.5% of GDP a year ago, as exports surged.

4. Cyprus

- GDP grew by 1.5% yoy in Q2 2011 from 1.7% yoy in Q1 2011 as tourism, commerce, and other services sector expanded, compensating for declining output in construction and industry.
- Between July and August 2011 all three major rating agencies, Moody's, S&P's and Fitch, downgraded the rating on Cyprus on concerns that the country may require financial aid because of its exposure to Greece, and because of the adverse impact on the economy from the severe damages in the Vasilikos power plant.
- The budget deficit swelled to 3.5% of GDP in H1 2011 from 1.9% of GDP in H1 2010, following an increase in expenditures of 9.15% and a marginal decrease of revenues 0.3%.

5. Serbia

- In Q2 2011 GDP grew by 2.2% yoy having decelerated from 3.4% yoy in Q1 2011. The good first quarter results are attributable to strong growth of the manufacturing and the transport sectors.
- The budget deficit was 2% of GDP in H1 2011 against a year-end target of 3.6% of GDP. The fiscal consolidation efforts continue, despite the concluding in April 2011 of the recent IMF loan accord.
- In H1 2011 the current account deficit stood at € 1,382 million or 4.3% of GDP in H1 2011 from € 1,375 or 4.7% of GDP in H1 2010

6. Albania

- Albania's economy has managed to maintain its positive pace of growth in early 2011 despite the weak international environment.
- The budget balance is under pressure because of weakening revenues.
- Inflation is within the Central Bank's target band.

7. Former Yugoslav Republic of Macedonia

- Real GDP increased by 5.1% in Q1 2011 following 1.8% growth in 2010, mainly reflecting a pick-up in construction and industry as well as, in domestic demand.
- The budget deficit was standing at 3.6% of GDP in Q1 2011, while the government is targeting a budget deficit of 2.5% of GDP in 2011 and 2% of GDP in 2012.
- The inflationary pressures have started to fade gradually since May due to deceleration of food and energy prices.

8. Ukraine

- Given the decline in international energy prices and in vegetable and fruit prices, headline inflation slowed to 10.6% yoy in July after peaking at 11.9% yoy a month earlier.

-Domestic demand remained strong for a second quarter in a row registering annual growth of 13% as increased household confidence boosted private consumption.

-High economic growth, rising corporate earnings and a broader taxation base helped budget revenues to rise by 24% in 7M 2011

- The current account deficit widened in H1 2011 to $ 2.5 bn from a surplus of $ 552 mn in H1 2010 (preliminary data). The FDI inflows remain sufficient to cover the current account deficit.

9. Turkey

- GDP continued its acceleration in Q1 2011 on the back of stronger domestic demand. Nevertheless, a slowdown over the coming quarters is now expected.
- After ending 2010 with a budget deficit equivalent to 3.6% of GDP, Turkey in the first half of 2011 posted a budget surplus of 2.9 billion liras, compared with the target for the full year of a 33.5 billion liras deficit (2.8% of GDP).
- The demand side inflationary pressures together with the expected increases in food and energy prices, as well as, the lira's depreciation have started to impact on headline inflation.
- The widening current account deficit remains a risk factor for the lira.

1. GREECE

Table 1. Basic Conjunctural Indicators (average annual percentage changes)					
	2008	2009	2010	2011	
				available period	
Retail sales volume	-1.4	-9.3	-6.8	-12.1%	Jan-May
Automobile sales	-7.0	-17.4	-37.2	-42.2%	H1
Tax on mobile telephony	5.3	13.2	37.1	-23.0%	H1
VAT revenue	5.0	-9.1	4.8	1.7%	H1
Consumption tax on fuels	28.9	18.6	30.3	-18.2%	H1
Private Consumption	3.0	-1.8	-4.5	-7.8%	Q1
Government Consumption	1.0	7.6	-6.5	-3.4%	Q1
Building activity (volume, according to permits)	-17.3	-26.5	-23.7	-49.2%	Jan-Apr
Cement production	-3.1	-21.4	-14.3	-32.7%	Jan-Apr
Public investment	9.3	-2.8	-11.3	-31.7%	H1
Fixed investment	-7.5	-11.2	-16.5	-19.2%	Q1
Change in Stocks and Stat. Dis.	47.9	-142.9	-120.0	15.5%	Q1
Unemployment	7.6	9.5	12.4	15.9%	Q1
Manufacturing production	-4.7	-11.2	-5.0	-9,5%	H1
Economic sentiment (1998-2006=100)	95.6	76.3	75.1	75.4	H1
-Industry	91.9	72.1	75.8	78.4	H1
-Consumer Confidence	-46	-45.7	64.0	-69.9	H1
PMI (Manufacturing)	50.4	45.3	43.8	45.4	July
Exports of goods - excluding oil (El.Stat.)	3.2	-15.9	8.5	11,6%	H1
Exports of goods (El.Stat.)	1.1	-18.2	10.8	40.0%	H1
Imports of goods - excluding oil (El.Stat.)	4.0	-20.2	-10.7	-15.0%	H1
Tourist arrivals (airports)	-1.4	-6.7	-0.3	10.0%	Jan.-July
Tourism receipts (BoP)	2.8	-10.6	-7.6	12,6%	H1
Exports goods & services	3.3	-18.3	3.8	-2.0%	Q1
Imports goods & services	4.0	-18.6	-4.8	-15.5%	Q1
GDP growth	1.0	-2.3	-4.4	-5.5%	Q1
Inflation (CPI)	4.2	1.2	4.7	2.4%	July
Current Account (% of GDP)	-13.0	-10.1	-9.4	-5.8%	H1

Source: Bank of Greece, Hellenic Statistical Authority (El.Stat.)

THE SECOND FINANCIAL SUPPORT PROGRAM TO GREECE (FSPII):

Following a relatively long and particularly painful gestation period, for Greece as well as for the other countries involved in the Eurozone sovereign debt debacle, the ***Eurozone heads of State agreed on 21 July 2011 to a second Financial Support Program for Greece (FSPII) with the following characteristics and structure:***

This new program is based on an estimate of total financing needs of Greece in the period 2011-2014, which amounts to € 158 bln. This can be financed by € 42 bln with the still undisbursed loans from the 1st Financial Support Program to Greece (FSPI) and € 28 bln is expected to be financed with revenues from the program of privatizations and public property development and utilization (PP&PPDU). Therefore the remaining uncovered financing needs of Greece in the current and the following three years are estimated at € 88 bln.

The basic characteristic of FSPII is the voluntary private sector involvement (PSI) contributing to the financing of the above € 88 bln uncovered financing needs of Greece. This PSI will involve the exchange of an estimated (by the Institute of International Finance or IIF) € 54 bln private sector bond holdings maturing in the period 2011-2014, or of € 135 bln private sector bond holdings maturing in the period 2011-2020, with new 15-30 year Greek bonds bearing a higher interest rate (4.0%-5.0% for par bond exchange or rollover and 6.0%-6.8% for an 80% discount bond exchange). The new Greek bonds will be collateralized with credit enhancements (30-year zero coupon AAA rated bonds) which will be provided to Greece by the European Financial Stability Fund (EFSF). These credit enhancements will amount to € 35 bln.

Therefore, only the remaining amount of € 34 bln (€ 88 bln - € 54 bln) will be provided to Greece as additional official loans through the EFSF in the FSPII. In addition, the EFSF will provide the € 42 bln in loans which are still undisbursed from FSPI. This total of € 76 bln will now carry a lower interest rate of 3.5% and will have maturities of 15-30 years, including a grace period of 10 years. Moreover, the maturities of the FSPI loans which have already been disbursed will also be extended to 15-30 years.

In addition to the above the EFSF will provide: (1) An amount of € 20 bln for a Greek debt buy-back (DBB) operation to buy Greek bonds from the secondary market at an average buy-back price of 61.43% contributing to the reduction of the Greek GG debt by € 12.6 bln. (2) An amount of € 20 bln to increase the resources of Greece's Financial Stability Fund (FSF) in order to recapitalize Greek banks if needed. Following this EFSF € 20 bln offering, the available resources of the Greek FSF will reach € 30 bln. No Greek bank has made use of this Fund until now.

Therefore, the new commitments for financial resources that will become available to Greece from the Eurozone and the IMF in the FSPII will be the following: New loans: € 34 bln, credit enhancements: € 35 bln, DBB: € 20 bln and for the Greek FSF: € 20 bln. Total: € 109 bln.

It is estimated that the DBB program and the PSI will contribute together to a reduction of the Greek GG Debt by € 26.1 bln, which is equivalent to 11.58% of GDP.

Assuming an average 9.0% discount rate it has been estimated that the PSI may cost to the participating private sector holders of Greek debt as much as 21% of the present value of this debt. However, this depends solely on the assumption for the 9.0% discount rate (3.0% the safe rate and 6.0% the risk factor for Greece, applied for the whole period of the next 30-years).

The FSPII provides the time needed in order to implement the Medium – Term Fiscal Strategy 2011-2015 (MTFS), agreed recently with the Troika and voted into law by the Greek Parliament. It should also be noted that the main measures adopted with the FSPII contribute substantially to the proper implementation of the MTFS. As recently pointed out by the European Commissioner Olli Rehn (Reuters, 5.8.2011), "a reduction of interest rates to about 4% should reduce cumulative interest payments by some € 25 billion between 2011 and 2020"."This implies a reduction in the debt ratio in 2020, without private sector involvement, of around 10 percent of GDP". If we add to that the effect on GG Debt of the PSI program, then the total effect of FSPII on reducing the GG Debt by 2020 may reach 22% of GDP.

In fact, ***a systematic analysis of the Greek debt dynamics following the adoption of the FSPII is***

Contents

provided by the Institute of International Finance in its Report on Greece (August 3, 2011), in which the following are pointed out:

"The various components of the agreement reached on July 21 by the Euro Area governments and private sector investors should help strengthen Greece's government debt dynamics. Both the sustainability of government debt and the fiscal outlook will improve, assuming the government implements its comprehensive adjustment and reform program in full and on time. ***Government debt will decline to 122% of GDP by 2015 and 98% of GDP by the end of 2020, from 142% of GDP at the end of 2010.*** This debt is net of financial assets, such as the cash buffers, bank recapitalization funds and collateral and escrow account linked to the bond exchanges. These estimates take into account the underlying assumptions of the July 21 agreement and compare with a reduction to 124% by 2020, as calculated on the same basis, under the projections published by the IMF in early July, prior to the agreement".

"Much of the larger reduction now in prospect reflects decreased interest payments by 2.6 percentage points of GDP on average after mid-decade; with primary surpluses at 6.0%-6.5% of GDP, as assumed by the EU/IMF program, lower interest payments will result in overall surpluses after 2015. In addition, the average maturity of bonds held by private investors is set to increase to 11 years from 6 years. To this end, new market borrowing at higher interest rates now is likely to be about € 50 billion through 2020".

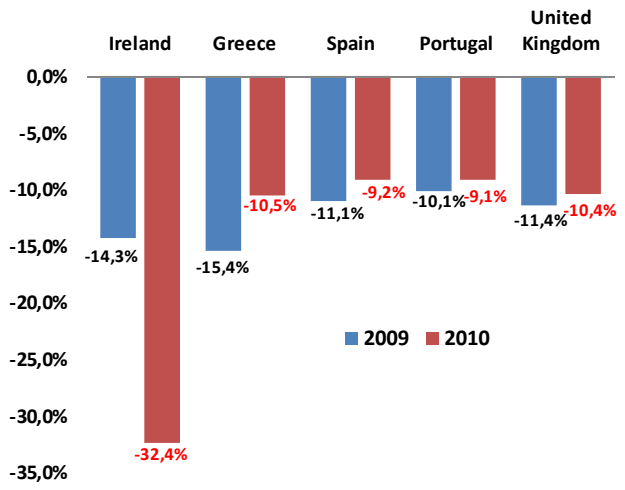
"The government's structural reforms agenda and its full implementation hold the potential to resolve long-standing structural weaknesses that have hampered the efficiency, competitiveness and productive capacity of the Greek economy. Were real GDP to grow 1% a year faster as a result of the improved debt sustainability and fiscal outlook, success in advancing structural reforms and expanded support from the EU for infrastructure development, GG ***debt net of financial assets linked to the agreement could decline to 90 percent by 2020".***

THE IMPLEMENTATION OF THE FISCAL ADJUSTMENT & STRUCTURAL REFORM (FAG&SR) PROGRAM IN 2010:

It was an unambiguous success, as it has been verified by the 3rd review of its progress by the representatives of the EC, the ECB and the IMF in February 2011, as well as by the OECD (July 2011). **In this short period of time, and under the worse possible international publicity, Greece has made substantial progress towards achieving the program's ambitious objectives.**

More specifically: ***A remarkable fiscal adjustment of 5 pps of GDP was recorded in 2010. As the OECD (July 2011) points out, "no other OECD country has achieved such a fiscal improvement in a single year over the past three decades".*** The general government deficit (GG deficit) declined to 10.5% of GDP in 2010 from 15.5% of GDP in 2009, despite the fact that tax evasion continued in this first year of adjustment and the recession was much deeper than expected, especially in H2 2010. Nevertheless, the Greek GG debt/GDP ratio reached 142.8% of GDP at the end of 2010 and is expected to reach 153% of GDP at the end of 2011. However, both the GG deficit and the GG debt for 2009 and 2010 have been inflated by the incorporation into the general government of the deficits and the liabilities of a multitude of state controlled entities (businesses and organizations), which in other EU countries fall outside the scope of general government.

Diagram 1. Fiscal Adjustment in Greece and in other European Union countries 2010



The implementation of the above substantial fiscal adjustment in 2010 was accompanied with ***a wide array of far reaching structural reforms,*** which were legislated and are well in the process of implementation within the very short period of 12-months. This program of structural reforms aims at ***the reversal of the structural rigidities, inefficiencies and excesses of the 2000s,*** when high wage and employment growth, in combination with low (or even negative) productivity growth in the public sector and in excessively protected activities, were the main contributors to the 2007-2009 fiscal derailment and to the gradual erosion of Greece's international competitiveness. Thus, the fundamental reform of the pension and health care systems and the equally important reform of the labour and product markets of the country, as well as the establishment of better governance practices in local and central government and in state controlled entities constitute a virtual brake with the past. Although most of these reforms are in the process of implementation and there still are a multitude of challenges lying ahead until these reforms will be fully functional, the progress that has been achieved until today in this field is even more remarkable that the progress in actual fiscal adjustment. In fact, some key reforms such as the reform of the pension system and the labour market are near to completion, while substantial progress has being made in 2010 and in 2011 concerning the opening up of closed professions and the overhauling of the public sector, i.e. the State Owned Enterprises (SOEs), Local Government Organizations (LGOs) and Central Government Services (CGCs). Overall, work in structural reforms continue unabated in 2011 and will be intensified until the end of the current and the following

years in the process of the implementation of the € 50 bln programme of privatizations and development and utilization of public property in the period 2011-2015. This whole process implies a gradual but substantial reduction of the Greek state's involvement in the economy and, in combination with the rationalization of the domestic labour market, will contribute to the attraction of a higher level of FDI in Greece from 2012 onwards.

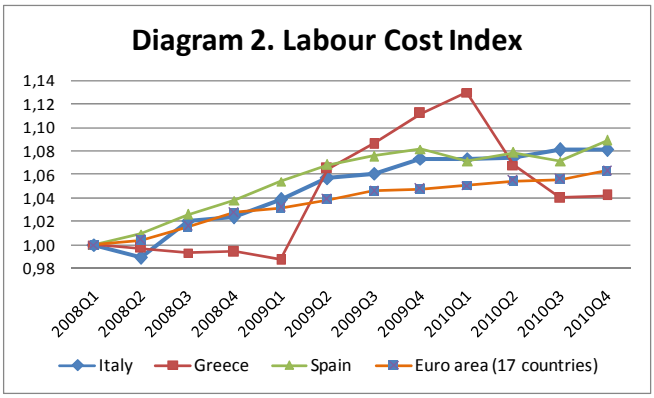
The above fiscal adjustment and structural reform effort contributed to, and it was negatively affected by, ***the substantial contraction of domestic economic activity, implying a -6.5% fall of GDP in H2 2010 and a sizable fall of -4.35% GDP in 2010 as a whole, with unemployment accelerating to 14.8% in December 2010 and to 15.8% in Q1 2011, from 12.5% in 2010 as a whole.*** The deepening of the recession in H2 2010, compared with a relatively mild GDP fall in H1 2010, was mainly due to the following two factors: First, following the spectacular 4-notches downgrade of Greece by Moody's in June 2010, to non-investment grade status, the country was exposed to the whimsical predictions from experts from all around the world of its imminent downfall to a state of bankruptcy or even worse. This led to an unprecedented fall of domestic consumer and business confidence, which implied a dramatic -14.9% fall of the volume of retail sales in Q4 2010 (-20.4% fall in December 2010), from -5.3% in Q2 2010 and +5.7% in Q1 2010, and an equally dramatic fall of business and housing investment. Moreover, the extraordinarily negative international press coverage, especially in presenting Greece as a country of unrest, made Greece the only European country that experienced a fall in its international tourism in 2010.

Nevertheless, the prospects in Q1 2011 for the evolution of economic activity in Greece in the following quarters and in 2011 as a whole were supportive of a positive economic outlook:

First, real GDP had registered a positive 0.7% annualized q/q growth in Q1 2011, following its dramatic -10.7% fall in Q4 2010. This spectacular turnaround was due to the impressive positive effect of net exports on GDP growth, which, on a yoy basis, reached 4.6 percentage points. On a yearly basis real GDP fell by -5.45% in Q1 2011, compared with its dramatic fall by -7.4% in Q4 2010. This fall was again the result of the unwarranted, abnormally high, fall of fixed investment by -19.2% in real terms, comprising an additional fall of government controlled investments by more than 10,5% in real terms.

Second, exports of goods and services and manufacturing orders from external markets had registered a particularly strong performance in Q4 2010 and an even stronger performance in Q1 2011, which continues unabated in Q2 2011 as well. Exports of goods had registered a 21.9% yoy increase in real terms in Q4 2010 and a 6.5% yoy increase in real terms in Q1 2011. Moreover, in H1 2011 exports of goods have registered an increase of 40.0% in nominal terms, while at the same period imports of goods excluding fuel have registered a new substantial fall of -14.4%. In the services sector, exports of services registered a fall by -8.3% in Q1 2011 mainly due to the fall of earnings from international shipping in a quarter in which tourist revenues, which register a healthy yoy growth, are not very important for Greece. This unfavorable balance will change in Q2 and Q3 where external tourism receipts are by far the most important item in the services exports. In fact, external tourist receipts were up by 5.6% in January-May 2011 and, according to EL.STAT, arrivals of foreign tourists were up by 13.1% yoy in Q1 2011. Arrivals of foreign tourists in the main airports of the country were up by 10.0% in January – July 2011 and by 15.1% in June and 11.0% in July 2011. Overall, advance bookings, reports from source countries and from tourist destinations in Greece are becoming stronger by the day, showing that 2011 is going to be a year of satisfactory growth of external tourism in Greece. Overall, net exports of goods and services, which have exerted a substantial positive effect on GDP growth in Q1 2011, are expected to have exerted an even stronger positive effect on GDP growth in Q2 2011 and the same is expected for the year 2011 as a whole. In fact the European Commission (Spring 2011) projects this effect to reach 5.0 pps in 2011.

Third, the above impressive performance of Greek exports of goods and services in Q4 2010 and in H1 2011, in combination with the continuous substantial fall in imports of goods and services (by -15.5% in real terms in Q1 2011), which partly indicates a trend for import substitution especially in the agricultural sector, ***are also based on the substantial internal devaluation and improvement of international competitiveness,*** which has already happened in Greece in the last 15-months. An indication of that is presented in Diagram 2, while, according to the European Commission (Spring 2011) the real effective exchange rate of Greece, with respect to the relative unit labour cost, has been devalued by 3.2% in 2010 and by a further 0.5% in 2011 and 2,2% in 2012.

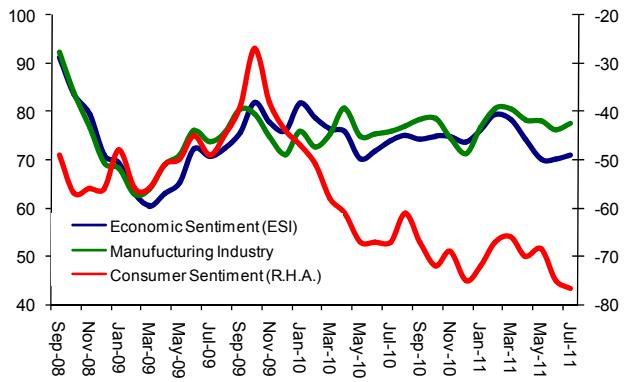


Fourth, the ***Greek economic sentiment (ESI) and business expectations in industry indices,*** which had registered a substantial fall in Q4 2010 (Diagram 3), implying an equally dramatic fall of private consumption in this quarter, ***bounced back in January – February 2011.*** Economic sentiment recovered in Q1 2011 reaching 79.4 in February and 78.4 in March 2011, from 73.7 in December 2010, contributing to the lower than expected fall of the volume of retail trade and of GDP as a whole in Q1 2011.

