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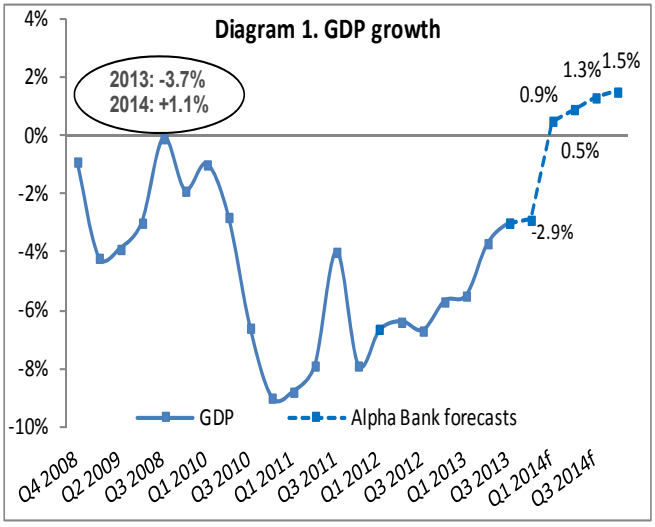
Greece
Economic & Financial Outlook

Executive Summary

- Greece's remarkable adjustment in the last three and a half years has led to the rebalancing of the economy. This was made possible through fiscal consolidation, mainly by reducing spending and expanding the tax base on a permanent basis. Moreover, substantial productivity-enhancing and employment-increasing structural reforms (especially in the labour and product markets) were implemented successfully. These developments have significantly boosted Greece's international competitiveness and net exports growth while substantially improving economic sentiment..

- Greece has benefited from the spectacular increase in external tourism in May-October 2013 which, in combination with the continuing healthy increase in the exports of goods, have contributed to the substantial deceleration of the falling trend of Greece's GDP to -3.8% in Q2 2013 and -3,0% in Q3 2013, from -5.6% in Q1 2013. A -3.7% GDP fall is now more likely in 2013 and positive yoy growth is expected to resume from Q1 2014.

- In 2013, a significant improvement in the general government (GG) primary balance was recorded, with a surplus of 0.4% of GDP, compared with a planned zero balance, from -1% of GDP primary deficit in 2012. For 2014, the GG primary surplus target has been set at 1.6% of GDP. In fact, the successful fiscal consolidation process is grounded on legislation adopted in November 2012, with spending cuts and revenue-increasing measures exceeding €15bn securing the implementation of the 2013-2014 budgets.



- Internal devaluation since 2009 has now recouped in full competitiveness losses during the 2000s, while the restoration of flexibility in the labour market and strong economic performance implies further gains in competitiveness in the following years. In this context, the net exports of goods and services deficit has shrunk from -14.1% of GDP in 2008, to -3.5% of GDP in 2012. It is now expected to fall further to -0.9% of GDP in 2013, and to turn into a surplus of 0.7% of GDP in 2014 and 1.4% of GDP in 2015. Also, Greece's current account (including net capital transfers) is expected this year to turn into surplus of 1.0% of GDP, from a deficit of -2.2% of GDP in 2012, and -8.6% in 2011.

- The substantial progress in fiscal consolidation achieved in 2013, and which is expected to be extended in 2014, together with further advances in the field of structural reforms and the implementation of the privatization program in much more favourable markets, set the stage for a sustainable and robust recovery of the economy from 2014 onwards. The economy's takeoff will be also assisted by the restart of works in Greece's major infrastructure projects and by fast improving liquidity conditions.

- The rapid implementation of the bank recapitalization program has made possible the inflow of much needed foreign capital in substantial amounts. International investors have banked in the much anticipated Greece's recovery, already pushing up prices in the Athens Stock Exchange. These developments have further contributed to improving investor's sentiment on Greece.

Table 1. Basic Conjunctural Indicators (average annual % change)

	2009	2010	2011	2012	2013	2013
						available period
Retail sales volume (except automotive fuel)	-9.3	-6.9	-8.7	-11.8	-11.1	Jan-Jul
Automobile sales	-17.4	-37.2	-29.8	-22.9	-2.4	Jan-Sep
Tax on mobile telephony	13.2	37.1	-16.8	-8.4	1.9	Jul
VAT revenue	-9.1	4.8	-2.8	-4.1	-9.5	Jan-Aug
Consumption tax on fuels	18.6	30.3	-18.3	-4.1	-7.2	Jan-Aug
Private Consumption	-1.6	-6.3	-7.7	-9.1	-6.3	Q2
Government Consumption	4.9	-8.7	-5.2	-4.2	-6.1	Q2
Private building activity (volume, according to permits)	-26.5	-23.7	-37.7	-30.6	-37.8	Jan-Jun
Concrete production	-21.4	-14.3	-37.8	-12.8	2.9	Jan-Jul
Public investment expenditure	-0.4	-11.3	-21.8	-7.5	-2.7	Jan-Aug
Fixed investment	-11.1	-15.0	-20.7	-17.7	-11.0	Q2
Change in Stocks and Stat. Dis.	-142.9	-26.1	-101.7	-237.6	-898	Q2
Unemployment	9.5	12.5	17.7	24.4	27.9	Jun
Manufacturing production	-11.2	-5.1	-8.5	-3.9	-0.2	Jan-Jul
Economic sentiment indicator	82.0	82.0	80.6	80.0	90.1	Jan-Sep
-Industry	72.1	75.8	76.9	77.2	88.6	Jan-Sep
-Consumer confidence	-45.7	-63.4	-74.1	-74.8	-70.7	Jan-Sep
PMI (manufacturing)	45.3	43.8	43.6	41.4	47.5	Sep
Exports of goods - excluding oil (El.Stat.)	-15.9	9.3	10.4	5.1	-2.6	Jan-Jul
Exports of goods (El.Stat.)	-18.2	11.6	37.0	…	6.2	Jan-Jul
Imports of goods - excluding oil (El.Stat.)	-20.2	-10.7	-12.4	-6.0	-6.0	Jan-Jul
Imports of goods (El.Stat.)	-24.1	-1.9	-6.9	…	-4.9	Jan-Jul
Tourist arrivals (airports)	-7.4	-0.7	8.7	-3.3	10.2	Jan-Sep
Tourism receipts (BoP)	-10.6	-7.6	9.5	-4.6	15.5	Jan-Jul
Exports goods & services	-19.4	5.2	0.3	-2.4	0.9	Q2
Imports goods & services	-20.2	-6.2	-7.3	-13.7	-11.8	Q2
GDP growth	-3.2	-4.9	-7.1	-6.4	-3.8	Q2
Inflation (CPI)	1.2	4.7	3.3	0.1	-0.4	Aug
Current Account (% of GDP)	-10.3	-9.2	-8.6	-1.7	0.6	Jan-Jul

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

Greece on a recovery trend

Greece's remarkable adjustment in the last 3.5 years has taken a new dimension in the first 10-months of 2013. The rebalancing of the economy has accelerated mainly through productivity-enhancing and employment-increasing structural reforms (especially in the labour and product markets), which have significantly boosted Greece's international competitiveness and net exports of goods and domestic services growth.

This has set the stage for a recovery in 2014 and robust growth of GDP from 2015. Key drivers will be:

a) Greece's valuable comparative advantages in tourism (including its position as a place of permanent retirement residence for old people), as well as in agriculture and in agriculture related manufacturing sectors, in industry (including energy and construction), and other important services sectors (including health and education).

b) The spectacular improvement in the international competitiveness of the country, both for exports and import substitution and as a place of establishment of internationally tradable industries, which is going to continue in the near and foreseeable future through the maturing of already implemented, or in the process of implementation, structural reforms.

c) The further improvement of the economic sentiment in the country, from its already encouraging level in September – October 2013, and especially the expected further gradual improvement of the still excessively depressed consumer sentiment. These developments will most certainly take place, as talks about Grexit are bound to be conclusively terminated in the following months as the stabilization and the recovery of the economy become more obvious and widely accepted. Therefore, the falling trend of private consumption is expected to decelerate fast to -2.0% in 2014 and +1.5% in 2015, from -6.2% in 2013 and -9.1% in 2012.