Overall, in Q1 2011 conditions were favourable for the successful continuation of fiscal adjustment and structural reform and more importantly for the

gradual recovery of the Greek economy. The impressive developments in Greek exports and imports are further supported by the substantial improvement of Greece's international competitiveness due to the fall of wages in the public and the private sector and the drastic reform and rationalization of the domestic labour market. In fact, ***the substantial fall in employment and the surge in unemployment to 16.6% in May 2011,*** also imply a sizable positive effect on productivity. This repositioning of Greece in the international competitiveness front is now also recognized by the IMF and the OECD (July 2011). The Greek business firms and the state are now more able to manage their labour force for higher productivity.

Diagram 3. Economic sentiment, business expectations and consumer confidence indicators



THE FAG&SR PROGRAM IN VIRTUAL DISARRAY IN MARCH-JULY 2011:

However, a number of substantial setbacks in Greece's adjustment effort appeared from March 2011 and in the following months, which threw the adjustment program in virtual disarray. The most important of the factors leading to these setbacks were the following:

The unprecedented aggressive action of the rating agencies Moody's and S&P's, which proceeded in March 2011 and then again in May 2011 with new multiple downgrades of Greece, spurring a flood of renewed publications internationally and in the domestic press predicting the virtual demise of the Greek economy and the restructuring of Greek sovereign debt. Based mainly on the European Commission's (February 2011 and Spring 2011) dire projections (analyzed below) and ignoring completely the aforementioned favourable developments in the field of fiscal adjustment, structural reform, competitiveness and development prospects, ***Moody's*** downgraded Greece to B1 with negative prospects on 7 March 2010 (from Ba1) and then again to Caa1 with negative prospects on 1 June 2011. Also, ***the S&P's*** downgraded Greece to BB- with negative prospects (from BB+) on 29 March 2011 and then again to B with negative prospects on 9 May 2011 and then again to CCC with negative prospects on 13 June 2011. Finally, ***Fitch*** downgraded Greece to BB+ with negative prospects on 14 January 2011 (from BBB-) and then again to B+ with negative prospects on 20 May 2011.

These actions gave a new impetus to the endless search in the international press for arguments to be fired against Greece. The apparent conclusion of international analysts and commentators was that Greece has done little of what is needed to get out from the crisis. Fiscal adjustment presented in Diagram 1 above, the pension system reform, the labour market reform, the health care system reform, the public sector entities reform, the local government reform, the tax system reform did not seem to matter. The argument was that there is more to be done. Of course, there is more to be done!

Moreover, these aggressive actions by the rating agencies implied a new drop of consumer and business confidence in Greece, from their encouragingly recovered level of March 2011, to a new extraordinarily low level in July 2011, which, if maintained, could spur new falls of domestic private consumption and investment and potentially offset the substantial positive effects on GDP growth from booming exports of goods and services and rapidly falling imports.

The actions of the rating agencies and the implied flood of dramatically negative publications about Greece's prospects, led to the explosive increase of Greece's spreads and CDS's in April-July 2011 (Diagrams 1 and 2). ***This has meant that Greece would not be able to tap again the bond markets from mid-2012, as it has been envisaged by the FSP I. Thus, the need arose for a second official Financial Support Package (FSP II) for Greece.*** In fact, from May 2011 the IMF stated openly that its contribution to the 5th trance of € 12 billion to Greece expected to be disbursed in July 2011 would depend on the Eurozone reaching a final decision for an adequate FSP2 covering Greece's financing needs until 2014.

Within the Eurozone strong opposition emerged to extending additional financing to Greece, leading to a public discussion concerning options for private sector involvement (PSI) in the FSP II and the need for the private bond holders and in particular the banks to incur part of the implied cost of adjustment. These discussions for an unspecified PSI destroyed confidence in the sovereign debt markets of all the Eurozone peripheral countries including Spain and Italy. The Eurozone sovereign debt crisis was being transformed rapidly into a Euro crisis.

These dramatic developments were supported to a great extent by the disappointing fiscal performance of Greece in H1 2011. The apparent failure in the implementation of the 2011 budget in H1 2011 is being judged especially in comparison with the targets set for the evolution of net current revenues and current primary expenditure in the Budget 2011. As it will be explained below, this disappointing performance was mainly the result of the following: a) Of the flawed tax bill that was voted by the Greek Parliament in April 2010, which, instead of contributing to the required substantial increase in net current tax revenues, led to an unprecedented fall of these revenues by -8.3% yoy in H1 2011. b) Of the unwarranted high targets set in November 2011 (when the budget 2011 was submitted) for the evolution of net current revenues in H1 2011. These points concerning

the setbacks in Greek fiscal adjustment effort in H1 2011 are analyzed in detail below.

Finally, the Troika itself made things worse by predicting in spring 2011 (European Commission) that despite the projected substantial increase in Greece's exports of goods and services by 10.7% in 2011 and the fall in imports of goods and services by -8.4%, implying a positive effect on real GDP growth by 5.0 pps, GDP would still fall in 2011 by -3.5%. For this to happen, the Troika was projecting a new dramatic fall in private consumption in 2011 by -6.4% yoy (following a -4.5% in 2010) and a further dramatic fall in domestic investment by -16.5% yoy in 2011 and by -1.9% in 2012 (from -16.5%yoy in 2010). This would happen in a period in which one of the main objectives of the Troika is supposed to be to improve competitiveness in the domestic economy of Greece and also in a period in which Greece has to absorb a big part of the € 17 billion awarded from the EU structural funds to co-finance investment projects in Greece in the period 2011-2013. Moreover, on top of the -7.6% fall of domestic demand in 2011 implied by the above assumptions, the European Commission also projected a fall in inventories, implying an additional 0.5 pps fall of real GDP in the current year.

Table 2. The effect of fiscal adjustment on GDP growth in 2011, in Greece and in other countries, according to the forecasts of the European Commission, Spring 2011.

	Fall in the GG Deficit (In % of GDP)	Real GDP growth	Fiscal Multilier
Greece	-1,0%	-3,5%	3,5
Spain	-2,9%	0,8%	-0,3
Italy	-0,6%	1,0%	-1,7
Lithuania	-1,6%	5,0%	-3,1
Hungary	-5,8%	2,7%	-0,5
Portugal	-3,2%	-2,2%	0,7
Slovakia	-2,8%	3,5%	-1,3
United Kingdom	-1,8%	1,70%	-0,9
Ireland	-21,9%	0,6%	-0,03

Source: European Commission, European Economic Forecasts, Spring 2011

Moreover, as shown in Table 2 according to the EC, the general government deficit in 2011 will not fall below the 9.5% of GDP on the basis that no action is undertaken to correct the situation. This means that for a fall of the Greek GG deficit by 1.0 percentage point of GDP, the GDP is going to fall by -3.5%. As shown in Table 2, Greece is an absolute special case of an economy according to the EC. Contrary to Greece, in Spain the deficit will be reduced in 2011 by 2.9 pps of GDP, but the GDP will increase by 0.8%, also in Ireland the GG deficit will fall to 10.5% of GDP in 2011 from 32.4% of GDP in 2010, but the GDP in 2011 will increase by 0.6%. In the United Kingdom the GG deficit will be reduced by 1.8 pps of GDP in 2011, while GDP will register positive growth of 1.7% and in Hungary the GG balance will register a surplus of 1.6% of GDP in 2011, from a deficit of -4.2% of GDP in 2010, while the GDP will register a positive growth by 2.7%.

Finally, the EC predicts an increase of the debt/GDP ratio for Greece to 157.7% in 2011 and to 166.1% in 2012, from 142.8% in 2010. This of course is the result of the above nominal GDP projections of the EC, in combination with its equally puzzling projection (puzzling because the EC is the main part of The Troika) that the Greek GG deficit will still reach the 9.3% of GDP even in 2012.

Needless to say that in today's situation of Greece the above projections of the Troika constitute, to a great extent, self fulfilling prophesies. Their effect in destroying economic sentiment in Greece and between the international investors is so great that it is possible that the actual developments in GDP growth and in fiscal adjustment will indeed turn out to be even worse than the projections. For example, a multitude of international commentators, including the rating agencies, are able now to base their calculations that the Greek government debt is unsustainable on the EC's projection that this debt will reach 166.1% of GDP in 2012. ***No one is going to take into account the fact that this figure has been calculated assuming a dramatic new fall of GDP in 2011 and this without fiscal adjustment and no privatization revenues, in 2011 and 2012.***

Additional credibility damage to the Greek economy was exerted by the continuous changes of the GDP measurement methodology by the new independent statistical authority of Greece (ELL STAT). The new methodology appears to exclude, to a higher extent than the old one, the plethora of non-recorded economic transactions from measured official GDP. And this is happening in a country in which at least 35% of economic transactions are not recorded in the official statistics. In fact this unofficial economy has received an additional boost in H1 2011 where it has been reported that more than 200.000 businesses failed to submit even their VAT declarations.

By including 16 public sector entities into the general government in November 2010 implied a substantial increase in their contribution to GDP up until 2009, inflating in particular real GDP in Q4 2009, while their effect on GDP in 2010 and in H1 2011 has been substantially reduced as most of these entities have entered a period of drastic restructuring with substantially reduced employment and earnings. This change alone implied a higher fall of GDP in 2010 as a whole (-4.35%, instead of 3.98%) and in particular a higher fall of GDP in Q4 2010 (-8.8%, instead -5.92%). It is important to notice that with the new measurement real GDP in 2010 (€ 171.9 bln) is higher than the one that was estimated when it was assumed that in 2010 GDP would fall by -4.0% (€ 171.87 bln). Nevertheless, the headline effect when the Q4 GDP growth was announced appeared as if there was a dramatic deterioration of growth dynamic.

Then, on June 9, 2011, Q1 2011 GDP growth data were published on seasonally adjusted basis, showing a positive q/q growth of 0,7% on an annualized basis and a fall of GDP yoy by -5.5% in Q1 2011, which implied a considerable improvement from the Q4 2010. This created intense anticipation for the data for Q2 2011 in order to judge weather the small improvement shown in

Q1 2011 will continue in the second quarter of the current year. However, instead of publishing the data on a seasonally adjusted basis in Q2 2011, the EL.STAT published the data again on a non-seasonally adjusted basis propagating the existing confusion concerning developments in the Greek economy in the last two years. The result is shown in Table 3.

Judging from the data on the non-seasonally adjusted basis we could conclude that in Q2 2011 recession was shallower than Q1 2011 and than Q4 2010. Moreover, the high percentage fall in GDP in H1 2011 is mainly due to the sizable base effects, as GDP had fallen slightly in H1 2010, and also to the fact that H1 2011 GDP growth has been negatively affected by the fall of expenditure of the Public Investment Budget by -42.3% in nominal terms, implying a negative effect on real GDP growth of -1.42 percentage points. On the contrary, in H2 2011 base effects will be substantially favourable and PIB expenditure is expected to have a positive effect on GDP growth of 0.1 pps. Therefore, we should expect a much lower yoy GDP fall in Q3 2011 and a positive yoy GDP growth in Q4 2011. Nevertheless, the GDP data so far, as published by EL.STAT, can be used by the European Commission to justify its predictions, as well as by experts on the Greek economy boasting that, as they have predicted, "Greece will remain in recession for a lot longer than the official forecasts predict". In fact, these experts predict that the Greek economy will continue to shrink in 2012 and in 2013 (Reuters, 12 August 2011).

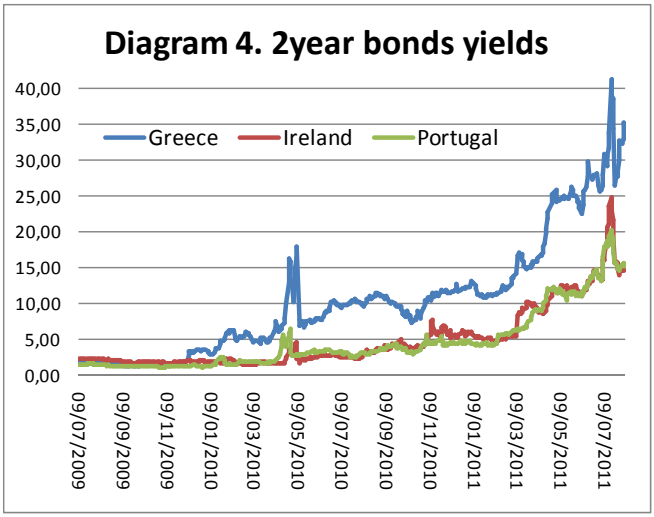
Table 3. Qarterly GDP

	Seasonally Adjusted Data		Not- Seasonally Adjusted Data	
	Million €	% yoy change	Million €	% yoy change
Q1 2009	45.344	-1,1%	40.736	-4,5%
Q2 2009	44.879	-2,7%	45.807	-1,0%
Q3 2009	44.606	-3,5%	47.233	-3,0%
Q4 2009	44.901	-2,1%	45.954	-1,1%
Q1 2010	44.053	-2,8%	41.036	0,7%
Q2 2010	43.488	-3,1%	43.962	-4,0%
Q3 2010	42.781	-4,1%	44.977	-4,8%
Q4 2010	41.583	-7,4%	41.930	-8,8%
Q1 2011	41.651	-5,5%	37.697	-8,1%
Q2 2011			40.908	-6,9%

Source: EL.STAT

The combination of all the above factors contributed to an unprecedented upward surge in Greece's and other peripheral countries' bonds and CDSs spreads, as shown in Diagram 6, and have cast considerable doubts as to whether Greece would indeed be able to re-enter the bonds markets in 2012 and 2013 as it was supposed to do under the assumptions of the FSP I. In fact, using the above mentioned projections of the European Commission, concerning developments in the Greek economy in the following years, it was a safe bet to predict a Greek Default (most possibly controlled and organized) with a generous haircut of the Greek sovereign debt in the very short term (Diagram 4.).

Overall, the economic situation had become critical and particularly risky, both for Greece and for the Eurozone as a whole, since early June 2011. These unprecedentedly negative developments implied that a second financial support program for Greece (FSP2) was now urgently needed. For this, however, to be seriously considered by Greece's Eurozone partners and the IMF. Greece should, within June 2011, come first to an agreement with the Troika for the content of a ***Medium - Term Fiscal Strategy (MTFS) 2011-2015*** aiming at: a) reducing the GG deficit to 7.5% of GDP in 2011 and to less than 1.5% of GDP in 2015, b) implementing privatization and public property development and utilization programs bringing revenues to the Greek state of € 20 bln until the end of 2012 and of € 50 bln until 2015 and c) proceeding faster and completing a far reaching structural reform program aiming at increasing national productivity, competitiveness and growth.



This program was indeed presented by the Greek Government in June 2011 and agreed with the Troika and more importantly it was passed, together with its implementation laws, through the Greek Parliament in early July 2011. Greece therefore had done its part dealing with the crisis, while at the same time contributing to maintain stability within the Eurozone. It, then, waited for the decisions of the Eurozone aiming at securing its finances in the following 2-3 years adjustment.

THE MEDIUM TERM FISCAL STRATEGY 2011-2015 (MTFS):

The Troika's conditions for the continuation of Greek financing in 2011 and the following years, that is the required fiscal adjustment and structural reform by Greece in 2011-2015, are rather overly restrictive. Nevertheless, the Greek government is now more determined than ever to implement this program in full and bring Greece back to fiscal sustainability, international competitiveness and economic growth: To this end, the government has adopted additional fiscal measures amounting to 6.5% of GDP in order to secure the implementation of the 2011 Budget as planned, aiming at reducing the GG deficit to less than 7.5% of GDP, from 10.5% of GDP in 2010. This will require a reduction of the GG primary deficit to 0.8% of GDP in 2011, from 4.9% in 2010 and 10.3% in 2009.

Moreover, the Government has adopted MTFS for the years 2012-2015, which specify the medium-term fiscal

and structural measures to ensure meeting the annual fiscal targets of the Adjustment Programme for 2012-15. ***These medium-term targets require a further fall of the GG Deficit*** from € 17.1 billion in 2011, to € 14.9 bln (6.5% of GDP) in 2012, to € 11.4 bln (4.8% of GDP) in 2013, то € 6.4 billion (2.6% of GDP) in 2014 and to € 3.7 billion (1.5% of GDP) in 2015 (See IMF, July 2011, Table 9).

This strategy has been finalized in co-operation with the Troika in its May-June 2011 review and approved by the Greek Parliament in early July 2011. The MTFS refers to both the fiscal measures needed to reduce the GG deficit as well as to the € 50 bln privatization and public property development and utilization program. Moreover, fiscal adjustment in most of the cases is being pursued through the implementation of far reaching structural reforms, implying a fundamental change in the institutional and organizational structure of the Greek economy.

FISCAL ADJUSTMENT IN 2011:

The 2011 Budget required a fall in the Greek GG deficit by 3.0 pps of GDP in 2011, or a fall of the GG primary deficit by 4.1 pps of GDP. In order to secure the achievement of this target the Greek Government had specified in the Budget 2011 revenue increasing measures amounting to 3.5% of GDP (€ 7.83 bln) and expenditure reducing measures amounting to 2.9% of GDP (€ 6.5 bln), implying a total adjustment of 6.4 pps of GDP (€ 14.33 bln).

However, ***the implementation of the Budget 2011*** in H1 2011 implied a fall of the net current revenues by -8.3%, compared with a requirement for an 8.5% increase for the year as a whole. On the other hand, net current primary expenditure was also higher by 4.5% in H1 2011, compared with a projected increase of 1.9%, and interest payments had already registered an increase 22.3% yoy, compared with a projected increase of 20.4% for the year as a whole. Overall, the execution of the state's budget in H1 2011 appeared to be considerably off the target set in the Budget 2011. In fact, during the May –June 2011 review of the implementation of the FAG&SR program by the Troika it was estimated that the required reduction of the GG deficit to less than 7.5% of GDP in 2011 would need additional revenue increasing and expenditure reducing measures amounting to € 6.5 bln. These measures were promptly specified by the Greek government, agreed with the Troika and included in the MTFS 2011-2015. More specifically:

On the revenues side the substantial shortfall in H1 2011 was mainly due to the fact that: a) the application of the new revenue increasing measures set in the Budget for 2011, amounting to more than 2.5% of GDP, was set to apply from July 2011 onwards. On the other hand, net current revenues in H1 2011 were hit by b) the much lower (by about € 900 million) withholding of personal income tax in this period due to the substantially reduced incomes of wage earners from July 2010, as well as to the much higher than expected revenue reducing effect of the substantial increase of tax free income and the reduction of tax rates from the beginning of 2011. Finally, net current revenues were also hit by c) a lump sum payment in April–June 2011 of € 1.0 billion of tax refunds for the settlement of such state's obligations carried through from previous years. In addition to the above it was assessed in June that some of the revenue increasing measures assigned in the Budget for 2011 would not in fact be implemented within 2011.

Therefore, it was estimated that for net current revenues for the year as a whole to register an increase of 5.6%, additional measures were needed, amounting to about € 4.0 bln and these measures were indeed specified and adopted in the MTFS 2011-2015, as shown in Table 4.

Of particular importance are measures as a) the reduction of the tax free personal income tax (PIT) threshold from € 12.000 to € 8.000, applied for the great majority of tax payers, b) the special surcharge of 1.0% to 4.0% imposed on taxable incomes of 2009 exceeding € 12.000 of all taxpayers from 2011 and until 2014 and c) the restructuring of property tax mainly through the substantial reduction of the tax free real estate objective value. These and other measures presented in Table 4, are designed to compensate for the loss of revenue in 2011 due to the misplaced and to a great extent erroneous provisions of the April 2010 tax law.