d) The further gradual improvement of liquidity in the economy with the continuation of the returning trend of deposits, as the economic sentiment is improving and the catastrophic side effects of the Cyprus debacle (which were evident especially in the evolution of deposits in the Greek banks in March-September 2013), will start been abated. Improving liquidity will help the rate of credit expansion in the country to return to positive territory, facilitating the recovery and growth of the economy.

e) The revival of investment in infrastructure and other state controlled investment and investment implied by the acceleration of the implementation of the privatization program in 2013 and the following years. More specifically, the Greek government has secured the agreement of the EU authorities to redirect structural funds financing towards the restart of works on the country's four (4) main highways, where construction work had stopped for almost three years. This will involve the transfer of funds from other dormant investment programs set to be co-financed by EU structural funds. Pending on the final approval of this new allocation of funds and of the new high way projects by the relevant EU bureaucracy, the Greek government and the re-established contractors in each of the four projects will have to coordinate their efforts so as to complete the projects by the end of 2015. For now there are assurances that the EU approval process will have finished before the end of 2013. Restarting in earnest work in these projects will imply the recovery of production and investment activity in construction sector and various other sectors of the Greek economy and it will give a substantial boost to total fixed investment and employment.

f) The improvement in the international competitiveness of the country is combined with ample supply of high quality and highly educated human capital, which is now eager to participate in domestic production and fill the increasing demand for internationally competitive labour inputs. Ageing constraints will not apply to Greece, at least until the end of 2020s, due to the availability of unemployed labour in large numbers.

These powerful growth drivers will contribute to the continuation of the already remarkable net export led recovery and growth, in addition with the attraction, from 2014 onwards, of fast increasing Foreign Direct Investment (FDI), both in the real estate sector and the privatization sectors as well as to other businesses sectors. Greece is now set to enter a most appropriate internationally competitive growth path, through the boost of investment financed mainly from domestic and foreign (FDI and business) capital and with primary general government and current account surpluses. Development and income generation through the over expansion of domestic demand with the use continuously increasing borrowing from abroad was never an appropriate or viable course for Greece.

Through the above valuable growth drivers the Greek economy is set for a mild recovery in 2014 and for the entry on a robust growth path from 2015 onwards. Over the longer term, Greece's GDP growth will be boosted by the following factors:

i) By the existing potential for high rates of growth of employment in the whole period 2015-2030. This increase in employment will come out from Greece's current surplus labour force position expected to be present even in the 2020s. This available and competitive labour supply will consist at the end of 2014 of more than 500.000 very young people - between 15 and 29 years old and of more than 950.000 people - between 15 and 44 years old. These people are unemployed and looking actively for a job. In fact, employment on a national accounts basis is now expected to fall again by -4.2% in 2013 and then to register an increase by 0.5% in 2014 and an average yearly growth of 1.73% in the period 2015-2020. With average real GDP growth reaching 3.4% in the same period, such a development would lead to a fall of unemployment to 21.9% of the labour force in 2020, from 27.3% in 2013 and 24.1% in 2016. Moreover, with an expected average growth of employment of 1.2% in the 10-year period 2021-2030, unemployment would fall to 12.1% of the labour force in 2030.

ii) By the existing potential for high rate of growth of productivity due to the restructuring of the economy towards the internationally traded goods sectors and the extensive drastic structural reforms allowing the Greek

businesses and the public sector to absorb surplus labour and to better manage human resources. In fact, in the business environment that is expected to prevail in the medium term in Greece, labour productivity is expected to grow by an average annual rate of 1.7% in the period 2015-2030. In fact, ***these trends in productivity growth will also be based on the existing strong possibility for the attraction of substantial FDI*** in sectors in which Greece possesses valuable and dynamic comparative advantages (tourism–including medical tourism, vacation housing, energy and especially renewables and natural gas, very high quality agricultural products, manufacturing - especially related to the processing of agricultural products, to natural resources and pharmaceuticals, other service industries, international shipping, etc.).