Table 4. Additional revenue increasing measures included in the MTFS 2011-2015

	Budget 2011	Additional Measures 2011	2012-2015
1. Curry over from measures of 2010	1.500		
1.1. Excise Taxes on fuels, tobacco and beverages	600		
1.2. Increase in VAT rates	750		
1.3. Penalties on un-lawful buildings	150		
2. New tax measures	4.050		
2.1. Increase of low VAT rates from 11% to 13% and other changes	650		
2.2. Increase of the excise tax on heating oil	400		
2.3. Special emergency tax on profitable businesses	1.000		
2.4. Reduction of the corporates tax rate (from 24% to 20%)	-320		
2.5. Objective criteria to determine taxable income and other measures	900		
2.6. Regulation and licencing of lucky games	700		
2.7. Penalties for illegal construction	300		
2.8. Increase of tax-relevant value of housing	270		
2.9. Green taxes	150		
3. Additional meassures	2.280		
3.1. Meassures to reduce tax and social security contributions evasion	1590		
3.2. Licences for mobile telephony and the Athens airport	690		
1. Increasing revenues of Social Security Funds (SSFs)		729	2.436
1.1. Funding the unemployment insurance fund		629	231
1.1.1. Contribution by public sector employees		455	0
1.1.2. Contribution by Self - Employed		100	0
1.1.3. Contribution by private sector employees		74	231
1.2. Increase of contribution of beneficiaries of OGA and ETAA		0	285
1.3. Introduction of Solidurity Fund in OAEE		0	600
1.4. Measures to reduce undeclared employment and contribution evasion		0	1.320
1.5. New pricing policy for pharmaceuticals paid by SSFs		100	30
2. Increase in hospital revenues		20	120
3. Special Levy on enterprises exempt from the public smoking ban		40	0
4. Improved tax compliance and reduction in tax evation		0	3.000
5. Reduction in tax exemptions/increases in other revenue		3.800	3.630
5.1. Evaluation and Reduction in tax Deductions and Exemptions		100	800
5.2. Reduction in the tax free PIT threshold (from € 12.000 to € 8.000)		1.350	0
5.1. A solidarity cintribution by all individuals		400	1.400
5.2. Increase in VAT on catering/restaurants from 13% to 23%		300	700
5.3. Restructuring of the recurrent ownership tax		500	715
5.4. Taxation of unauthorised buildings		300	-200
5.5. Chnages in the tax regime of tobacco		150	150
5.5. Rergulation on private boats/yachts		150	-100
5.6. Higher VAT rates on natural and liquified gas and soft drings		250	315
5.7. Increase in Vehicle circulation tax		100	0
5.8. Emergency tax on vehicles and high value real estate		100	-100
5.9. Financial transactions tax		100	0
Total revenue increasing measures	**7.830**	**4.549**	**9.186**

Source: Medium Term Fiscal Strategy 2011-2015

On the expenditure side, net current primary expenditure in H1 2011 was hit by higher than expected demands for current budget financing from social security funds experiencing a substantial fall of their social contribution revenues reaching € 1.69 bln in January-July 2011. Thus, net current primary expenditure registered a 4.7% increase in the first seven months of the year, compared with a projected growth of this expenditure of only 1.9% in 2011. Of course additional cuts in primary expenditure were set to be applied in H2 2011, including: a) the application the unified structure of wages in the public sector, securing substantial cuts on unjustifiably high wages and a generally lower wage bill, b) the drastic reform of the system of social benefits, which will now be

provided only to those that really need them, c) the reduction of employment in the public sector, where employment has already been cut by 83 thousand in 2010 and d) the on going rationalization and reduction of health care expenditure, comprising an additional cut of pharmaceutical expenditure by € 1.4 billion in 2011 and the cut of hospital provisions expenses by an additional € 0.7 bln in 2011. Most of the above expenditure reducing measures was better specified and quantified in the MTFS and additional measures added for reducing GG expenditure in 2011, as shown in Table 5.

Overall, it is now estimated that current primary expenditure may come to register an increase by 0.7% in 2011 (compared with 1.9% in the Budget 2011). Moreover, defense equipment expenditure will be € 100 million from the budgeted level and maturing government guarantees extended to sectors outside the general government will be higher by about € 80 million than the budgeted level. Moreover, interest payments are projected to be € 80 million above the budgeted level. Finally, the cut of expenditure of the PIB is now estimated to reach € 950 million. ***Overall, the state's budget deficit (central government) is now expected to reach the € 19.8 billion, exactly as budgeted.***

Table 5. Additional expenditure reducing measures included in the MTFS 2011-2015

	Budget 2011	Additional Measures 2011	2012-2015
1. Rationalization of the public sector wage bill	1600	800	1.375
1.1. Wages and pensions policies (curry over from 2010)	1.500	0	0
1.2. Hiring through the implementation of the 1:10 and 1:5 attrition rule		350	620
1.3. Increase in weekly working hours from 37.5 to 40.0 and reduction in overtime payments		130	310
1.4. Reduction by 50% of contractual employees	100	245	105
1.5. Part-time employment and long term unpaid leave		75	340
2. Reduction in Operating Expences	500	140	444
3. Closure/Merger of public sector entities/reduction in subsidies		491	279
4. Reorganization in State-owned enterprises	800	0	1.314
5. Reduction in Defence expenditure	500	0	1.200
6. Rationalization of costs of public healthcare services (Hospitals)	700	0	694
7. Rationalization of medical pharmaceutical expenditures	1.400	250	735
8. Reduction in expences of SSFs & rationalization of social spending		1.008	3.475
8.1. Unemployment benefits, housing for workers, and other welfare benefits		345	286
8.2. Means-testing for provision of pension benefits		330	511
8.3. Reduction of lump-sum pensions in line with contributions		120	130
8.4. Adjustment in suplementary pensions		50	810
8.5. Special 8% charge on pensioners under 60-years old, with pensions above € 1.700/m		88	88
8.6. Reduction by 6% of pensdions of Sailors Insurance Fund		50	50
8.7. Reduced expenditure on the main OGA pensions		0	210
8.8. Stricter inspection of beneficiaries of disability pensions		25	600
8.9. Comprehensive review and rationalization of social programs		0	760
9. Improved fiscal performance of Local Government	500	0	1.355
10. Rationalization of Public Investment Budget Expenditure	500	700	0
Total revenue increasing measures	**6.500**	**3.389**	**10.871**

Source: Medium Term Fiscal Strategy 2011-2015

Furthermore, ***a GG deficit reduction*** also includes the following structural reform efforts:

a) The drastic reorganization of the 17 public sector entities, which were included into the general government from November 2010. This reorganization is projected to imply a substantial reduction of the deficit of these entities amounting to more than € 800 million in 2011 as a whole. In fact, in January – May 2011 this deficit (before government subsidies) was lower by € 411.2 million compared to its level in January-May 2010. This was achieved despite the fact that total revenues before subsidies of these entities were down by -15% in January-May 2011, due to the continuous work stoppages in most of these entities in a series of protestations of their personnel, trying to prevent the drastic reform of labour relations in their organizations in the on going process of their restructuring. Nevertheless, the restructuring including sizable cuts in wages and operating costs was legislated and is being implemented as planned. The number of employees in these entities was reduced by 3.357 employees in January-May 2011 and it is expected to be reduced further in the remainder of the year. Normal operation has now been established in these entities and for the year as a whole it is also expected a substantial increase in their revenues due to improved collection practices and an increase in tickets *and other prices of services offered.*

b) The reorganization of local government entities, with a budgeted expenditure saving of € 500 million in 2011. This program is in the process of its application and despite considerable difficulties and setbacks faced in the initial stages of establishment and development of the new local authorities the projected benefits are expected to be realized as planned.

c) Concerning Social Securities Funds, the results of efforts to reduce their deficits are mixed. The substantial fall in pension and health care expenditure of these funds due to measures already applied, tend to be supplanted by the substantial shortfall of their budgeted revenues. Contribution evasion has been increasing in 2010 and in 2011, notwithstanding the effect of the recession.

The above and other developments will be reinforced during the year with the purpose to secure the budgeted reduction of the GG deficit below the 7.5% of GDP.

FISCAL ADJUSTMENT 2012-2015:

The Medium – Term Fiscal Strategy (MTFS) 2012-2015, is aiming at a GG deficit reduction to 2.6% in 2014 and to 1.5% in 2015, as summarized in Table 6. This, in combination with revenues from privatizations and the better management of public property reaching € 50 bln in 2011-2015, implies a stabilization of GG debt at the level of 155.3% of GDP in 2012 and to a gradual fall of this debt to 135.8% of GDP in 2015 and below the 100% of GDP in 2021. This involves a rise of the GG revenue to 42% of GDP in 2015, from 39.1% of GDP in 2010, while the fall of the GG primary expenditure is substantial reaching to 33.9% of GDP in 2015, from the very high 44.0% of GDP in 2010. These developments will lead to a GG primary surplus of 7.7% of GDP in 2015, which constitutes an adjustment of 12.7 pps of GDP from 2010. This large required adjustment is mainly due to the excessively pessimistic assumptions concerning: a) nominal GDP growth in 2011-2015, which averages 2.0% despite the assumed substantial activity in the field of privatizations, and b) interest payments in 2011-2015, reaching the very high level of 9.2% of GDP in 2015. Following the adoption of the Financial Support Program II (FSP II) for Greece, which comprises secure financing for Greece for the whole period 2011-2020 at relatively low interest rates, especially for official credit, both nominal GDP growth is expected to be higher and interest payments much lower.

In order to address the above fiscal consolidation objective for the period 2012-2015, the Government has identified additional fiscal adjustment measures amounting to € 21.7 bln. This by 53% will imply additional substantial cuts of GG expenditure, amounting to € 11.51

billion and 47% revenues boosting measures amounting (€ 10.21 billion). Moreover, these measures will address the interest payments increase, which following the decision for the FSP II is expected to reach € 5.3 bln and the rest, in combination with GDP growth from 2012 onwards, will address the needed primary surplus increase by € 18.6 bln. The main categories of measures that are scheduled be applied in order to bring about the required fiscal adjustment of € 21.7 bln in the period 2012-2015 are presented in Tables 4 and 5.

Table 6. The Medium-Term Fiscal Strategy 2012-2015						
in € bn	2010	2011	2012	2013	2014	2015
Primary Expenditures (General Gov.)	101,3	93,8	93,0	90,1	86,5	85,3
Interest Payments	12,6	15,2	18,2	19,7	22,0	23,1
Total Expenditures (General Gov.)	113,9	109,0	111,2	109,8	108,5	108,4
Total Revenue (General Gov.)	89,9	91,9	96,3	98,4	102,1	104,7
General Government Deficit	-24,0	-17,1	-14,9	-11,4	-6,4	-3,7
General Government Primary Deficit	-11,4	-1,9	3,3	8,3	15,6	19,4
Nomian GDP (in € bn)	***230,1***	***225,9***	***228,4***	***235,0***	***243,0***	***251,8***
Nominal GDP (%Δ)	-2,4%	-1,8%	1,1%	2,9%	3,4%	3,6%
Table 6.1. General Government Deficit, as a % of GDP						
Total Revenue (General Gov.), as a % of GDP	39,1%	40,7%	42,2%	41,9%	42,0%	41,6%
Total Expenditures (Gen. Gov.), as a % of GDP	49,5%	48,2%	48,7%	46,7%	44,6%	43,1%
Primary Expenditures (Gen.Gov.), as a % of GDP	44,0%	41,5%	40,7%	38,3%	35,6%	33,9%
General Government Deficit, as a % of GDP	-10,4%	-7,6%	-6,5%	-4,9%	-2,6%	-1,5%
Gen. Gov. Primary Deficit, as a % of GDP	-5,0%	-0,8%	1,4%	3,5%	6,4%	7,7%
Interest, as a % of GDP	5,5%	6,7%	8,0%	8,4%	9,1%	9,2%
Table 6.2. General Government Debt						
	2010	2011	2012	2013	2014	2015
General Government Deficit	-24,0	-17,1	-14,9	-11,4	-6,4	-3,7
Maturing Government Guarantees	5,3	5,8	4,0	2,8	2,0	1,0
Privatisations and State Asset Mngment (2011-2015: € 50 bn)	0,0	-3,8	-12,0	-12,0	-11,0	-11,2
General Government Debt (in € bn)	328,6	347,7	354,6	354,0	349,4	341,9
General Government Debt, as a % of GDP	**142,8%**	**153,9%**	**155,3%**	**150,6%**	**143,8%**	**135,8%**
Note: The debt scenaria do not incorporate increases in the GG debt for bank assistance and credit enchancements for the voluntary private sector rollover						

More specifically, the main policies that are going to be applied by sector in order to achieve the above fiscal adjustment outcome are as follows;

The public sector wage bill will be cut by an additional € 2.9 billion in 2012-2015, following the cuts of about € 1.8 billion in 2011 and € 3.3 bln in 2010. Therefore, the compensation of the general government employees will fall to 11.3% of GDP in 2011 and to less than 9.0% of GDP in 2015, from 11.8% of GDP in 2010, 13% of GDP in 2009 and 10.8% of GDP in 2003. The Eurozone average was 10.6% of GDP in 2010 and is set to fall to 10.3% of GDP in 2011. The main policy measures that are applied in this sector are the following: a) The substantial reduction of employment in the general government sector through attrition, with the application of a hiring rule of 1:10 in 2011 and 1:5 in the following years, and also through the substantial reduction in contract employment and involuntary redundancies. Employees considered being in excess or redundant in public services will be either furloughed into a separate labour reserve or moved in other departments in need of more employees or even loose their employment in the public sector. Time spend in the labour reserve will be limited to no more than 12-months at no more than 60% of their wage. At the end of this period, employees may be moved on other public sector entities or departments, or their employment contract may even be terminated. In fact, employment in the public sector is expected to fall at the end of 2015 by 150 thousand compared with 2011. For this, the government has already legislated and implemented the increase in the working hours in the public sector to 40 hours a week, from 37.5 hours a week and the substantial reduction in overtime pay. b) The reduction by at least 10% of contractors hired by the public sector, as well as of the number of employees in permanent posts and positions of responsibility. c) The application of the unified wage structure in the public sector, cutting excessively high wages and benefits. Overall there is great scope for substantial savings in this sector, which according to the IMF's projections may exceed the € 5.0 bln for the period 2011-2015.

Intermediate consumption of goods and services in the public sector is set to be reduced by an additional € 1.7 bln in 2011 and € 1.1 bln in 2012-2015. Intermediate consumption of the general government reached 7.3% of GDP in 2009, and fell to 5.8% of GDP in 2010. Now, it is expected to fall further to 5.2% of GDP in 2011 and 2012 and then to fall even further to below the 4.2% of GDP in 2015. This will be achieved by the on going process of rationalization of procurement processes throughout the general government, including the central government, the healthcare sector, as well as public entities and organizations. Centralized procurement processes with the use of electronic platforms are already in use with satisfactory results. The main requirement is the drastic reduction of excessive operational expenses of all public sector services. Moreover, various subsidies provided by the public sector for newspaper distribution and the cost of managing the public investment budget will be cut substantially or abolished. Therefore, this item can be stabilized at around 4.2% of GDP from 2015 onwards, securing also that the relevant public sector services will continue functioning effectively. Of particular importance concerning the rationalization of public sector expenditure in goods and services, are the concerted efforts in the last 15-months for rationalizing health expenditure in hospital procurement and pharmaceutical spending.

Streamlining health expenditures, aiming at a € 2.3 bln cut of GG health care expenditure in 2011 and an additional cut of € 1.4 bln in 2012-2015: This expenditure was contained to the level 4.1% of GDP in 2010 (taking into account the annual central government handouts to the health care departments of the social security funds), from 4.3% of GDP in 2008. This GG health care expenditure can be reduced further through the rationalization of operations of hospitals implying a substantial reduction of the relevant cost per patient per case. The new Health Map of Greece will enable the Ministry of Health to identify hospitals that can be merged or closed. Also, primary health care has been introduced and reinforced in order to reduce the current congestion on most hospital units. Finally, the new centralized procurement system is expected to produce substantial savings in health care cost. However, the greatest opportunity for the rationalization of the working of the health care system in Greece arises from the prospect of the introduction of a radically new pricing model of public health care services. This prospective new policy represents the great chance to increase Public Health Care savings by more than € 2.5 bln annually and at the same time to improve greatly health care services offered by the public sector in Greece.

A substantial part of health care expenditure is the pharmaceutical expenditure which had reached abnormally high levels in Greece until 2009. This

expenditure was budgeted to be cut by € 1.4 bln in the Budget 2011 and with the MTFS it was decided to be cut by an additional € 250 million in 2011 and by another € 735 million in 2012-2015. Again in this area there is substantial effort to reduce oversubscription and excessive public expenditure on drags, through the rationalization of the public hospital procurement practices, the full implementation of the e-prescription system, the rationalization of social security funds practices on pharmaceutical spending (especially the rationalization of spending for the procurement of drags from pharmacies) and the expansion of the use of generic drugs. From all these activities there is great scope for achieving GG expenditure savings in combination with the great benefits arising from the rational functioning of the system. However, the single most important measure that is needed for a substantial improvement of the functioning of the system is the drastic increase of the payment for the drugs by the patients themselves. With this measure the savings that can be achieved would surpass the projected amount.

Closure or Merger of Public Entities aiming at a reduction of the relevant state expenditures by € 1.3 billion in 2011-2014 (IMF estimates): There is ample room for savings to be achieved in this sector and at the same time to increase substantially the operational efficiency of these entities. The government intends to proceed with a re-evaluation of the mandate and expenditures of all public sector entities that receive grants from the state. The new Educational Map of the country is used to identify the primary and secondary education schools and institutes that can merge or close in 2011-2012. Moreover, tertiary education schools and institutions may also be restructured in the period 2011-2015. Government and ministries department and public entities abroad will be examined as to whether they can merge or close. Of particular importance is the programmed merger or closure of tax and custom offices, which must only aim to the substantial increase in their operational efficiency. A € 400 million saving is expected from the reorganization of tax authorities, while much better results in capturing tax evasion are also expected.

Restructuring of state –owned entities, with expected saving (expenditure cutting and revenue increasing) of € 1.3 bln: We have already referred to the performance of 16 public entities in January-May 2011, where there was a substantial reduction of their deficit. The GG expenditure saving from this area will reach € 800 million in 2011 and an additional € 1.3 bln in 2012-2015. This will by achieved with the full implementation of the restructuring plans of OSE (the rail transport organization) and of OASA (the Athens city transportations company) and with increasing focus on actions (increasing tickets and other prices and substantially improving collection practices) to substantially increase revenues from these entities. Especially OASA has the monopoly of the whole Athens city transportations and its ability to increase revenue is really substantial. Moreover, the same applies to Athens periphery railway, which needs to develop properly. On the other hand, new restructuring plans are applied to the other state owned entities, including public TV and the Hellenic Aerospace Industry (EAV), which is in line to be privatized. Finally, substantial savings are expected through the reorganization, rationalization of management and a substantial increase in productivity of defense and other industries. Overall, revenue increasing and expenditure cutting measures in these activities may bring about savings exceeding the € 3.0 billion.

Reduction of Defense spending by an additional € 1.7 bln in 2011-2015: This is again an area where substantial savings can be achieved. Defense expenditure of the current budget reached € 4.98 bln in 2010, from € 6.3 bln in 2009. In addition, expenditure for defense equipment reached € 1.5 bln in 2010, from € 2.17 bln in 2009. Overall, defense spending absorbed again 2.82% of Greek GDP in 2010, while the average defense spending in the European Union does not exceed the 1.0%. The cut in defense spending until now comprised flat cuts in wages and benefits of personnel, while there is also a great opportunity for savings from better management of procurement and expenditure in this sector with the purpose of substantially increasing productivity and value for money. In particular, defense procurement spending and operational expenses may be greatly reduced, while there also is a great need to reduce or better utilize and exploit army camps.

Reduction of Social Security Funds (SSFs) expenditures and streamlining of other social spending: An additional saving of € 1.0 bln in 2011 and € 3.48 bln in 2012-2015 has been projected from this sector. This is an area of great importance. Social benefits other than social transfers in kind reached the 20.3% of GDP in 2011, from 20.8% in 2009, and this compares with 17.5% of GDP in the EU-17. Excluding payments for pensions, these non-pension social benefits still exceed the 9.0% of GDP (€ 21.0 bln). First, the government has already published its plans to proceed immediately with the fundamental reform of the Supplementary Social Security Funds in order to safeguard their long term sustainability. This will make even stronger the already substantially improved long term sustainability of the Greek Social Security System. It will also produce substantial additional cuts in expenditures in the following years. Secondly, the government has decided to introduce a means – testing approach, with the establishment of income and wealth thresholds, for determining the beneficiaries of welfare benefits (See Table 5 for more details). For this purpose a single organization will be established which will be responsible for the provision of social transfers, lowering also operational expenses to the minimum possible. This new system will also enable the government to examine the provision of targeted welfare benefits to the most vulnerable members of the population. Overall the savings that can be made in this sector, mainly through the much needed rationalization of the system used, can again exceed the projected amounts. Moreover, a substantial increase of the revenues of the system from social security contributions could also be envisaged. In fact, actual GG social contributions received reached the 12.9% of GDP in 2010, from 11.7% of GDP in 2003. However, in the current period social contribution evasion has reached unprecedented levels and in combination with the effect of the recession, have been causing substantial revenue holes in the system. Therefore, the relevant SSFs services are implementing drastic measures in order to bring about a much needed

recovery of social security revenues both in 2011 and in the following years.