With these projections for GDP growth in 2013-2014 and with healthy annual GDP growth of the order of 3.4% from 2015 onwards, Greek GG debt is projected to fall below the 110% of GDP in 2020, even without any additional debt relief measures from the part of Greece's official lenders. These projections for a more favourable GDP recovery and fiscal adjustment trends in 2013-2014 and also in 2015 - 2020, which lead unambiguously to Greek GG debt sustainability, are based on the better than projected fiscal adjustment and developments in the Greek economy, especially in the first 10-months of 2013, as analyzed in the following chapters of this Report. We turn now to a more detailed analysis of Greece's debt burden and of the reasons why this debt must be considered as easily manageable and almost neutral concerning its effect on Greece's economic growth.

Greece's debt burden is now manageable

The Greek GG debt has been substantially reduced through the following operations: ***First, through the successful completion of PSI plus project in March-April 2012, which has*** implied a nominal net deduction of the Greek GG debt of the order of € 54.9 bn, or by 28.4% of 2012 GDP. Moreover, the new GGBs issued in the PSI, amounting to about € 61.3 bn had a term of 30 years (final maturity is in 2042) and an amortisation period starting on the 11th anniversary of the issue date. These new GGBs bear a coupon of 2.0% from February 2012 to February 2015, 3.0% from March 2015 to 2020, 3.65% in 2021 and 4.3% in the period 2022-2042. ***Secondly, through the buy-back program of new GGBs at the low prices prevailing in December 2012.*** With this program GGBs of face value € 31.8 bn were recovered (including € 14.5 bn from Greek banks) and this operation was estimated (by the IMF) to imply a reduction of the Greek GG debt in 2020 by about 10.0 percentage points of GDP. ***Third, through lowering to 50bps (from 150bps) of the margin over 3-month EURIBOR on the € 53 bn debt*** provided to Greece through the Greek Loan Facility (GLF) and also the elimination of the 10 bps operating fee on EFSF lending. With this, the Greek GG debt in 2020 was lowered by an additional 2.6 pps of GDP. ***Finally, through the decision to remit to Greece profits on GGBs purchased by the ECB under the securities market program (SMP) and also to rollover GGBs held by Eurozone National Central Banks (NCBs) under the Agreement on Net Financial Assets (ANFA). With these,*** Greece is estimated (by the IMF) to receive an amount of about € 9.3 bn until 2020, which will reduce the Greek GG debt in 2020 by about 4.6 pps of GDP.

The above operations have resulted to a drastically restructured Greek GG Debt, which ***in nominal values*** fell to 156.9% of GDP in 2012, from 170.3% in 2011. However, it is estimated by the IMF that the GG debt/GDP ratio will increase again to 175.7% in 2013. This increase will be mainly due: a) to the inflow of the funds to the Hellenic Financial Stability Fund (HFSF) for the completion of the recapitalization of Greek banks in H1 2013, b) to financial assistance tranches in order to pay the Greek state's overdue liabilities to the private sector (amounting to about € 9.0 bn) and c) to the assumed fall of nominal GDP by -5.3%.

This, still abnormally high, headline figure of the Greek debt, has been used by analysts in order to continue to make pronouncements and judgments about the "un-sustainability of this debt", the perceived "inability of Greece to service it, or even its inability to repay it", the pressing need for a new "haircut", or "restructuring", etc. Most analysts assume that the March 2012 PSI, the December 2012 buyback operation, the substantial reduction of interest payments for servicing this debt, the return to Greece of the profits of ECB from their holding of GGBs and, more importantly, the unprecedented fiscal adjustment achieved by Greece in the last four years have done nothing to reduce the debt/GDP ratio, which still stands at the formidable level of 175% of Greece's drastically reduced GDP in 2013.