Enhancing tax compliance: This should have been one of the main pillars of fiscal adjustment in Greece. This is also one of the sectors in which the government has not had any success stories to tell until 2011, explaining the unsatisfactory performance of tax revenues until July 2011. However, t***he government has now published a new operational plan for tackling tax evasion.*** It plans to increase the quantity and effectiveness of targeted audits in small and big businesses and in particular targeted audits concerning VAT declarations. Also, the government plans to enhance the effectiveness of auditing of medium and large enterprises through the utilization of new information systems and methods. Tax offences by individuals with large wealth assets will be clearly identified and the government must make a more determined and effective effort in order to collect the arrears and fines owed to the State. On the wake of substantial transfers of financial wealth by many wealthy individuals abroad in recent months from incomes generated in Greece, the government must require to learn weather this has been properly taxed. Also, there is need for more effective taxation of real estate assets from the central or the local governments. Finally, now is the time to make a more efficient effort to tackle smuggling and the contraband (untaxed) trade. The government's projection for additional revenues of the order of € 3.0 bln in 2012-2015, compared with the depressed tax revenues in 2010 and in 2011, is very conservative and does not actually constitute a real brake with the past in this very critical area. This can be made more obvious from the following: ***a) Revenues from current taxes on income and wealth fell in Greece to the 7.6% of GDP in 2010 and in 2011,*** from 8.6% of GDP in 2001 and 8.5% of GDP in 2005. This compares with 14.7% in Italy, 15.6% in Belgium, 15.9% in Finland, 10.5% in France, 10.3% in Germany, 10.7% in Ireland, 12.8% in EU-15, 12.3% in EU-27 and 11.4% in the USA. If we assume that the fight against tax evasion in Greece and the new measures on property taxes will be of minor success and succeed only to rise the direct tax revenues from the 7.6% of GDP in 2011 to a more acceptable 9.1% of GDP in 2015, then additional revenues from only this direct taxation in 2015 will reach the € 5.7 bln (Table 7). ***b) Revenue from indirect taxes*** is expected to reach the 13.4% of GDP in 2011, from 12.4% in 2010 and the very low 11.1% of GDP in 2009. Also, for the period 2012-2015 a further increase is projected for this revenue to a little higher than 14.2% of GDP. In fact indirect tax revenue is expected to increase faster than nominal GDP in 2012-2015 boosted also by the expected recovery of the economy, especially from 2013 onwards. The much higher rates of VAT and of the excise taxes on oil and other products will bring about additional revenues when the economy reaches out of the current recession. Therefore, revenues from this source may also be higher in 2013-2015 than is currently projected. ***c) Revenue from collection of overdue and verified tax liabilities amounting to € 42.5 billion at the end on June 2011.*** This also must contribute to the above projected increase of the direct and indirect tax revenues. In fact, the new legislative environment concerning the collection of overdue tax receivables and the new organizational framework concerning the tax administration is expected to help to capture a substantial part of these receivables. ***Concerning the reduction in social insurance contribution evasion, the target is to increase revenues by € 3.5 billion until 2015, by drastically reducing the share of uninsured labor to 12% (in line with the EU average) from today's 26%.*** The government plans a joint collection mechanism for tax and social insurance systems. Verified overdue social insurance contributions by businesses to the state exceed today the € 6.5 billion. Overall, enhancing tax compliance and through the collection of overdue tax receivables the Greek State can secure additional revenues of € 12 billion (including social security contributions), projected in the MTFS 2012-2015.

Table 7. Current taxes on incom and wealth

		Falling tax evasion		*Fixed tax evasion*		
	Nominal GDP	Direct taxes % of GDP	Direct tax revenues	Direct taxes % of GDP	Direct tax revenues	Additional revenues
2010	230.050	7,60%	17.484	7,60%	17.484	0
2011	225.900	7,80%	17.620	7,60%	17.168	452
2012	230.700	8,10%	18.687	7,60%	17.533	1.154
2013	237.300	8,80%	20.882	7,60%	18.035	2.848
2014	245.400	9,10%	22.331	7,60%	18.650	3.681
2015	254.200	9,60%	24.403	7,60%	19.319	5.084

Source: European Commission, Spring 2011, EAD Alpha Bank estimates

Moreover, reduction of tax free personal income tax threshold (from € 12.000 to € 8.000) and the reduction of other tax exemptions in tandem with some selective additional tax increases constitute the latest revenue increasing package of the government aiming at the substantial increase of tax revenues by € 3.8 bln in 2011 and additionally by € 3.63 bln in 2012-2015. The specific categories of new measures are presented in Table 4 and their main characteristic is the relatively low risk of not securing the projected revenues. In fact these measures are functioning as substitutes of revenues last due to the flawed April 2010 tax law. An important change of policy will be that a tax exception will be awarded in the future only on the basis of social and economic criteria.

Finally, the government plans to facilitate the substantial increase in Local Government revenue from their own resources: This is source o GG revenue untapped in Greece until today. Local authorities can increase revenue from fees, tolls, rights, pricing of services offered and a multitude of other revenue rising sources. The new organizational structure of well organized and self sufficient local government organizations will be used to contribute in this direction. Therefore, this new local administration is able to contribute to a reduction of the GG deficit by more than € 1.5 billion in 2015, compared with 2011, while also improving substantially local entities governance.

Overall, the Greek government has already undertaken substantial measures in order to reduce direct tax evasion and increase the tax base of the country and in particular real property taxes. Following the MTFS 2011-2015, the Troika has now accepted the real possibility that a higher percentage of direct and indirect taxes to GDP will be a substantial factor contributing in tandem with the substantial GG expenditure reduction, to the needed fiscal adjustment. The Government intensified its efforts to reduce social security contributions evasion, while with the new pension system the pensions provided by the

pension funds in the future will be determined manly by the cumulated value of these contributions. Hence, despite the substantial difficulty that the government is facing in the current recession in its effort to increase revenue from this source, it is expected that the system will improve gradually in the following years implying an increase of the ratio of revenues from social contributions to GDP in 2015 above the 13.0% of GDP, from 12.6% of GDP in 2010 and 12.9% of GDP in 2011.

STRUCTURAL REFORM:

The Troika endorses the progress achieved in the field of structural reforms in Greece in 2010-2011 and demands an even more decisive implementation of the still existing reform programmes, including the programmes of privatizations and public property development valued at more than € 50 bln. However, even today they do not seem to count any positive effects of these reforms and programmes on facilitating fixed investment, tax revenue growth and the timely recovery of the economy in 2012-2015. According to their projections, the economy will grow until 2015 much below potential with dire consequences for the needed fiscal adjustment.

Nevertheless, the fundamental reform of the pension system and the labour and product markets, the establishment of better governance practices in local and central government and in state controlled entities and the € 50 bln programme of privatizations and development of public property in the period 2011-2015 (€ 20 bln in the period 2011-2013), constitute the main thrust of the structural reform effort ***and are expected to facilitate the recovery from 2012 and boost GDP growth from 2013 onwards.*** This privatization effort and the effort to utilize public property in Greece constitute the second part of the Medium – Term Fiscal Strategy 2012-2015 and its implementation will be facilitated by the new organizational and institutional structure of the public sector and the economy as a whole.

RECENT GDP DEVELOPPMENTS:

The fall of real GDP in H1 2011 (a period of continuing and intensifying turmoil and uncertainty in the Greek economy) was -7.5% yoy, on a non-seasonally adjusted basis, following a substantial fall by -8.8% in Q4 2010 and against the high basis of GDP in H1 2010 where the fall of GDP did not exceed -1.8%, compared with -4.35% in 2010 as a whole. There was some improvement in Q2 2011, where the GDP fell by -6.9%, from -8.1% in Q1 2011 and -8.8% in Q4 2011. In fact, the substantial fall of GDP in H1 2011 was mainly due to the following a) To the extraordinary fall of state controlled investment in this period, as Public Investment Budget (PIB) expenditure fell by -42.5% in H1 2011 implying a fall of GDP annual growth by -1.4 pps. Moreover, PIB revenues did not exceed the € 0.7 billion in H1 2011, from € 3.92 bln planned for 2011 as a whole. b) To the continuing destructive uncertainty and extraordinarily depressed consumer and business confidence for reasons analyzed above. c) To the huge unfavorable base effects burdening H1 2011, as developments in the main economic aggregates in this period bearing the full effect of the measures of the FAG&SR program, are compared with developments in the same economic aggregates in H1 2010, before the application of the FAG&SR. In fact, disposable income of wage earners in H1 2011 was as much as 15% lower than in H1 2010 and this despite the substantial fall of tax revenue in this period. On the other hand, disposable income of wage earners in H2 2011 will be comparable with their income in H2 2010.

Taking into account the above and also the fact that economic activity in Greece in Q3 2011 will be dominated by the booming tourist sector (with revenues from foreign tourism registering an impressive 21.7% yoy increase in June 2011), we would expect that the fall of GDP will be substantially lower in Q3 2011 and even more so in Q4 2011 where substantially favorable base effects may contribute to a positive yoy GDP growth. On this basis GDP fall for 2011 as a while may still be below -4.0%, assuming some form of stabilization of government controlled investment with absorption of the budgeted plans from the European Union Structural funds. More specifically, according to the existing data, the drop of GDP in 2011 will be determined by the following:

Fixed investment registered a substantial fall by an estimated -19.2% in Q1 2011, on top of its -8.4% fall in Q1 2010. This follows the substantial fall of fixed investment in 2010 by an estimated -16.5% yoy, following its fall by -11.2% in 2009 and by -7.5% in 2008. These developments in Q1 2011 and in 2010 were mainly the result of extraordinary government delays in implementing: **a)** the Public Investment Budget (PIB), ***b)*** investment projects under the Community Support Framework (CSF) 2007-2013 co-financed by the structural funds of EU, c) investment projects in the field of Public Private Partnerships (PPP), ***d)*** approved investment projects under the previous investment incentives law, which expired in January 2010, as well as e) the continuing fall in residential investment. Substantial base effects and the existing concerted effort to mobilize government and private sector investment in H2 2011 may contribute to a stabilization of fixed investment in this period to the very low level of investment in H2 2010.

Government consumption fell by a much lower than expected -6.3% in Q1 2011, following a -14.9% fall in Q4 2010 and a -6.5% fall in 2010 as a whole, following its surge by 10.3% in 2009.

Private consumption fell sharply by -7.8% in Q1 2011, fallowing a fall by -8.0% in Q4 2010 and by -4.5% in 2010, following its -2.2% fall in 2009. This development was mainly due: a) to the substantial increase of VAT rates and fuel and other excise tax hikes, which were applied in April 2010, July 2010 and January 2011, b) to the collapse of consumer confidence, due to the unprecedented uncertainty concerning the future of the Greek economy, especially in H2 2010 and Q2 2011, c) to the fall of real disposable income in 2010 by an estimated -6.2% for the year as a whole and by more than -12% in Q4 2010 and in H1 2011. This fall in disposable income was much lower than expected due to the failure to collect planned tax revenues on income and wealth and social securities contributions. The fall of disposable income in H2 2011 is estimated to be less than 4.0% yoy due mainly to tax measures included in the MTFS 2011-2015.

Exports of goods and services registered a positive 3.8% increase in 2010, from a -20.1% fall in 2009. However, in Q1 2011 their growth was again -2.0% affected mainly by the fall of income from international shipping. The higher tourism revenue had a minor effect on GDP growth due to the low level of activity in this sector in Q1 of each year. On the other hand, imports of goods and services registered an unexpectedly small fall by -4.8% in 2010, but a much higher fall by -15.5% in Q1 2011. Moreover, the falling trend of imports of goods and services continued unabated in Q2 2011. Overall net exports registered a positive effect on GDP growth of the order of 2.1 pps in 2010 and of 4.6 pps in Q1 2011. They are also expected to register a high positive effect of the order of 4.0 pps in 2011 as a whole.

DEVELOPMENTS IN THE MAIN SECTORS OF THE ECONOMY:

The performance of the tourist sector is turning to be much better than expected until recently. Arrivals of foreign tourists to the main Greek airports in January - July 2011 were up 10.0%, comparing with an increase by 5.4% yoy in January-April 2011. More specifically, arrivals in June were up by 15.5% and in July up by 11.1%. In 2011 as a whole arrivals are now expected to surpass 10%, following a small increase of 0.6% in 2010. On the other hand, revenue from foreign tourism was also up by 12.2% in January-June 2011, with the yoy increase in June 2011 reaching 21.7%. For 2011 as a whole tourist revenues are expected to increase be more than 10% higher than in 2010, when these revenues had registered a fall by-7.6% yoy. It should be noted that arrivals of foreign tourists ***in 2010*** had been unfavourably affected by protest demonstrations that took place in Athens in H1 and in Q4 2010, as well as by major disruptions in overall economic activity caused by the track drivers strike in Q3 2010. In fact, minor incidents of social unrest were exploited by the world media to the highest degree possible, with substantial negative effects on Greek tourism and on the Greek economy in general, especially in May and July 2010. Also, In July 2011 tourism was again negatively affected by the strike of TAXI owners, who were objecting to the opening up of their profession to free competition from new entrants. This action lasted for more than 15-days causing disruptions on tourist activities in a very important period for Greek tourism.

Greece's net merchant shipping receipts *were down by a sizable 11.0% in January – June 2011, compared with their increase by 14.7% in H1 2010.* However, outflows from the same source were also -8.5% down in the same period. Overall the net surplus revenue from shipping was lower by -13.8% in H1 2011, compared with its increase by 9.2% in H1 2010. Therefore, in H1 2011 net shipping revenues had an important negative effect on GDP growth, reversing the positive effect on growth of these revenues in H1 2010.

In the manufacturing industry (accounting for about 8% of value added in the Greek economy), the falling trend of production continues mainly due to the substantial fall on production: a) of traditional industries (textiles, clothing, footwear), which face intensifying competition from low cost countries, b) of industries (like non metallic minerals), which are related to the domestic construction activity and c) of industries (like shipyards), which until now were basing their production activity on non competitive orders by ministries (and in particular by the Ministry of Defense) and on their participation on public procurement programs. ***Therefore, manufacturing production fell by -9.5% yoy in H1 2011, from -4.3% yoy in H1 2010 and from a -5.1% yoy fall in 2010, a -11.3% fall in 2009 and a -4.5% in 2008.***

Some important sectors of the Greek manufacturing, especially those with substantial export activity, registered ***positive growth in production in 2010 and in H1 2011***, or minor fall of production, as shown in Table 8. In particular ***the food industry,*** which is the most important sector of the Greek manufacturing industry, registered a relatively small fall of production in 2010 and in 2011, of the order of -3.5% annually, as it is affected positively by increasing exports and negatively by the depressed domestic demand. Other exporting sectors, ***as the basic metals and metal products*** are registering positive growth despite being affected negatively by the substantial fall of domestic construction activity, especially of housing investment. The sector which has been affected the most negatively by the depression in the construction sector was ***non-metallic minerals*** (in particular cement industries), which also faced substantial difficulties in some of their exporting markets.

Diagram 5. Manufacturing Production

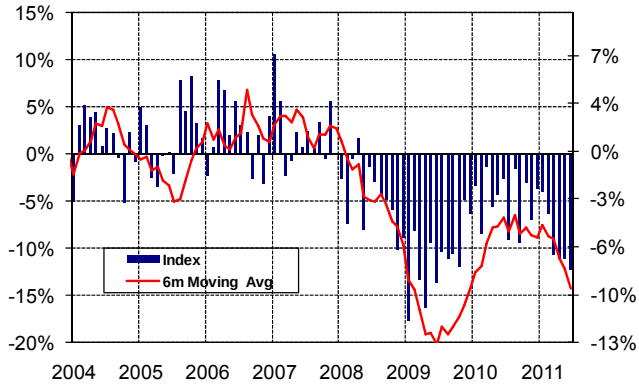


Table 8. Basic sectors of the Greek manufacturing industry

	Weights	H1 2011	2010	2009	Level end June 2011 (2005=100)
Food	18,2	-3,5%	-3,6%	-2,7%	91,4
Beverages	6,0	-9,1%	-7,6%	-4,8%	89,2
Tobacco	1,9	10,0%	-17,5%	-2,7%	78,5
Oil (refineary) products	11,3	-19,3%	5,7%	-0,1%	90,3
Chemicals	5,3	-4,7%	1,9%	-14,6%	86,0
Pharmaceuticals	2,5	0,2%	2,3%	18,3%	154,9
Basic metalls	8,0	10,3%	12,0%	-17,9%	102,4
Manuf. of metall products	5,1	-3,1%	2,9%	-17,7%	77,3
Machinery and equipment	2,1	4,0%	-17,1%	-27,0%	66,3
Wood and cork products	1,2	0,4%	9,4%	-27,3%	66,9
Plastic products	4,2	-7,5%	-6,3%	-13,7%	84,7
Non-Metallic Minerals	10,3	-34,4%	-14,3%	-24,2%	41,3
Electrical equipment	3,0	-11,5%	4,4%	-20,1%	72,2
Textiles	3,1	-18,4%	-20,4%	-27,8%	39,3
Clothing	3,4	-27,8%	-22,9%	-23,6%	38,9
Other transport equipment	1,6	-31,5%	-56,5%	-18,6%	30,2
Vechicles, trailers and others	0,8	-35,9%	-7,4%	-13,3%	31,0
Repair and instalation of machinery	4,1	-11,1%	-26,7%	-15,2%	49,2
Manufacturing Industry	**100,0**	**-9,5%**	**-5,0%**	**-11,2%**	**76,8**

Source: ELL. STAT.

On the other hand, the fast falling trend of production of the textiles, clothing and footwear sectors continued unabated in 2010 and in H1 2011, with their production index standing at 39.3, 38.9 and at 52.5 respectively at the end of June 2011 from 100 in 2005.

Overall, the index of business expectations in Greek industry had improved substantially to 80.6 in February 2011, from 71.3 in December 2010, bur it fell again to 78.5 in April 2011, 76.2 in June 2011 and to 77.5 in July. ***The relevant PMI index*** had been fluctuating around 43 until February 2011, but it improved to 45.4 in March 2011, 46.8 in April 2011, 45.5 in June and 45.2 in July, showing again persistence in the falling trend of the manufacturing production in recent months. The positive effect from the dynamic increase in exports of goods and exports orders has been over-compensated from the persistently low level of domestic demand.

Of particular importance is the healthy increase of the new industrial orders index by 3.9% in H1 2011, compared with an increase by 4.2% in H1 2010. This is due to the substantial increase of orders from exporting markets by 25.9% in H1 2011, on top of a 25.1% increase in these orders in H1 2010. Moreover, the index of industrial turnover registered an 8.3% increase in H1 2011, on top of its increase by 5.4% in H1 2010. Again here sales to exporting markets surged by 29.9% in H1 2011, on top of their increase by 22.3% in H1 2010.

PRIVATE CONSUMPTION*: The volume of retail sales* has registered a fall by -12.1% in January – May 2011, from the high level of the index in January-May 2010, where the index had registered a small fall of -0.4%, compared with its sizable fall by -6.2% in 2010 as a whole. Due to substantial favourable base effects, the falling trend of the index of the volume of retail sales in the remainder of the year will decelerate from July 2011 onwards, with a possible positive yoy increase in December 2011, as shown in Table 9.

Table 9. Expected yoy increase of the volume of sales in the retail trade

	2009	2010	2011
Q1	-14,3%	5,8%	-14,7%
Q2	-14,6%	-5,8%	-10,4%
Q3	-7,9%	-10,5%	-8,3%
Q4	-8,6%	-13,7%	-4,9%
Year	-11,4%	-6,2%	-9,7%
Projections EAD Alpha Bank			

Of particular importance is the fact that the volume of retail sales has recovered in 2011 in the big department stores, where all sales are recorded, while there is a substantial fall of the volume of sales of the multitude of small shops due to their inability to compete with the department stores and the supermarkets and also due to their ability to avoid recording a sizable part of their transactions. The above data are related to the fact that more than 200 thousand small businesses have failed to submit VAT declarations in H1 2011. On the other hand, the fall of sales of durable goods in 2010 and in 2011 is related to the substantial fall of disposable incomes in H1 2011 but also to the abnormally depressed consumer and business confidence in the Greek economy, which persists until July 2011 (See Diagram 3). Concerning ***the business confidence in the retail trade sector,*** the relevant index in fluctuating at substantially low levels, but it has seen some improvement in the latest months. It reached the 56.9 in July 2011, from 52.9 in May 2011 and from 50.8 in July 2010. Consumer confidence may improve substantially with the finalization of the Second Financial Support Package for Greece (FSPII), which is set for the middle October 2011.