Table 2. The GG Debt burden for Greece

Total amount of GG debt (bn €)	**305,0**
Average Maturity 2013-2047 (years)	17,2
GG Debt maturing in 2014 (bn €)	24,1
GG Debt maturing in 2015 (bn €)	16,1
GG Debt maturing in 2016-2024 (bn €)	61,9
Average yearly GG Debt maturing in 2016-2024 (bn €)	6,9
GG Debt maturing after 2025 (bn €)	202,9
Average yearly GG Debt maturing in 2025-2047 (bn €)	8,78
GG Debt maturing after 2030 (bn €)	165,4
Average annual amortization payments (bn €)	8,7
Average annual interest payments (bn €)	9,0
Average yearly payments for servising the debt (bn €)	17,7
Average nominal GDP 2013-2047 (bn €)	317,0
Average annual servising cost/GDP (%)	**5,6%**

However, the above over-simplifications concerning the new Greek debt burden appear to misrepresent or misinterpret in a rather extreme manner the real characteristics of this debt, which are clearly shown in Table 2 above. More specifically, the above presentations and their conclusions fail to point out and take into account the very important characteristics of Greece's new GG debt position, as follows:

First, that the New Greek GG debt is an already widely restructured debt with an abnormally very long average maturity exceeding 17.2 years and with a very low average annual interest rate burden, which in the period 2013-2022 does not exceed 2.6% of GDP and with an average annual servicing cost (of amortization plus

interest payments) not exceeding 5.6% in the following 35 years. In fact, as shown in Table 2, from the total Greek GG debt of € 305 bn, an amount equal to € 203 bn matures in the period 2025-2057 and an amount equal to € 165.4 matures in the period 2030-2057. Moreover, most of the (already substantially reduced) interest payments, which are still recorded on an accrual basis in the Greek budget, will actually start being paid from 2023 onwards, following the 2013-2022 grace period awarded by the Eurogroup November 26, 2012 decisions.

Second, the above analysis indicates that, ***the only debt servicing requirement which could be considered to be excessively burdensome compared with Greek GDP is that for the following years 2014 and 2015.*** Moreover, this is so if it is also assumed that market access for Greece in these two years will not still be possible. As shown in Table 3, an abnormally high amount of debt maturities were left in 2014 (€ 24.9 bn) and in 2015 (€ 16.1 bn), following the Eurogroup decisions of November 26, 2012. In particular, in 2014 these maturities concern debt towards European Central Banks (€ 17.7 bn) and the IMF (€ 7.4 bn). These abnormally high maturities in 2014 imply that even after the financing which still remains from the Eurozone (€ 10,4 bn) and from the IMF (€ 8,9 bn), the remaining GG Debt servicing cost for Greece is still relatively high, of the order of € 14.3 bn or 7.8% of GDP (Table 3). This GG Debt servicing requirement in 2014 will be covered by: (i) the GG primary Surplus of 2013 (€ 0.5 bn), ii) the GG Primary Surplus of 2014 (€ 2.8 bn), (iii) the privatization receipts, which are expected now to reach € 4.0 bn in 2014 and (iv) by the return to Greece of the profits of National Central Banks (NCBs) from GGBs purchased by the ECB under the SMP program (€ 2.5 bn). Moreover, the cost of the recapitalization of Greek banks in 2012 and in 2013 did not exceed the € 41 bn, while the IMF had projected it to reach € 48.2 bn. In part, this was due to the net private capital inflows during the recapitalization of banks, which reached € 3.5 bn. All these sources of financing add up to € 13.2 bn, which is short of about € 1.0 billion from the amount needed for the full servicing of Greece's debt in 2014. This gap may be financed by the issue of additional treasury bills. The IMF does not recognize the above savings from the recapitalization of the banks and therefore estimates a financing gap for 2014 of the order of € 4.4 bn.

In a similar way, the IMF has calculated the corresponding financing gap for 2015 of € 6.6 bn. However, taking into account higher revenues from the privatization program and the expected exercise of a part of warrants in order to buy bank shares from HFSF, this gap may be reduced to € 3.2 bn and can be easily financed through new GGBs issuance. For the period 2016-2025 annual servicing payments (amortization plus interest payments) of the Greek GG debt do not exceed on average the 7.5% of GDP, while Greece's gross financing needs (assuming an average primary surplus of 3.5% of GDP and annual privatization revenues of 1.2% of GDP) will not exceed the 3.0% of GDP (Table 4).