Diagram 6. Volume of retail sales

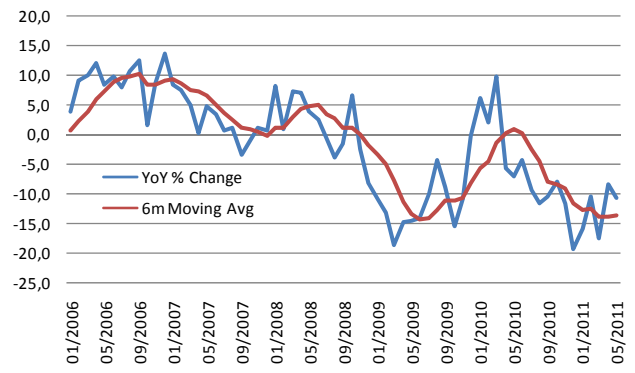


Table 10. Index of the Volume of Retail Sales

2005=100	January - December			January - May		
Specialized store categories	Index 2009	Index 2010	*Annual %*	Index 2010	Index 2011	*Annual %*
Supermarkets	106,9	101,4	*-5,1*	104,8	97,8	*-6,7*
Department stores	109,2	96,6	*-11,5*	92,0	94,0	*2,2*
Food-beverages-tobacco	93,2	88,9	*-4,6*	92,5	78,8	*-14,8*
Pharmaceutical products, cosmetics	109,2	107,7	*-1,4*	119,2	100,5	*-15,7*
Clothing and footwear	97,6	86,5	*-11,4*	95,7	75,8	*-20,8*
Furniture, electrical equipment	101,8	88,8	*-12,7*	91,5	71,6	*-21,8*
Books, stationery, other goods	83,0	79,4	*-4,3*	78,2	75,6	*-3,3*
Overall Index	**100,0**	**93,8**	***-6,2***	**98,1**	**85,6**	***-12,8***
Index (except automotive fuel)	**98,8**	**92,0**	***-6,8***	**96,5**	**84,8**	***-12,1***

Source: Hellenic Statistical Authority

Pervasive uncertainty and abnormally low consumer confidence have affected the most the ***new passenger cars market and the housing market. New passenger cars registrations*** have registered another substantial fall of -39.1% in January-July 2011, following their sizable fall by -26.9% in January – July 2010 and by -37.2% in 2010, -17.4% in 2009 and -7.0% in 2008. Registrations fell to 72.2 thousand in the first seven months of 2011, from 118.6 thousand in the same period of 2010. Therefore, ***expenditure on imported cars*** fell to € 630.7 million in H1 2011, from € 1.282 million in H1 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 fall -49.2% yoy in January-April 2011, compared with its fall by -23% in January-April 2010 and by -23.6% in 2010,-26.5% in 2009,-17.1% in 2008, -5.0% in 2007 and -19.5% in 2006 and from a big increase of 35.2% in 2005. In fact, the volume of residential construction fell to 35.32 million m^3 in 2010, from 102.24 million m^3 in 2005. These developments led to a continuous falling trend ***of residential investment in real terms, of*** -18.6% in 2010, -21.7% in 2009, -29.1% in 2008 and -8.9% in 2007. It is now estimated that these investments will register another fall by -24% in 2011. Thus, residential investment is expected now to fall to about € 5.0 bln in 2011, from € 14.7 bln in 2006. This level is extraordinarily low for Greece and a gradual recovery may be expected from H2 2012. In the current period, ***the aforementioned adverse developments in consumer and business confidence delay the revival***

of both residential investment and economic activity in this sector. In fact, the index of business expectations in construction fell again to a low of 28.8 in July 2011, from 29.9 in June 2011, 29.4 in April 2011, after its recovery to 34.6 in February 2011 from 29.1 in January 2011.

INFLATION: Inflation in Greece decelerated to 2.4% in July 2011, fro, 3.3% in June 2011, 3.9% in April 2011, 4.5% in March 2011, 5.2% in December 2010, as in October 2010, 5.6% in September and August 2010, 5.5% in July 2010, with average CPI inflation reaching 4.7% in 2010. This surge in inflation in 2010 and in early 2011 was 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. Additional increases in VAT rates and other taxes from early 2011, in combination with substantial increases in the international price of oil and other commodities, implied that inflation remained high in the first four months of 2011 as well, in order to start its fast deceleration process from May 2011 onwards. The fall in July was also affected by the higher than usual summer sales, while it is expected that inflation will reach again 2.7% in September and 2.5% in December 2011. Overall, inflation is expected to remain high, above 3.3% average in 2011 as well, despite the expected substantial fall of domestic demand. Then, average CPI inflation is expected to fall further to 1.7%.

BALANCE OF PAYMENTS: The current account deficit (CAD), including net capital transfers, reached € 12.98 bln in H1 2011, down -7.3% from H1 2010 and -1.5% from H1 2009. The deficit reached € 21.98 billion (9.6% of GDP) in 2010, down -7.7% from 2009, following its substantial fall by -22.5% in 2009.

Developments in the Greek BoP in 2009, 2010 and H1 2011 reflect the effect of the substantial fall of domestic demand due to the international economic crisis (and the huge fall in exports) in 2009 and Greece's own debt crisis and the extensive fiscal adjustment and structural reforms undertaken in 2010 and 2011, with the exporting sector recording impressive growth, especially in H2 2010 and in H1 2011. More importantly, in 2011 the external tourism sector contributes substantially to the export based recovery of economic activity in the Greek economy.

Of particular importance is the drop of the deficit of the trade balance by -6.9% in H1 2011 and by -8.1% in 2010, following its fall by -30.2% in 2009. Exports of goods have registered a healthy increase by 21.5% in H1 2011 and by 11.5% in 2010, following their fall by -22.7% in 2009. On the other hand, imports of goods registered an increase by 2.7% in H1 2011, following their 1.1% increase in H1 2010. In fact, payments for imports of goods are maintained relatively high mainly due to the excessive increase by 28% in H1 2011 and by 27.4% in 2010 of payments for imports of fuels. In fact, imports of goods excluding fuels and ships fell by -7.3% in H1 2011, following their fall by -12.6% in 2010 and by -24% in 2009. Exports of goods excluding fuels and ships registered a substantial increase by 16.2% in H1 2011, following their fall by -1.3% in 2010 and by -17.8% in 2009. Therefore, the trade balance excluding fuels and ships, registered a new sizable fall by -21.5% in H1 2011, following its fall by -19.1% in 2010 and -27.1% in 2009.

A second important development was the increase by 4.5% yoy in H1 2011 and by 4.7% in 2010 of the surplus of the balance of services, following its fall by -26.2% in 2009. More specifically: Earnings from external tourism were up 12.6% yoy in H1 2011 (+21.7% in June 2011), following their fall by -7.6% in 2010 and -10.6% in 2009. On the other hand, revenues from shipping were down by -11% in H1 2011, following their increase by 13.8% in 2010. Finally, payments for services abroad fell by -6.4% in H1 2011, following their increase by 6.3% in 2010 from their fall by -15.3% in 2009.

Table 11. Greek Balance of Payments (€ Billions)

	2009	2010	H1 2010	H1 2011
Trade Balance (TB)	-30,76	-28,28	-15,27	-14,21
Exports	15,32	17,08	7,79	9,47
Imports	-46,09	-45,36	-23,06	-23,68
Services Balance	12,64	13,23	4,53	4,73
Tourism Receipts	10,40	9,61	2,85	3,21
Shipping Receipts	13,55	15,42	7,72	6,88
Income Balance	-8,98	-9,23	-4,44	-4,83
Payment of Interest, Divid. & Profits	-12,86	-12,64	-6,15	-6,31
Transfers' Balance	3,31	2,30	1,18	1,32
Current Account (CA)	-23,80	-21,98	-14,00	-12,98
CA (% of GDP)	-10,1%	-9,6%	-6,1%	-5,8%
Capital Account	24,40	21,99	14,19	13,16

Source: Bank of Greece

Thirdly, the deficit of incomes balance reached the € 4.8 bln in H1 2011, a little higher than the corresponding deficit in H1 2010. Payments for interest, dividends and profits to foreign investors in Greek government bonds and shares were slightly higher, by 2.7% yoy in H1 2011, following their fall by -8.1% in H1 2010.

Finally, the surplus of current and capital transfers balance was 12.5% yoy higher in H1 2011, following its fall by -50% in H1 2010.

In ***the capital account*** of the Greek balance of payments, net capital inflows reached € 13.1 bln in H1 2011, from € 14.2 bln in H1 2010. ***Net capital outflow through foreign direct investment (FDI)*** reached € 0.71 bln in H1 2011 from net inflow of € 0.48 billion in H1 2010. This was mainly due to lower FDI by foreign firms in Greece of € 0.04 bln (H1 2010 € 0.92 bln), as well as to the increase of FDI by Greek firms abroad to € 0.88 billion (Q1 2010: € 0.21 bln). ***Net Capital outflows for portfolio investment abroad by Greek residents*** reversed to inflows of € 5.1 bln in H1 2011 (inflows of € 8.6 bln in H1 2010). On the other hand, in H1 2011, net capital outflows from foreign residents through the liquidation of portfolio investment in Greece reached the € 14.8 bln in H1 2011, from outflows of € 13.6 bln in H1 2010. ***Finally, there was a substantial net inflow of other investments (primarily bank and Government borrowing and lending)*** of € 23.6 bln in H1 2011, from a net inflow of € 18.7 bln in H1 2010. This net inflow in H1 2011 comprises a net inflow of € 3.4 from deposits of foreign residents in domestic financial institutions and the inflow of € 20.2 bln of official financing, while deposits abroad from domestic residents reached € 0.11 bln, from € 16.6 bln in H1 2010.

MONEY & FINANCIAL MARKETS: **MONEY & FINANCIAL MARKETS**: Credit expansion to businesses and households fell by -1.2% at end-June 2011, from its fall by -0.5% at end-April 2011 and 0% at end-December

2010. In particular, the annual rate of change of mortgage and consumer lending stood at -1.7% and -5.8% respectively at end-June 2011, from -1.5% and -4.8% respectively at end-April 2011. Moreover, lending growth to businesses decelerated to 0.2% at end-June 2011, from 1.2% at end-April 2011 and 1.1% at end-December 2010. Overall, the annual rate of change of credit to the private sector is expected to decelerate further to around -3.0% by year-end 2011, from 0% at year-end 2010. For 2012, a recovery of up to 1.0% credit expansion is contemplated.

By the end of July 2011, the main ASE composite index was down -28.4% on a yoy basis (FTSE-20 stocks: -36.4%, mid-cap FTSE-40: -39.6% and small caps FTSE-80: -22.0%), from -35.6% at end-2010. Following these developments, at the end of July 2011 52.5% of the total stock exchange value of listed firms was in the hands of foreign investors (€ 37.3 billion), up from € 27.4 billion at end-2010.

Diagram 8. Credit Expansion

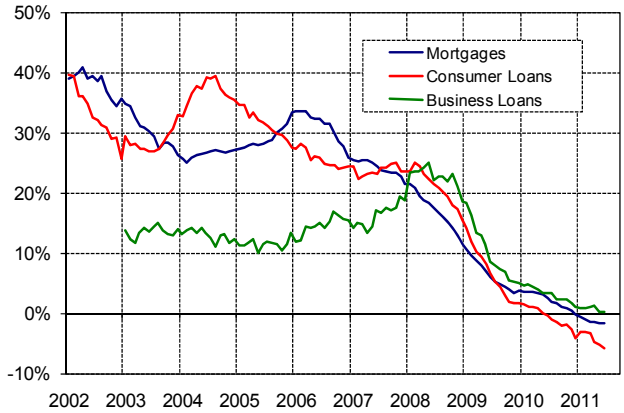
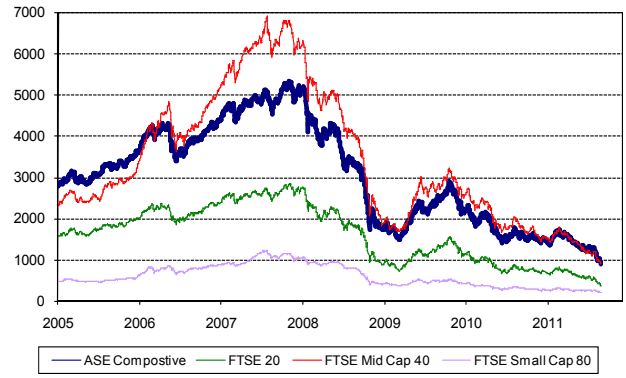


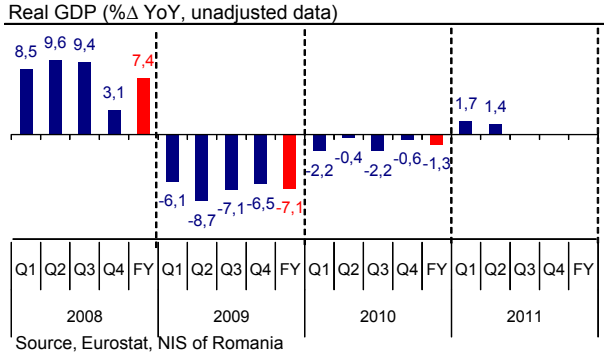
Diagram 9. Athnes Stock Exchange Indices



2. Romania

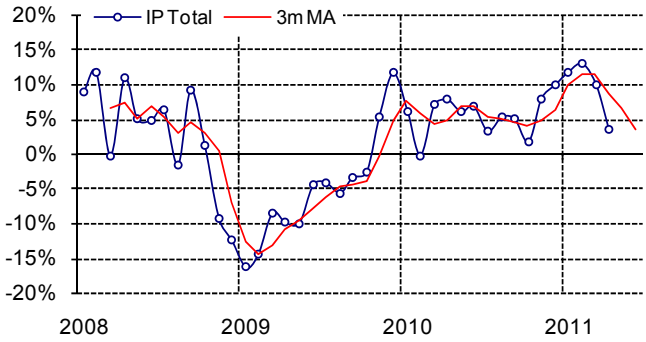
Economic Overview: The economy continues to expand albeit at a slower pace. GDP grew by 1.4% yoy in Q2 2011 from 1.7% yoy in Q1 2011. The recovery of the economy continues to be driven by growth in exports and so the outlook is very much dependent on continued growth of European demand.

Real GDP (%Δ YoY, unadjusted data)



Source, Eurostat, NIS of Romania

Industrial Production - (%Δ YoY)



Source: Datastream

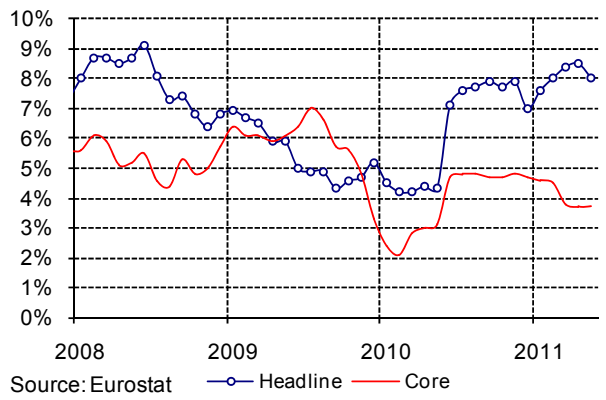
The authorities and the IMF became engaged, in March 2011, in a new 24-month agreement worth about € 3.5 billion (with additional precautionary support from the EU of € 1.4 billion and a loan of € 0.4 billion from the World Bank). The new accord is supportive of the economic recovery by focusing on enhancing potential growth via targeted policies in conjunction with fiscal consolidation measures. The second review of the economy under the terms of the new agreement was concluded successfully in July 2011 with the IMF stating that all end-June performance criteria were met. The authorities of Romania continue to treat the new agreement as precautionary and have not drawn on the available resources. In its review of the economy the IMF concludes that the outlook for positive GDP growth of 1.5% in 2011 is supported by expectations of a good harvest and strong exports, while the growth of 3.5% to 4% in 2012 remains dependent on improved domestic demand and better absorption of EU structural funds.

Fiscal policy: The implementation of the fiscal consolidation program in the context of the new agreement with the IMF continues smoothly. The budget deficit was RON 11.3 billion or 2.1% of GDP in H1 2011 according to the finance ministry from 3.5% of GDP in H1 2010. This significant reduction in the budget deficit was achieved on the back of a 9.6% increase in public revenues to RON 85 billion which were boosted by strong VAT revenues, excise duties and capital revenues. Public expenditures on the other hand rose by just 0.7% yoy in H1 2011 to RON 96.2 billion. The government is targeting a reduction of the budget deficit to 4.4% of GDP in 2011

from 6.5% of GDP in 2010 and 7.4% of GDP in 2009. According to the government's budget strategy for 2012-2014 the budget deficit will fall to 3% of GDP in 2012, 2.5% of GDP in 2013 and 2.2% of GDP in 2014.

INFLATION: Inflationary pressures continue. Headline inflation spiked at 8.5% in May 2011. In June 2011 headline inflation stood at 8%. In H2 2011 inflationary pressures are expected to subside as the effect of the VAT hike by 5 percentage points last year will cease to effect the calculation of the consumer price index. Developments in the global food and energy markets as well as the execution by the government of its fiscal consolidation plans will be key in containing inflationary expectations and inflation itself. The Central Bank inflation forecast stands at 3.0% for end-2011 and end-2012 and 2.5% for end- 2013 onwards, within a band of ± 1 pp.

Harmonized Consumer Price Inflation - (%Δ YoY)



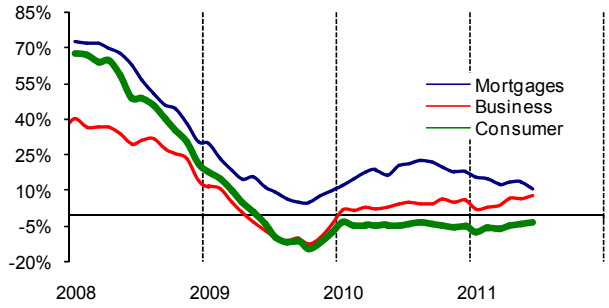
BALANCE OF PAYMENTS: The current account deficit narrowed to 2% of GDP in H1 2011 from 3% of GDP in H1 2010, as export growth continued to outstrip import growth and the current transfer's balance kept on improving. FDI inflow amounted to € 1.015 million in H1 2011 from € 1.227 million a year ago.

Current Account: Jan.-Jun.'11 (€ million)			
	Jan.-Jun.'11	Jan.-Jun.'10	0,2646
Exports	22.011	17.169	28%
Imports	24.510	20.356	20%
Trade Balance	-2.499	-3.187	-22%
Services Balance	-542	-504	8%
Income Balance	-1.256	-993	26%
Current Transfers Balanace	1.696	1.039	63%
Current Account Balance	-2.601	-3.645	-29%
Source: Central Bank of Romania			

EXTERNAL DEBT: Total external debt increased by 6.8% since the start of the year to € 97.1 billion by end-June 2011 but declined as a percent of GDP to 74% from 74.5% at end-2010. The composition of total external debt into medium & long-term and short-term remained was at 78% versus 22% at end-June 2011 from 80% versus 20% at end-2010. IMF borrowings, excluding the amount received by the Ministry of Finance, increased by 5.1% during this period to € 9.5 billion.

MONEY & FINANCIAL MARKETS: The local currency continued to appreciate against both the Euro and the US Dollar until the end of April 2011 (by -4% and -9.7% respectively) but has since depreciated against both currencies (by 5.6% and 9.6% respectively up to 11th of August 2).

Credit Growth (%Δ YoY)

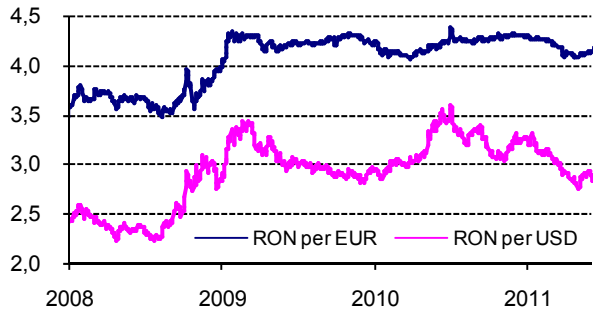


Source: Central Bank of Romania

The Central Bank of Romania undertook a series of policy rate cuts reducing the basic rate from 10.25% in January 2009 to 6.25% in May 2010. It has since kept it there until its latest Board meeting on 3.8.2011.

Credit expansion (euro basis) to the private sector has picked up moderately. Credit expansion stood at 4.4% yoy in June 2011 (businesses: 8.1%, households: 0.7%). The non performing loans stood at 13.4% at end June 2011 up from 11.9% at end-2010 and 7.9, however the pace of increase has slowed. According the 2nd review of the economy by the IMF under the new SBA agreement commercial banks remain well capitalized and liquid, with the capital adequacy and loans to deposit ratios at 14.8% and 114.8% respectively at end-March 2011.

Exchange Rate Developments



Soure: Bloomberg

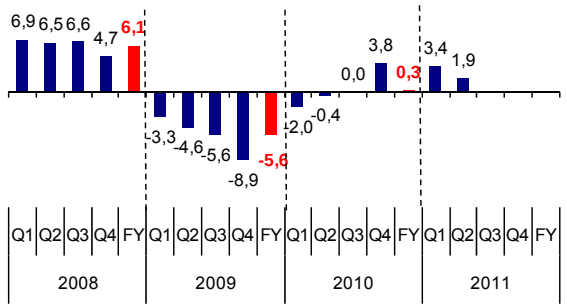
3. BULGARIA

ECONOMIC OVERVIEW: Economic growth remained positive but slowed to 1.9% yoy in Q2 2011 from 3.4% yoy in Q1 2011 and 3.8% yoy in Q4 2010. Domestic consumption remained relatively weak, growing by just 0.9% yoy (individual: 1.1%, collective: -2.9%). Gross fixed capital formation was especially robust, growing by 9.5%

yoy in Q2 2011 from 1.6% yoy in Q1 2011. Exports and imports of goods and services grew by 11.6% and 7.9% respectively on an annual basis and by -0.5% and 2.4% respectively on a quarterly basis in Q2 2011.