Table 3. Greek GG Debt servicing cost and its financing in 2014 and 2015

	2014	2015
GG Debt maturing (bn €)	24,9	16,1
Interest payments (bn €)	8,7	9,8
Total Servicing cost (bn €)	33,6	25,9
Eurozone and IMF financing (bn €)	19,3	11,0
To be financed by Greece (bn €)	14,3	14,9
Remaining Greece's GG Debt servicing Cost, % of GDP	***7,8%***	***7,8%***
Means of financing		
GG Primary Surplus 2013	**0,5**	
GG Primary Surplus	***2,8***	***5,7***
Privatization revenues	***4,0***	***2,5***
ECB related Incom (SMP and ANFA)	***2,5***	***2,0***
Net Private capital inflows in Banks	***3,5***	***1,5***
Treasury bills	***1,0***	***0,0***
New GGBs issuance		***3,2***
Total financing	***14,3***	***14,9***
Funding Gap (Alpha Bank estimates)	***0,0***	***0,0***
IMF Estimates (IMF Est., July 2013)	***4,4***	***6,5***
Sorce: IMF (June 2013) and Minsistry of Finance		

Therefore, assuming that the small financial gap in 2014 and (probably) in 2015 will be properly covered, it is evident from Table 4 that Greece does not face any financing gap on servicing its GG debt in the foreseeable future. As shown in Table 4 and in Diagram 2 bellow, even in 2014 Greece's total gross financing needs are of the order of 13.2% of GDP, which is much less than the financing needs of many other developed countries (Japan, Italy, USA, Spain, Belgium, Portugal, the UK and France), as can be estimated from IMF's October 2013 data on Advanced Economies Gross Financing Needs (Table 5). Moreover, excluding from this figure of gross financing needs the amount of financing provided to Greece by its official borrowers (the IMF and the Eurozone), which is programmed to reach € 19.3 bn in 2014 and € 11.1 bn in 2015, then the remaining gross financing need of Greece even in 2014 does not exceed the 2.6% of GDP and the 2.2% OF GDP in 2015. From then on and for the whole period 2016-2025, the annual gross financing needs of Greece do not exceed on average the 2.0% of GDP, even with a primary surplus not higher than the 3.0% of GDP and considerably low revenues from privatizations (See Table 4).

Table 4. Greece's Gross Financing Needs in the period 2014-2025

	Maturing Debt (Bn €)	Interest pay-ments (Bn €)	Total Servicing cost (TSC) (Bn €)	GG Primary Surplus with profits from SMP GGBs		Privati-zation Revenues	**Gross Financing Needs**		IMF and EC financing	Re-maining financing Need	
				Billion €	% of GDP	Billion €	Billion €	% of GDP	Billion €	Billion €	% of GDP
2014	24,9	8,7	33,6	5,5	3,0%	4,0	24,1	13,2%	19,3	4,8	2,6%
2015	16,1	9,8	25,9	7,7	4,1%	3,0	15,2	8,0%	11,1	4,1	2,2%
2016	7,1	10,5	17,6	10,7	5,4%	3,0	3,9	2,0%	6,6	-2,7	-1,4%
2017	7,5	11,0	18,5	10,0	4,8%	3,0	5,5	2,6%	0	5,5	2,6%
2018	3,9	10,5	14,4	9,0	4,1%	3,0	2,4	1,1%	0	2,4	1,1%
2019	7,9	10,5	18,4	9,6	4,2%	2,5	6,3	2,7%	0	6,3	2,7%
2020	4,1	10,5	14,6	9,0	3,7%	2,0	3,6	1,5%	0	3,6	1,5%
2021	4,2	10,5	14,7	8,5	3,4%	2,0	4,2	1,7%	0	4,2	1,7%
2022	5,9	10,5	16,4	9,5	3,7%	2,0	4,9	1,9%	0	4,9	1,9%
2023	8,2	10,5	18,7	9,5	3,5%	2,0	7,2	2,7%	0	7,2	2,7%
2024	8,6	10,5	19,1	9,7	3,5%	2,0	7,4	2,7%	0	7,4	2,7%
2025	7,3	10,5	17,8	9,5	3,3%	2,0	6,3	2,2%	0	6,3	2,2%