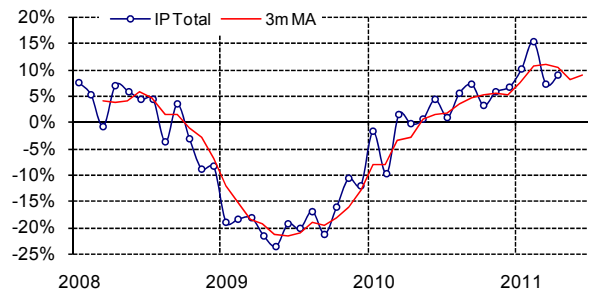
In July 2011 Moody's upgrade the county's rating to Baa2 from Baa3 citing the successful implementation of fiscal consolidation measures. Moody's expects that the budget deficit will follow below 3% of GDP in 2011.

Real GDP (%Δ YoY, seasonally and calendar adusted data)



Sourece: Eurostat, NIS Bulgaria

Industrial Production - (%Δ YoY)



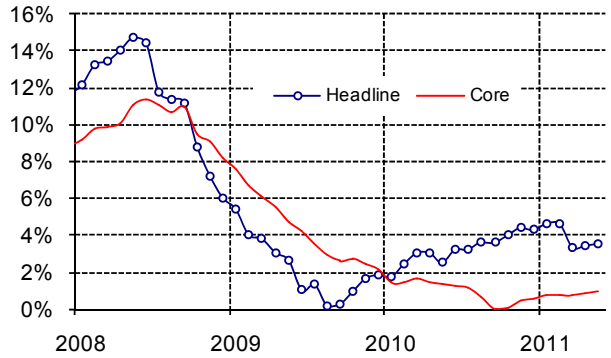
Source: Datastream

FISCAL POLICY: Fiscal policy remains overall restrictive. As a result, the budget deficit narrowed by BGN 864.8 million in H1 2011 to BGN 649.7 million, as compared to its year ago level. As a percent of GDP the budget deficit was 0.9% in H1 2011 from 2.1% in H1 2010. The government was able to accomplish this notable reduction in the budget deficit by keeping a tight lid on public expenses which were marginally down on the year by 0.2% to BGN 12.7 billion, while public revenues were up by 7.6% to BGN 12 billion boosted by higher tax revenues. It is hoped that the pending elections at the end of October 2011 will not derail the fiscal consolidation process.

The balance on the fiscal reserve account (FRA) stood at BGN 5,154 million at the end of June 2011 from BGN 6,012 million at end-2010 and BGN 7,673 at end-2009. The FRA has provided a welcome buffer for the government through the period of economic crisis. However as these reserves are needed to support the currency board the government it is good to see that FRA balance at the end of June 2011 has increased by BGN 471 million from its low point at the end of April 2011.

INFLATION: After accelerating to 4.6% in March 2011 headline inflation fell to 3.5% in June 2011. Core inflation remains at significantly lower levels at 0.9% in June 2011. Overall, with international food prices set to stabilize in the coming months the inflation outlook looks favourable.

Harmonized Consumer Price Inflation - (%Δ YoY)

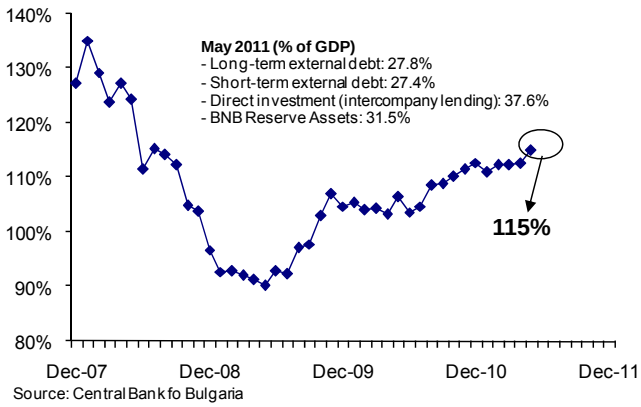


Source: Eurostat

BALANCE OF PAYMENTS: There was a marginal trade surplus of € 47 million in H1 2011 from a trade deficit of € 568 million in H1 2010, as exports surged by 56% yoy outstripping the growth of imports. Moreover the services surplus increased to € 134 million in H1 2011 from just € 7 million in H1 2010, while the incomes deficit narrowed by -24% yoy to € 287 million. The movement in the current transfers balance was negligible. Overall there was a surplus in the current account of € 253 million or 0.6% of GDP in H1 2011 from a deficit of € 554 million or 1.5% of GDP in H1 2010. In the capital account, the FDI account recorded a net outflow of € 23.7 million in H1 2011 from a net inflow of € 443 million in H1 2010.

Current Account: Jan.-Jun.'11 (€ million)			
	Jan.-Jun.'11	Jan.-Jun.'10	%Δ
Exports	4.757	3.058	56%
Imports	4.710	3.625	30%
Trade Balance	47	-568	-108%
Services Balance	134	7	1874%
Income Balance	-287	-379	-24%
Current Transfers Balanace	359	386	-7%
Current Account Balance	253	-554	-146%
Source: Central Bank of Bulgaria			

Central Bank Reserve Assets / Short-term External Debt



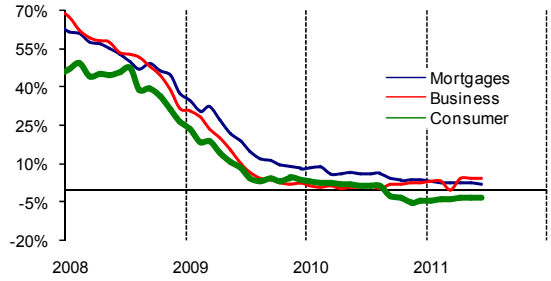
Source: Central Bank fo Bulgaria

EXTERNAL DEBT & INT. RESERVES: Total gross external debt was € 36.1 billion at the end-May 2011 from € 36.7 billion at end-2010 and € 37.7 billion at end-2009. The ratio of foreign reserves with the Central Bank to short-term debt was 115% at end-May 2011 from 113% at end-2010 and 90% at end-May 2009.

MONEY & FINANCIAL MARKETS: Bulgaria maintains a currency board pegging 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.

In June 2011 credit expansion stood at 2.6% yoy from 1.4% in December 2010, 3.8% in December 2009 and 31.6% in December 2008. Business financing grew by 4.4% yoy in June 2011 and credit to households declined by 0.5%. Consumer credit declined by 2.9% while mortgages grew by 2.5%. As the currency board arrangement remains a key pillar of monetary policy, the Central Bank is constrained as to the measures it may take to boost credit expansion to the private sector.

Credit Growth (%Δ YoY)



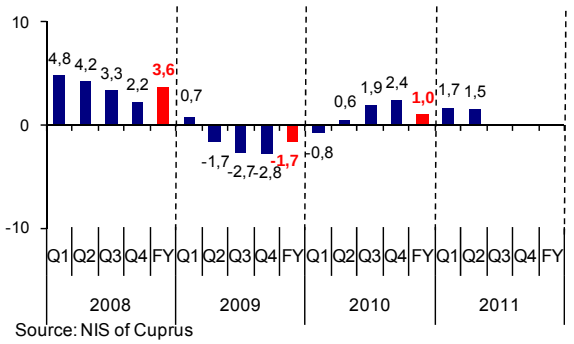
Source: Central Bank of Bulgaria

4. CYPRUS

ECONOMIC OVERVIEW: GDP grew by 1.5% yoy in Q2 2011 from 1.7% yoy in Q1 2011 as tourism, commerce, and other services sector expanded, compensating for declining output in the construction and industrial sectors. Between July and August 2011 all three major rating agencies, Moody's, S&P's and Fitch, downgraded the rating on Cyprus on concerns that the country may yet require financial aid.

The economic outlook has been negatively affected by the damages at the Vasilikos power station, the biggest and most modern energy production facility in Cyprus, after an explosion in a nearby naval base on the 11th of July. Effectively, 793 MW of energy production capacity have now been wiped out pushing the Cypriot economy into an energy crisis. The exact of the damages and the time needed to return to normalcy is far from clear. Initial estimates of the economic cost range from around € 1 billion to as much as € 3 billion. However, the costs to the government for borrowing from the money markets remain at a historically elevated level. The prompt support of the European Union and the implementation of austerity measures by the government will be crucial components in the Cyprus's effort to steer clear of the need to enter an official economic support mechanism with the IMF. Time is definitely pressing as Moody's and S&P's in July and Fitch in August downgraded the rating on Cyprus to Baa1, BBB+ and BBB respectively. Among the reasons cited by the agencies are: a) concerns that the destruction at the Vasilikos power plant will put added pressure on Cyprus's fiscal position, b) the increasingly fractious domestic political climate with all that this implies for implementation of structural reforms and austerity measures, and c) the risk that some Cypriot banks will require financial assistance from the state due to their high exposures to Greece.

Real GDP (%Δ YoY, unadjusted data)



Source: NIS of Cuprus

There is currently available 683 MW of electricity generation capability from the remaining two power plants of Cyprus, 440 MW from the Dekelia plant and a further 223 MW from the Monis plant. However as the energy demand during the summer normally exceeds 1100 MW there are severe supply shortages at this most fragile time for the tourism sector of the economy. Aside from trying to economize as much electricity as possible by demanding caution from consumers, the real solution can only come from boosting the supply of electricity. Towards this end, the Energy Regulator has made an open invitation for the submission of tenders by foreign operators to add to the island's electricity generation capacity through mobile units. Moreover, Cyprus will be able to draw, from the occupied territories as much as 100 MW of electricity, from Greece 70 MW, and from Israel 12 MW. Finally, it is hoped that the two most modern units of the Vasilikos power plant, each of which has capacity 220 MW, can become operational again by next summer.

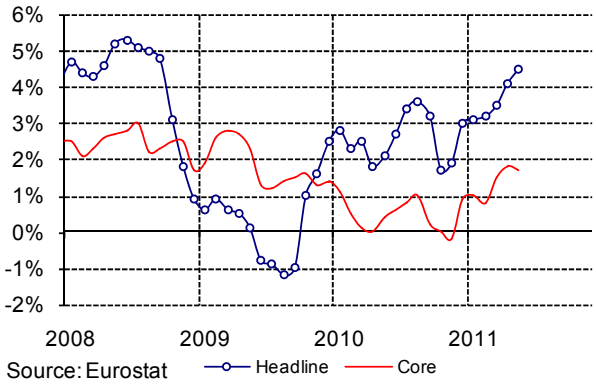
FISCAL POLICY: The budget balance continued to deteriorate in Q2 2011 pushing the budget deficit up to 3.5% of GDP or € 637 million in the first half of 2011 from 1.9% of GDP or €329 million in the corresponding period of 2010. The total revenues amounted to €2,927 million (down by 0.3% yoy) while the total expenditures reached € 3,564 million (up by 9.2% yoy). The budget deficit was 4.9% of GDP in 2010.

The public debt stood at 60.3% of GDP at the end of H1 2011 from 61% of GDP at the end of 2010. In its spring

forecasts, the European Commission foresaw a small increase of the public debt to GDP ratio by the end of 2011 to 62.3%. However the operating environment has altered following the damages at the Vasilikos power station. Notably, if the government were to issue debt to cover the associated costs then the public debt to GDP ratio will likely fall somewhere between 65% and 75% of GDP depending on how much the economic cost associated with the damages turns out to be.

INFLATION: Inflationary pressures remain elevated, pushing headline inflation to 4.5% in June 2011 not far from the high level experienced in June-July 2008 before the onset of the recession. There is a real risk that inflation will spike even more as a result of the damages in the Vasilikos power station as the substitution possibilities (such as increasing the production level of older and less technologically advanced domestic power stations, as well as increased imports) will certainly be more expensive.

Harmonized Consumer Price Inflation - (%Δ YoY)



Source: Eurostat

BALANCE OF PAYMENTS: The current account deficit stood at 3.7% of GDP or €673 million in Q1 2011 having increased by over 70% yoy, notwithstanding an impressive 26% yoy growth of exports. Imports also grew but by a more modest 7% yoy, however as this increase occurred from a higher base level there was overall a marginal increase of the trade deficit. The more defining factors behind the widening of the current account deficit is the declining surplus in the services and income balances. In the capital account, at €66 million, net foreign direct investment inflows remain relatively subdued.

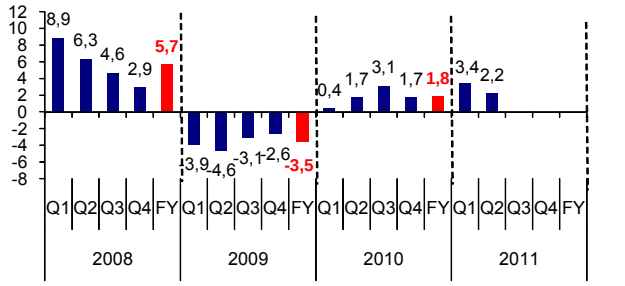
Current Account: Jan.-Mar.'11 (€ million)			
	Jan.-Mar.'11	Jan.-Mar.'10	%Δ
Exports	335	266	26%
Imports	-1.454	-1.361	7%
Trade Balance	-1.119	-1.094	2%
Services Balance	519	638	-19%
Income Balance	-6	113	-105%
Current Transfers Balanace	-67	-49	37%
Current Account Balance	-673	-392	72%
Source: Central Bank of Cyprus			

MONEY & FINANCIAL MARKETS: Credit growth to the private sector remains subdued. Credits to the private sector grew by 7.4% in June 2011 from 7.8% in May 2011 and 7.2% in December 2010. Business loans grew by 8.1% yoy and loans to households by 6.3% yoy in June 2011. Mortgages and consumer credit rose 3.5% and 8.6% yoy respectively in June 2011. Private sector deposit growth has also slowed recently having returned to the single digits in June 2011 for the first time since March 2010. In June 2011 private sector deposit growth stood at just 5.9% from 13.7% in May 2011 and 20.3% in December 2010. Private sector deposits from domestic residents actually declined by 2.6% yoy in June 2011 from positive growth of 10.6% yoy in December 2010. Private sector deposits from non-residents increased by 23.2% yoy in June 2011 from 43.4% in December 2010. The loan-to-deposit ratio stood at 90.1% in June 2011 from 86.3% in December 2010 and 96.8% in December 2009.

5. SERBIA

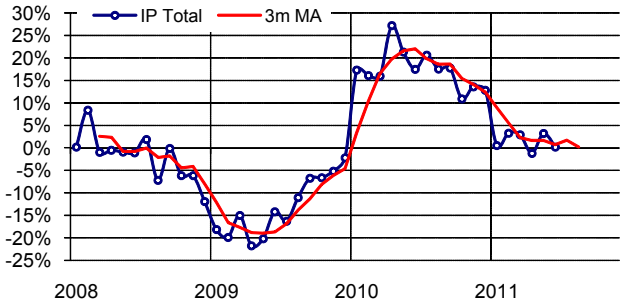
ECONOMIC DEVELOPMENTS: The economy continues to grow albeit at levels that are low relative to the pre-crisis period. GDP increased by 2.2% yoy in Q2 2011 (flash estimate) from 3.4% yoy in Q1 2011 (updated up from 3%) and 1.8% in 2010. Economic growth in 2011 is powered by investment.

Real GDP (%Δ YoY, unadjusted data)



Source: NIS of Serbia
Note: constant 2002 prices (Q1&Q2 2011 are at last year's prices)

Industrial Production - (%Δ YoY)



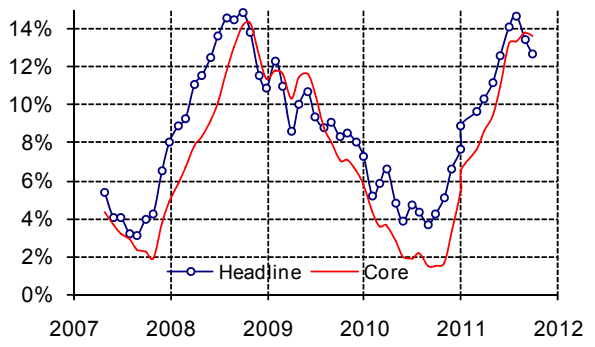
Source: Datastream

The significant pick up of the economy in Q1 2011 was primarily the result of strong growth in some industrial sectors, notably 'manufacturing', 'mining & quarrying', and 'electricity, gas & steam supply' were up by 6.2%, 3.9% and 7.5% yoy respectively. Some services sectors also experienced positive growth, notably 'transportation & storage', 'financial & insurance activities',

'accommodation & food services activities' and 'information & communications' were up by 9.8%, 6.2%, 5.7% and 5.7% yoy respectively.

FISCAL POLICY: The fiscal consolidation efforts continue. According to the recent loan accord with the IMF, which was concluded last April, the budget deficit is to be cut from 4.5% in 2010 to 4.1% in 2011 and then gradually to just 0.5% in 2015. In H1 2011 the budget deficit was RSD 67.3 bn or 2% of GDP, versus a year-end target of RSD 120.5 bn or 3.6% of GDP, as public revenues amounted to RSD 351.3 bn (up by 9% on the year) and public expenditures to RSD 418.5 bn (up by 12.9%).

Consumer Price Inflation - (%Δ YoY)



Source: Central Bank of Serbia

INFLATION: After rising for twelve consecutive months to 14.7% in April 2011, headline inflation decelerated to 13.4% in May 2011 and 12.7% in June 2011. The volatility of prices are mainly due to changes in food products. As international food prices are expected to decelerate from their recent highs in the coming months this trend is likely to continue. The progression of the fiscal consolidation program of the government will impact on the time-frame in which headline inflation will re-enter the target range of the Central Bank (targets for end-2011 and end-2012 are 4.5% and 4% respectively, ± 1.5 pps).

BALANCE OF PAYMENTS: The current account deficit narrowed by a whopping 14 percentage point to 6.9% of GDP in 2009. In H1 2011 the current account deficit stood at € 1,382 million or 4.3% of GDP in H1 2011 from € 1,375 or 4.7% of GDP in H1 2010. The trade deficit grew by 8% yoy in H1 2011 as exports increased by 23% and imports by 17% but from a higher base. Net FDI in H1 2011 reached € 566 million from € 420 million a year ago. Portfolio investment increased many-fold to € 766 million € 73 million respectively.

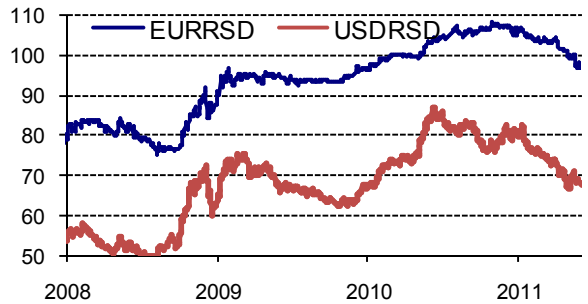
EXTERNAL DEBT & INT. RESERVES: In H1 2011 the stock of external debt decreased by 4.4% to € 22.7 billion. It is estimated that total external debt as a percent of GDP has declined by 11.5 pps in H1 2011 to 70.6% from 82.1% as nominal GDP is forecast to increase by 11.1% in 2011 due to high inflation. The split between short- and medium/long- term debt and between public- and private-sector debts, as a percent of the total, stands at 4.3% to 95.7% and 40.2% to 59.8% respectively.

Current Account: Jan.-Jun'11 (€ million)			
	Jan.-Jun.'11	Jan.-Jun.'10	%Δ
Exports	4.113	3.335	23%
Imports	6.657	5.691	17%
Trade Balance	-2.544	-2.357	8%
Services Balance	40	-13	-401%
Income Balance	-365	-372	-2%
Current Transfers Balanace	1.487	1.367	9%
Current Account Balance	-1.382	-1.375	0%
Source: Central Bank of Serbia			

Stock of External Debt as of 30.06.2011 (in million of EUR)	
Total External Debt	**22.734**
Public Sector External Debt	**9.138**
Medium and long-term debt	***9.138***
of which IMF sba	1.506
Short-term Debt	**0**
Private Sector External Debt	**13.597**
Medium and long-term debt	**12.630**
of which Banks	3.413
of which Enterprises	9.217
Short-term Debt	**966**
of which Banks	895
of which Enterprises	72
Source: Central Bank of Serbia	

The Central Bank's foreign exchange reserves stood at € 10.4 billion at end-July 2011 up € 417.2 million on the month, driven by the sale of government euro-denominated securities worth € 128 million.

Exchange Rate Developments



Soure: Bloomberg

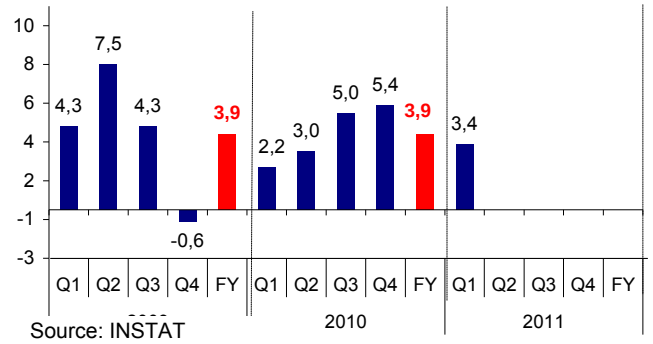
MONEY & FINANCIAL MARKETS: Heightening inflationary pressures led the Central Bank to raise its key policy rate by a cumulative 450 basis points from 8% in May 2010 to 12.5% in April 2011. As inflationary pressures subsided in May and June 2011 which the Central Bank believes is the start of a disinflationary trend leading it to lower its key policy rate by 50 basis points at its meeting on the 9th of June and by a further 25 basis points at its meeting on the 7th of July. The Central Bank is expecting inflation to return to its target range in H1 2012.

Credit expansion to the private sector strengthened to 18% in May 2011 from 14.8% in December 2010 and 10.9% in May 2010. In June 2011 it decelerated to 16.1% (Euro basis). Loans to businesses and to households grew by 18.3% and 12% yoy respectively in June 2011. The growth rate of private sector deposits accelerated to 9.4% yoy in June 2011 from 4.6% yoy in December 2010. The loan to deposit ratio stood at around 136% in June 2011 from 131% in December 2010 and 119% in December 2009.

6. ALBANIA

ECONOMIC OUTLOOK: Albania's economy has managed to maintain its positive pace of growth in early 2011 despite the weak international environment. Economic growth slowed at 3.4% in the first quarter of 2011 down from 5.4% posted in the fourth quarter of 2010. Transport has been the main driver of growth in Q1 2011, followed by industry and construction sector, while telecommunication and services registered negative growth. The construction sector mainly boosted by public investments in infrastructure, while negative growth in the telecommunication sector was due to lower mobile phone tariffs. The IMF predicts Albania GDP to grow by 2.7% this year, while the government by 5.0%. The economic growth for the rest of the year will rely on foreign demand for Albanian products, as well as, the developments in Greece which is a major trading partner.

Real GDP (%Δ YoY, unadjusted data)

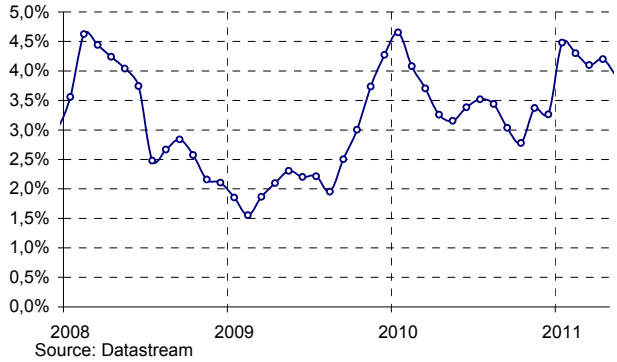


Source: INSTAT

FISCAL POLICY: The government adopted the 2011 budget projecting a fiscal deficit of 3.5% of GDP and has set a ceiling of 3% of GDP for the annual budget deficit for the period 2012-2014. The budget envisages total revenue to rise to 27.3% of GDP in 2011, while total expenditure to increase to 30.8% of GDP. In the first five months of the year revenue mainly VAT and excise taxes dropped due to the weak domestic demand. On the other hand, total expenditure increased due to higher wages in public services and government subsidies. In light of the above developments, the budget deficit was 2.5 times higher the deficit in the corresponding period a year ago. Due to the fact that the budget balance is under pressure because of less revenue collection, the IMF advised the Government to cut spending and to increase taxes. The flat tax could be raised to 12-15% from the current level of 10%. The IMF also, projected the budget deficit to rise to 4.7% of GDP in 2011. The debt-to-GDP ratio was at 59.4% in 2010 from 59.7% in 2009 and the government expects it to decline to 58.3% in 2011.

INFLATION: The inflation pressures have remained firmly above the BoA's 2-4% target band, since February due to the higher prices of imported goods, the weakening of the local currency and the tax increases on tobacco. The decline in prices of fresh food is the basic contributor of inflation deceleration in June at 3.9%. Inflationary outlook, though reflecting a relatively high reading, remains well anchored. Inflation might not increase significantly in the coming months due to the unwinding of the rise in administrative prices (water, electricity tariffs) in 2010 and to deceleration in the international price of oil.

Consumer Price Inflation - (%Δ YoY)



Source: Datastream

BALANCE OF PAYMENTS: The rapid increase of exports and moderate rise of imports have led to a slight improvement of the trade deficit. Specifically, trade deficit reduced by -3% in Q1 2011, as exports increased by 44% versus a 15% increase in imports (US dollar basis). Within Q1 2011 the local currency had a balanced performance, it depreciated against the Euro by around 0.82% and appreciated against the US Dollar by around 0.95%

Current Account: 2011 ($ million)			
	Q1 2011	Q1 2010	%Δ
Exports	507	352	44%
Imports	-1.068	-931	15%
Trade Balance	-560	-580	-3%
Services Balance	-63	-18	255%
Income Balance	16	-19	-185%
Current Transfers Balanace	269	292	-8%
Current Account Balance	-338	-325	4%
Source: Central Bank of Albania			

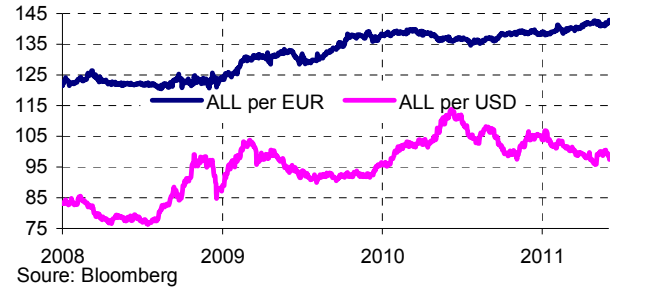
The current account deficit is anticipated to narrow gradually during the coming years. In 2011 current account deficit is therefore expected to be around 10.2% of GDP from an estimated 11.9% of GDP in 2010. In the first three months of 2011 the current account deficit was 2.6% of projected GDP from 2.8% of GDP a year ago. Net FDI had a substantial fall of its volume in Q1 2011 to $ 74 million from $ 229 million a year later because of the sluggish economic activity in Italy and Greece, Albania's major trading partners and contributors of FDI. Workers' net remittances had an expected slowdown in Q1 2011 to $210 mn from $235 mn a year later. On the other hand other investment recorded a net inflow of $184 million from a net outflow of $ 50 million due to deposits inflows and the local currency's performance.

MONEY & FINANCIAL MARKETS: The local currency depreciated against the Euro by around 1.7% and appreciated against the US Dollar by around 6.2% in H1 2011.

The BoA raised its key policy rate by 25 bps in March at 5.25%. Since then it has kept the rate on hold as monetary conditions in the medium term would help to get

inflation back to its 2-4% target corridor. Credit expansion decelerated in Q2 2011 to an average rate of 7.3% yoy (Euro basis) from an average 8.9% yoy in Q1 2011. In June 2011 credit expansion decelerated to 7.7% from 9.5% in March, with loans to households growing by 1.6% yoy. The loans to deposits ratio stood at 60.6% in June 2011 from 62.6% in December 2010.

Exchange Rate Developments

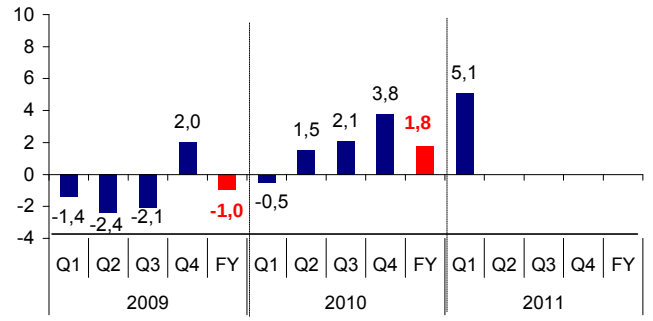


Soure: Bloomberg

7. FYROM

ECONOMIC DEVELOPMENTS: Following a modest recovery with a GDP growth revised from 0.7% to 1.8% in 2010, the economy is set to expand in 2011. Real GDP broadened by 5.1% (preliminary figures) in Q1 2010 compared to a revised annual drop of 0.5% a year ago, mainly reflecting a pick-up in construction and industry as well as, in domestic demand. Strong growth was supported by external demand in Q1 2011. On the supply side, construction was the main driver of the economic growth with an annual increase of 21.2% while mining and quarrying had a growth of 7.9% yoy due to high international prices. Recent industrial production figures point to slower pace of expansion of domestic production in Q2 2011. According to Central Bank (NBRM), the annual GDP growth is estimated at 4.3% in Q2 2011, while IMF envisages country's GDP growth to reach 3% in 2011.

Real GDP (%Δ YoY, unadjusted data)

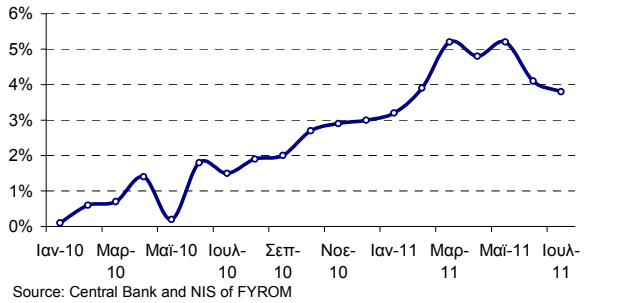


Source: NIS of FYROM

FISCAL POLICY: The general government budget deficit reached 2.5% of GDP in 2010 from 2.6% of GDP in 2009. Revenues in Q1 2011 were higher by 6.4% yoy. Taxes, the biggest contributor of budget revenues were up by 12.4% yoy. In the same period profit tax, a strong indication of recovery of corporate sector rose by 4.7% while in Q2 2011 the annual increase is expected to exceed 97%. At the same time, expenditures increased by 4.5% in Q1 2011. The budget deficit was standing at 3.6% of GDP in Q1 2011, while the government is targeting a budget deficit of 2.5% of GDP in 2011 and 2% of GDP in 2012. In April, the authorities in order to finance the budget deficit draw €220 million out of the €390 million available under the Precautionary Credit Line (PCL) with IMF.

INFLATION: The inflationary pressures have started to fade gradually since May due to deceleration of food and energy prices. In January-July the average inflation rate was 4.3% yoy from 0.9% in 2010. Inflation was 3.8% yoy in July 2011 driven by a 7.2% increase in the prices of food products and a 7.0% increase in the price of utilities. In Q3 2011, the inflation is expected to slow down due to lower energy prices and lack of strong domestic demand. The Central Bank predicts that the average inflation rate to be in the region of 4.5% throughout the year.

Consumer Price Inflation - (Δ% yoy, end of period)



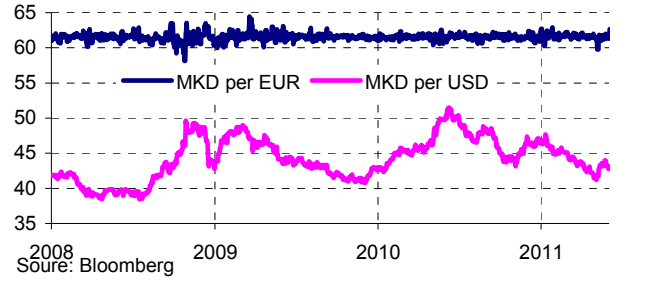
Source: Central Bank and NIS of FYROM

BALANCE OF PAYMENTS: The current account deficit widened to $ 350 million in the period January-April 2011 from $ 169 million in the corresponding period of 2010. Exports continued its dynamic momentum, growing by 48% yoy. Imports had also a marked rise of 45% yoy mainly due to imports of equipment and machinery which were not included in the past statistics. Net current transfers continued its growth reaching $ 526 million or 5.2% of projected GDP. Net FDI inflows increased by 138% yoy in the first four months of 2011 amounting $ 252 million, which is 2.5% of the projected GDP. The current account deficit for 2011 is expected to widen around to 5.5% of GDP from 2.9% of GDP in 2010.

Current Account: Jan.-Apr.'11 ($ million)			
	Jan.-Apr.'11	Jan.-Apr.'10	%Δ
Exports	1.349	910	48%
Imports	2.213	1.530	45%
Trade Balance	-864	-620	39%
Services Balance	41	13	207%
Income Balance	-53	-81	-34%
Current Transfers Balance	526	518	1%
Current Account Balance	-350	-169	107%
Source: Central Bank of FYROM			

MONEY & FINANCIAL MARKETS: The stabilization of inflation helped the Central Bank (NBRM) to retain its 28 days-bills rate to 4.0% in Q2 2011. The O/N Lombard rate remained also at 5.5% in the same period. The decrease of inflation is likely to ease the pressure on NBRM to hike interest rates in the coming months.

Exchange Rate Developments



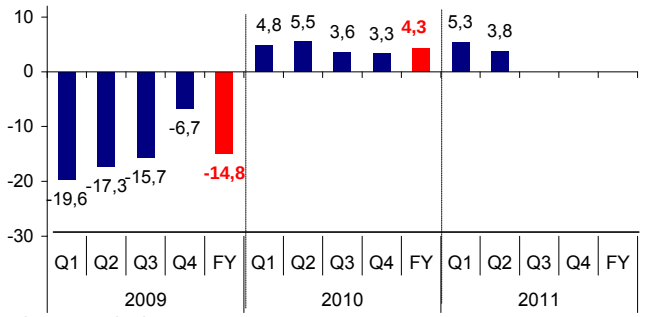
Soure: Bloomberg

Credit expansion accelerated to 8.5% yoy in June 2011 from 4.4% yoy in December 2010 (Euro basis). In June 2011 loans to businesses grew by 9.4% and to households by 7.0%. The ratio of non-performing to total loans was 9.4% at the end of March 2011 from 9.3% at the end of 2010. The banking sector remains well capitalised with capital adequacy ratio (CAR) twice higher than the required level, at 16.8% in Q1 2011.

8. UKRAINE

ECONOMIC OVERVIEW: Despite a strong comeback in the first quarter of 2011 the economy slowed it's growth expansion from 5.3% yoy in Q1 2011 to 3.8% yoy in Q2 2011 (preliminary data). This development was expected due to a base effect. The domestic demand remained strong for a second quarter in a row at a similar rate (+ 13% yoy) to the first quarter as improving confidence push households to decrease savings in favour of spending. Households took advantage of the real wage growth (+16.5% yoy in nominal terms) but in the long run a moderate growth is expected as the implementation of new prices on gas and weaker global growth will affect personal income. External trade was a drag on growth due to a slow down in foreign demand mainly in metallurgical industry. A mission from the IMF will visit Ukraine from August 29 to September 9 to continue discussions on the 2nd tranche of the $15.2 bn standby loan arrangement. Ukraine so far got total disbursements of $3.4 bn. As Ukraine failed to implement pension reform and to increase gas tariffs a scheduled $1.5 bn tranche in March was postponed. However, in June the parliament passed the pension reform in the first reading. Despite this positive development, gas rates remain a pending issue. Given the growing dissatisfaction with measures undertaken the government may try to avoid any change on gas prices this year. Ukraine's sovereign 5 year CDS spreads remain at high level among the CEE countries driven by risk aversion due to debt crisis in EU.Undoubtedly every step to get back IMF program on track will improve country's risk profile. Buoyant domestic demand is expected to support growth expansion in H2 2011. The government is expecting GDP growth to reach 4.7-4.8% in 2011, compared to 4.2% in 2010.

Real GDP (%Δ YoY, unadjusted data)

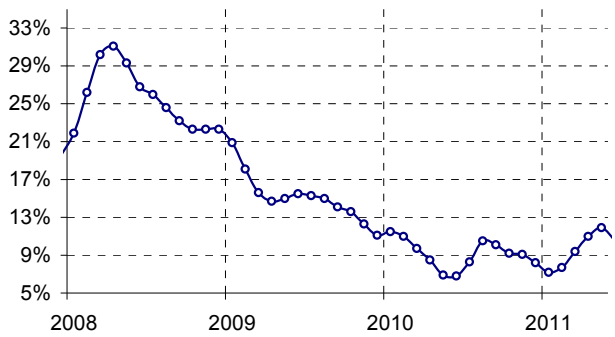


Source: NIS of Ukraine

FISCAL POLICY: High economic growth, rising corporate earnings and broader taxation base helped budget revenues to rise by 23.9% yoy in 7M 2011. In particular proceeds from taxes were up 48.5% yoy while non tax revenues up by 17% in 7M 2011.Tax receipts are expected to lose speed the coming months due to lower corporate tax rate (2pp to 23%) and growing comparison base. Fitch ratings upgraded it's outlook for Ukraine's credit rating to positive from stable due to government's effort to narrow budget deficit. Ukraine retained it's B rating (5 levels below investment grade). Fiscal consolidation and economic expansion should help debt to stabilize around 30% of GDP this year. The agency envisages budget deficit to be at 4% of GDP in 2011 from 7.9% in 2010. Despite the satisfied tax revenue growth the key factor to fiscal consolidation will be government's spending program especially in 2012 (parliamentary elections).

INFLATION: Since May the inflation rate moved into the double digits due to significant base effect. Given the decline in international energy prices and in vegetable and fruit prices headline inflation slowed to 10.6% yoy in July after peaking at 11.9% yoy a month earlier. The acceleration of inflation from 7.2% in February encouraged the Central Bank to follow a hawkish stance. The Central Bank raised reserve requirements for the banks effectively from July 1st. In particular required reserves ratio for FX call deposits and current accounts was hiked from 7% to 8%. At the same time in order to extend FX deposit maturities the Central Bank increased reserve requirements for short term and long term maturities from 4% to 6% and 2% respectively. The reserve requirements for local currency deposits remained at 0%. The central bank's action to tighten bank liquidity will support the local currency and prevent acceleration of core inflation. The high possibility of postponement of a hike in natural gas tariffs and an expected good agricultural harvest may drive inflation at lower level from the current one by year end.

Consumer Price Inflation - (%Δ YoY)



Source: NIS of Ukraine

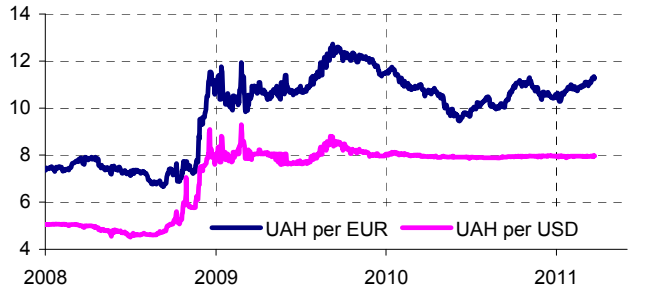
BALANCE OF PAYMENTS: The current account deficit widened in H1 2011 to $ 2.5 bn from a surplus of $ 552 mn in H1 2010 (preliminary data). Exports made up $33.3 bn and it's growth increased to 42.7% yoy mainly due to higher prices for ferrous metals and mineral products, the elimination of export quotas on corn and the high world prices for grain. Imports rose by 51.3% yoy in H1 2011, led by higher energy prices and volumes of oil and gas products. The trade deficit rose by 149.5% yoy in H1 2011 to $5.1 bn which supported by the surplus in services' trade balance ($2.2 bn). However, the surplus of capital and financial account made up $4.3 bn in H1 2011 from $3.9 bn in the respective period last year. Inflows of net FDI remained strong thanks to recapitalization of a domestic bank, a eurobond sovereign issue of $1.25 bn and Ukrtelecom privatization proceeds. In particular, net FDI accelerated to $3.0 bn in H1 2011 (+ 41.8%) from $2.1 bn in H1 2010.Th"e FDI inflows remain sufficient to cover the current account deficit in 2011. The Central Bank's reserves which stood at $ 37.8 bn in July up 22% yoy are strong to withstand a short term capital outflow while the recent outlook upgrade by Fitch ratings should enhance country's position in the financial markets.

Current Account: H1 2011 ($ million)			
	H1 2011	H1 2010	%Δ
Exports	33.308	23.342	43%
Imports	38.415	25.389	51%
Trade Balance	-5.107	-2.047	149%
Services Balance	2.157	2.237	-4%
Income Balance	-1.474	-974	51%
Current Transfers Balanace	1.902	1.336	42%
Current Account Balance	-2.522	552	-557%
Source: National Bank of Ukraine			

MONEY & FINANCIAL MARKETS: Banking liquidity remained at high levels during H1 2011 adding to inflationary pressures. The Central Bank in order to absorb ample liquidity activated it's deposit certificate facility. At the same time in order to counter local currency's depreciation raised mandatory reserve requirements while hiked required reserves for FX call deposits and current accounts. Credit expansion (euro basis) shrank 7.1% yoy in June 2011 from an expansion 1.8% yoy in March 2011 and 9.8% in December 2010. Loans to corporates reduced by 0.7% yoy, while loans to households declined by 21.1% yoy.

Private sector deposit growth grew 6.5% in June 2011 while the loan to deposit ratio was standing at 77.4% in June 2011 from 86.6% in December 2010. During H1 2011 the local currency was under strong depreciation (10%) mainly against euro, while the liberalization of FX market had no immediate effect on the market.

Exchange Rate Developments

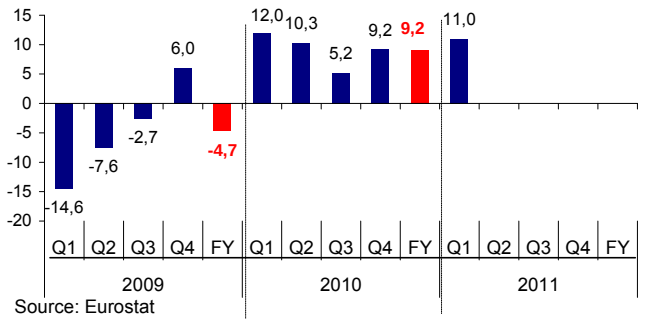


Source: Bloomberg

9. TURKEY

ECONOMIC OVERVIEW: Turkey's economy grew by 9.2% yoy in real terms in 2010, recording the highest growth rate in Europe after suffering 4.7% stagnation in 2009. The GDP figures so far this year, recorded a growth rate of 11.0% yoy in Q1 outpacing even China's rate. This is the fifth quarter in a row that the economy has recorded positive growth. The good shape of the economy helped the ruling party to win a third term in parliamentary elections on June 12.

Real GDP (%Δ YoY, unadjusted prices)



Source: Eurostat

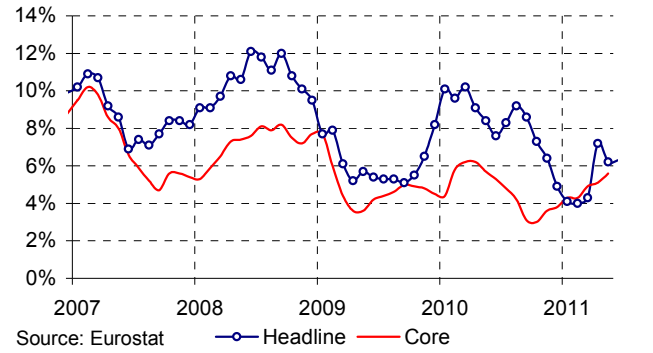
The robust expansion in Q1 2011 reflected strong private consumption, which rose 12.1% yoy from 9.0% in Q4 2010, boosting domestic demand growth to 15.9% yoy from 14.7% yoy in Q4 2010. Investment remains strong, but decelerated from the 42.1% annual increase registered in Q4 to 33.6% in Q1. Moreover, government consumption continued its expansion. According to IMF's latest forecast, the economy is expected to register a growth rate of around 8.7 % in the current year.

FISCAL POLICY: After ending 2010 with a budget deficit equivalent to 3.6% of GDP, Turkey in the first half of 2011 posted a budget surplus of 2.9 billion liras, compared with the target for the full year of a 33.5 billion liras deficit (2.8% of GDP). Accordingly, budget expenses equalled 143.2 billion liras, while budget incomes reached 146.1 billion liras. This strong budget performance, particularly in an election year, is mainly due to a surge in tax

revenue and lower interest expenditure. Government has collected nearly 8 billion liras from taxpayers as part of a tax amnesty program in the first half of the year while plans to gather almost 30 billion liras by year end. The non-interest surplus in H1 increased by 2.1% compared to the same period in 2010 and reached 25.3 billion liras. Despite the strong economic outlook in Q1, the gradual moderation of the growth rate due to the euro zone debt crisis and the slowing growth in US, the fiscal policy required to tread carefully.

INFLATION: Headline inflation has started to creep higher after ending Q1 of 2011 at 4.0%. The demand side inflationary pressures together with the expected increases in food and energy prices, as well as, lira's depreciation have started to kick in to the headline inflation, bringing the annual inflation in July 2011 at 6.3%. Nevertheless, the average inflation in July 2011 was standing at 5.3% compared to 9.0% the corresponding period in 2010. Core inflation is still moderating, albeit remaining at a reasonably high level. The Central Bank maintained its year-end CPI forecasts at 6.9% for 2011 and 5.2% for 2012. With the recent increase in oil prices, it is recognised that inflation would accelerate in the H2 in 2011.

Consumer Price Inflation - (%Δ YoY)



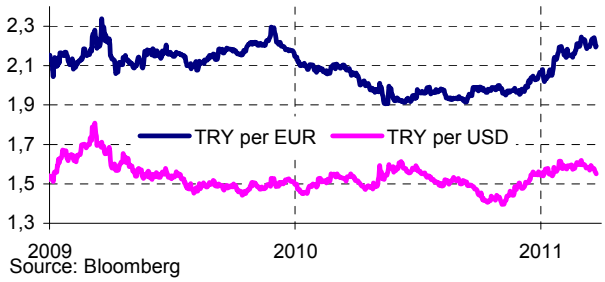
BALANCE OF PAYMENTS: The widening of the current account remains a risk issue in the macroeconomic profile of the country. The current account registered a deficit of $45.0 billion during H1 2011 or 5.8% of projected GDP from $20.3 billion or 2.8% of GDP the same period in 2010. The net contribution from the external side of the economy remained negative, as imports continued to outpace exports. The trade balance is the main explanation of the current account deficit. Exports of goods and services expanded 18%, while imports accelerated further by 45% in annual terms.

Export/import coverage ratio which had been 73.6% in H1 2010, declined to 59.8% in annual terms in H1 2011. Meanwhile, direct investment in Turkey reached $6.2 bn in the first six months of 2011 increasing $3 billion over the same period of 2010 contributing to a rise of the net FDI to current account deficit ratio to 10.8% in 2011 from 11.2% in 2010. The capital inflow directed mainly into the financial services sector. What is more encouraging in regard to trade balance is the low level of exports compared to GDP (11% E), which indicates potential growth in the future.

Current Account: Jan.- Jun.'11 ($ million)			
	Jan.- Jun.'11	Jan.- Jun'10	%Δ
Exports	68.968	58.404	18%
Imports	-115.399	-79.399	45%
Trade Balance	-46.431	-20.995	121%
Services Balance	5.183	3.727	39%
Income Balance	-4.453	-3.516	27%
Current Transfers Balanace	693	537	29%
Current Account Balance	-45.008	-20.247	122%
Source: Central Bank of Turkey			

MONEY & FINANCIAL MARKETS: Since late last year, the Central Bank of Turkey's has been following an unorthodox monetary policy based on lower interest rates to discourage short-term capital inflows and high reserve ratios to restraint domestic demand. The concerns about the ballooning current account deficit contributed to the weakening of the Turkish lira. The Central Bank in order to strengthen the currency halted dollar-purchase auctions and reduced the FX reserve ratios. As expected, the outcome of the national elections was a non-event for markets. However, slower than expected inflation in July 2011 removed any constraint that the Central Bank may have and it was decided on Aug 4, to reduce its policy rate (1-week repo rate) by 0.5% to a record low of 5.75% to safeguard the economy from the impact of European debt problems and the growing risks in the global economy. At the same time the Central Bank increased the O/N borrowing rate from 1.5% to 5.0% and kept the lending rate unchanged at 9.00% narrowing the interest rate corridor and limiting the short term volatility. The relaxed monetary policy should keep pressure on the Turkish lira but its behaviour against the single currency will depend on the trend of the EUR/USD rate and the size of the current account deficit.

Exchange Rate Developments



9. ECONOMIC DATA – GREECE

(% change unless otherwise noted)

Yearly Data	2006	2007	2008	2009	2010	2011f	2012f
Real GDP Growth	4.5	4.5	1.1	-2.1	-4.5	-3.9	0.6
Gross Fixed Total Investments (including stocks)	8.1	5.5	-7.7	-11.1	-16.5	-8.8	-1.5
- Residential Investment	29.1	-8.6	-29.1	-21.7	-18.6	-17,0	3,0
- Equipment	14.2	22.3	6.6	-11.8	-23.5	-7.5	1,0
Unemployment (percent)	8.9	8.3	7.7	9.5	12.5	15.8	16.2
Employment	1.9	1.7	0.2	-0.7	-2.7	-3.3	0.3
Consumer Price Index (year average)	3.2	3,0	4.2	1.3	4.7	3.5	1.8
Unit Labor Cost (1995=100)	2.3	3.6	6.2	4.3	-0.4	-1.8	-0.2
Credit Expansion (Private Sector)	21.1	21.5	15.9	4.1	-0.1	-3.0	1.0
Government Deficit (as % of GDP)	-5.7	-6.4	-9.8	-15.4	-10.4	-7.6	-6.5
Current Account (as % of GDP)	-9.6	-12.4	-13,0	-10.1	-10.5	-8.5	-6.0

Source: Alpha Bank Research, IMF

Quarterly Data	2009	2010	2010	2010	2010	2010	2011
		I	II	III	IV		available period
Economic Activity (period average)							
Retail Sales Volume	-9.3	5.7	-0.2	-3.9	-15.1	-6.8	-12.1(Jan-May)
Construction Activity	-26.5	-20.6	-24.3	-25,0	-19.9	-23.7	-49.2(Jan-Apr)
Industrial Production (Manufacturing)	-11.2	-4.3	-4.2	-5,0	-2.8	-4.8	-9.5 (Jan-Jun)
PMI (manufacturing)	45.3	44.6	42.6	44.3	43.5	43.8	45.2 (Jul)
Economic Sentiment Indicator	70.6	78.8	72.3	74.2	74.1	75.1	70.0 (Jun)
Index of Business Expectations in Manufacturing	72.1	74.6	76.9	77,0	74.8	75.8	76.2 (Jun)
Consumer Sentiment Index	-45.7	-52	-65	-65	-72	-64	-75.0 (Jun)
Credit Expansion (end of period)							
Private Sector	4.1	3.5	2.6	1.2	-0.2	-0.1	-1.2 (Jun)
Consumer Credit	2,0	1,0	0,0	-2.1	-4.2	-4.2	-5.8 (Jun)
Housing	3.7	3.5	2.3	1,0	-0.4	-0.4	-1.7 (Jun)
Business	5.1	4.2	3.7	2.3	1,0	0.9	0.2 (Jun)
Tourism	7.8	8.2	3.9	4.5	2.9	2.9	0.5 (Jun)
Prices (end of period)							
Consumer Price Index	1.2	3,0	5.2	5.5	5.1	4.7	2.4 (Jul)
Core Inflation	2.4	1.7	3.3	3.7	3.3	3,0	0.6 (Jul)
Interest Rates (period average)							
Savings	0.56	0.38	0.37	0.39	0.44	0.45	0.40 (May)
Short-term Business Loans	6.07	5.84	6.12	6.39	6.64	6.79	7.34 (May)
Consumer Loans (up to 1 year)	11.53	11.13	11.14	12.12	12.17	12.33	12.64 (May)
Housing Loans (over 10 years)	4.08	3.6	3.69	3.97	4.1	4.06	4.83 (May)
3 month Euribor	0.7	0.63	0.77	0.85	0.94	1.11	1.38(May)
10 year Bond Yield	5.17	6.24	8.3	10.79	10.03	12.47	3.05 (May)
National Accounts							
Real GDP	-2,0	-0.7	-5.1	-5.7	-6.6	-4.5	-5.5(Q1)
Final Consumption	-2.2	1,0	-5,0	-5.6	-8.6	-4.5	-7.8(Q1)
Investment	-11.2	-5,0	-17.1	-7.1	-19.4	-16.5	-19.2(Q1)
Exports of goods & services	-20.1	2.2	3.2	-0.9	12.8	3.8	-2.0(Q1)
Imports of Goods & services	-18.6	0.5	-8.4	-8.9	-3.2	-4.8	-15.5(Q1)
Balance of Payments (in € mn - Cumulative)							
Exports of Goods	15.3	3.5	7.8	12.2	17.1	17.1	9.5(Jan-Jun)
Imports of Goods	46.1	11.8	23.1	34.5	45.4	45.4	23.7(Jan-Jun)
Trade Balance	-30.8	-8.3	-15.3	-22.3	-28.3	-28.3	-14.2(Jan-Jun)
Invisibles Balance	6.1	-1.5	0.9	5.9	6.3	6.3	1.2(Jan-Jun)
Invisibles Balance / Trade Account	19.8%	18.1%	5.9%	26.6%	22.3%	22.3%	8.6%(Jan-Jun)
Current Account	-24.7	-9.8	-14.4	-16.3	-22,0	-22,0	-13.0(Jan-Jun)
Direct Investments	1.1	0.9	0.9	0.4	0.7	0.7	-0.7(Jan-Jun)
Portfolio Investments	27.1	4.9	-5,0	-18.3	-20.9	-20.9	-9.7(Jan-Jun)
Athens Stock Exchange (end of period)							
Composite Index	2.196,0	2.067,0	1.434,0	1.471,0	1.414,0	1413.9	1,204.15 (Jul)
% change	22.9	22.7	-35.1	-44.7	-35.6	-35.6	-28.41 (Jul)
Market Capitalization ASE (% of GDP)	34.6	32.8	23.4	24.4	23.3	23.3	19.9 (Jul)

Source: Hellenic Statisticsl Authority (EL.STAT.) and Alpha Bank Research

10. ECONOMIC DATA – SOUTHEASTERN EUROPE

Romania	2007	2008	2009	2010	2011 (f)	2012 (f)
Real Economy						
Real GDP	6.3	7.4	-7.1	-1.3	1.9	3.4
Private Consumption	11.9	9.0	-10.2	-1.7	0.8	3.0
Government Consumption	-0.1	7.2	1.6	-3.6	-1.5	1.5
Gross Fixed Investment	30.3	15.6	-25.2	-13.1	4.0	6.0
Exports (Goods & Services)	7.8	8.3	-5.3	13.1	8.5	7.5
Imports (Goods & Services)	27.9	7.9	-20.9	11.6	6.7	8.2
Prices						
HICP Inflation (Avg)	4.9	7.9	5.6	6.1	6.7	4.0
General Government (%GDP)						
Overall Balance	-3.1	-4.8	-7.3	-6.5	-4.4	-3.0
Balance of Payments (% GDP)						
Current Account Balance	-13.4	-11.6	-4.2	-4.2	-4.6	-5.1

Bulgaria	2007	2008	2009	2010	2011 (f)	2012 (f)
Real Economy						
Real GDP	6.4	6.2	-5.5	0.2	2.7	4,0
Private Consumption	9.0	3.4	-7.6	-1.2	2.0	3.8
Government Consumption	0.3	-1.0	-6.5	-1.0	-0.5	0.5
Gross Fixed Investment	11.8	21.9	-17.6	-16.5	4.5	6,0
Exports (Goods & Services)	6.1	3.0	-11.2	16.2	7.0	7.5
Imports (Goods & Services)	9.6	4.2	-21.0	4.5	6.7	7.0
Prices						
HICP Inflation (Avg)	7.6	12,0	2.5	3.0	4.2	4.5
General Government (%GDP)						
Overall Balance	3.5	3.0	-0.8	-3.9	-2.5	-1.3
Balance of Payments (% GDP)						
Current Account Balance	-26.8	-24.0	-9.9	-0.8	-1.5	2.0

Cyprus	2007	2008	2009	2010	2011 (f)	2012 (f)
Real Economy						
Real GDP	5.1	3.6	-1.7	1.0	0.8	1.8
Private Consumption	9.4	7.1	-2.9	0.8	2.0	3.0
Government Consumption	0.3	6.2	5.8	0.5	1.5	2.0
Gross Fixed Investment	13.4	6,0	-9.1	-7.9	4.2	4.5
Exports (Goods & Services)	6.1	-0.3	-11.3	0.6	1.4	1.5
Imports (Goods & Services)	13.3	8.1	-19.3	3.1	4.1	4.0
Prices						
HICP Inflation (Avg)	2.2	4.4	0.2	2.6	3.8	2.8
General Government (%GDP)						
Overall Balance	3.4	0.9	-6.0	-4.9	-7.0	-7.3
Balance of Payments (% GDP)						
Current Account Balance	-11.7	-17.5	-8.3	-7.2	-7.8	-8,0

Serbia	2007	2008	2009	2010	2011 (f)	2012 (f)
Real Economy						
Real GDP	6.9	5.5	-3.5	1.8	3.0	4.1
Private Consumption	3.1	7.9	-2.5	-1.8	0.2	3.0
Government Consumption	18.2	1.6	-5.1	-2.4	-1.5	0.7
Gross Fixed Investment	25.6	1.9	-9.3	-0.1	1.6	5.0
Exports (Goods & Services)	17.2	8.9	-12.4	19.1	17.0	15.0
Imports (Goods & Services)	26.0	9.3	-21.8	4.1	6.2	7.4
Prices						
Consumer Price Inflation (Avg)	6.5	12.4	8.1	6.2	9.9	4.1
General Government (%GDP)						
Overall Balance	-1.9	-2.6	-4.3	-4.5	-4.1	-3.1
Balance of Payments (% GDP)						
Current Account Balance	-15.9	-20.9	-6.9	-7.1	-7.4	-6.6

Albania	2007	2008	2009	2010	2011 (f)	2012 (f)
Real Economy						
Real GDP	5.3	8.3	3.9	3.9	3.5	3.6
Private Consumption	-	-	-			
Government Consumption	-	-	-	-	-	-
Gross Fixed Investment	-	-	-	-	-	-
Exports (Goods & Services)	-	-	-	-	-	-
Imports (Goods & Services)	-	-	-	-	-	-
Prices						
CPI Inflation (Avg)	2.9	3.4	2.3	3.6	3.8	3.4
General Government (%GDP)						
Overall Balance	-3.9	-5.5	-7.1	-3.0	-3.4	-3.0
Balance of Payments (% GDP)						
Current Account Balance	-10.3	-15.3	-15.5	-10.4	-10.2	-9.8

FYROM	2007	2008	2009	2010	2011 (f)	2012 (f)
Real Economy						
Real GDP	6.1	5,0	-0.9	1.8	3.0	3.5
Private Consumption	7.5	7.4	-3.9	1.1	2.4	3.0
Government Consumption	-0.3	10.6	-6.4	-3,0	1.0	1.2
Gross Fixed Investment	17.1	5.4	0.9	-7.5	13.5	8.0
Exports (Goods & Services)	11.8	-6.3	-10.7	22.7	13.0	8.0
Imports (Goods & Services)	16.1	0.8	-11.1	10.7	15.0	9.5
Prices						
HICP Inflation (Avg)	2.3	8.3	-0.8	1.6	4.4	3.8
General Government (%GDP)						
Overall Balance	0.6	-0.9	-2.7	-2.5	-2.5	-2.2
Balance of Payments (% GDP)						
Current Account Balance	-7.1	-12.8	-6.7	-2.9	-5.8	-5.7

Ukraine	2007	2008	2009	2010	2011 (f)	2012 (f)
Real Economy						
Real GDP	7.9	2.4	-14.8	4.3	4.5	4.6
Private Consumption	17.0	12.8	-14.9	7.0	5.5	5.2
Government Consumption	1.8	1.1	-2.4	3.3	1.5	1.8
Gross Fixed Investment	6.6	-1.2	-50.5	3.2	8.0	13.0
Exports (Goods & Services)	2.8	5.7	-22.0	4.5	5.8	4.6
Imports (Goods & Services)	23.9	17,0	-38.9	11.1	12.8	6.4
Prices						
CPI Inflation (Avg)	12.8	25.2	15.9	9.4	10.6	9.3
General Government (%GDP)						
Overall Balance	-2.0	-3.2	-6.2	-7.4	-4.2	-4.0
Balance of Payments (% GDP)						
Current Account Balance	-3.7	-7.1	-1.5	-2.1	-2.4	-2.6

Turkey	2007	2008	2009	2010	2011 (f)	2012 (f)
Real Economy						
Real GDP	4.7	0.7	-4.8	9.2	4.5	4.5
Private Consumption	5.5	-0.3	-2.3	6.6	7.0	6.0
Government Consumption	6.5	1.7	7.8	2.0	3.5	4.0
Gross Fixed Investment	3.1	-6.2	-19.0	29.9	20.0	8.3
Exports (Goods & Services)	7.3	2.7	-5.0	3.4	4.0	4.0
Imports (Goods & Services)	10.7	-4.1	-14.3	20.7	18.0	10.0
Prices						
HICP Inflation (Avg)	8.8	10.4	6.3	8.6	5.8	6.5
General Government (%GDP)						
Overall Balance	-1.6	-2.2	-5.5	-3.6	-1.5	-1.2
Balance of Payments (% GDP)						
Current Account Balance	-5.9	-5.7	-2.3	-6.7	-8.8	-8.0

Source: Central Banks, National Statistical Institutes, IMF, Economist Intelligence Unit, Eurostat, World Bank, Alpha Bank Economic Research
Note: Data for a 2010 are preliminary
(f): Forecast Alpha Bank Economic Research