Note: (a) The GG Pripary surplus includs the return of profits of NCBs from GGBs purchased under the SMP program of ECB. b) Financing Needs for Greece in 2014-2015 are before the already commited financial aid from the IMF and the EZ

Source: IMF (October 2012 and June 2013) and EAD Alpha Bank calculations

Third, the Greek GG Debt amounting to € 305 bn in the end of Q1 2013 contains an amount of at least € 25.5 bn, which represents the contribution of the EFSF (through the HFSF) to the recapitalization of the four systemic banks in Greece. Moreover, it contains another € 9.0 bn

which are surplus funds of the HFSF held as a security for the case in which one or more of the systemic banks would need additional capital in the following years. Overall, taking into account the favourable developments in the economy in Jan.- September 2013, we could assume that it is very possible that the main part of the € 25 billion which have been contributed towards the recapitalization of the banks by the HFSF in May 2013, will be sold by the HFSF to the private sector. This will take place through the exercise of the warrants. Therefore, the main part of the € 25.5 bn will be returned to the Greek state until the end of 2016, reducing accordingly the Greek GG debt.

Greece's unprecedented adjustment

In the last four years, Greece has fundamentally improved its development prospects through the achievement of: a) an unprecedented fiscal adjustment, turning a general government (GG) primary deficit of 10.4% of GDP in 2009 to an expected sizable primary surplus of the order of 0.8% of GDP in 2013, b) a striking improvement in competitiveness of its internationally-traded products, measured by an internal devaluation of its unit labour cost based on real effective exchange rate of 17.3% in Q4 2012 in comparison with Q4 2009, which is estimated to reach 21.8% in Q4 2013, creating conditions for dynamic export growth and substantial import substitution and c) significant progress in structural reforms, especially in the labour and product markets, which have facilitated and also secure the sustainability of the gains in fiscal adjustment and international competitiveness for the foreseeable future.

This impressive adjustment of Greece was achieved on the back of extremely adverse economic conditions, policies and depressing projections about the prospects of the Greek economy, which have allowed analysts to predict or contemplate Greece's exit from the Eurozone. Such conditions have also led to negative political and social developments, which were exacerbated in particular from mid-2011 to end-2012 and are still present in 2013 as well.

More specifically, of particular concern today is the risk of potential political instability in Greece, following the unavoidable negative developments arising from the shock-adjustment of incomes and wealth to much lower levels in the last four years and the continuing pressures by the Troika for more and more austerity measures, especially in the period between June 2011 and November 2012. These developments have hurt social cohesion and lowered popular support for the adjustment program. In fact, the extremely negative operating environment in 2011-2012 led to a collapse of confidence and an outflow of deposits that dried up domestic liquidity, exacerbating the negative effect on Greek GDP emanating from the drastic fiscal adjustment and structural reform measures. As a result, GDP fell by -7.1% in 2011, -6.4% in 2012 and by a still high -5.6% in Q1 2013, notwithstanding the substantial positive effect on GDP growth from the rapidly rising net exports (+3.7 percentage points in 2012 and also 1.8 pps in Q1 2013). Moreover, the dramatic fall of economic activity, the fall of employment in the public sector (by about 162.7 thousand people in Q2 2013 compared with Q2 2009) and in the private sector (by 421.4 thousand people in Q2 2013 compared with Q2 2010), due in particular to the almost complete stoppage of both public and private investment and the actual exodus from the markets of a multitude of non competitive businesses, have led to a surge in unemployment to 27.1% of the labour force in Q2 2013 (Q1 2013: 27.4%), with youth unemployment exceeding 60%.

However, economic conditions are improving fast from Q2 2013 onwards on the back of the following developments: a) The substantial improvement of economic sentiment in the country, in comparison with H2 2012, due to the better than expected fiscal adjustment in 2012 and in January – August 2013 and to the firm decision of the Eurogroup on 26 November 2012 for the continuation of unabated financing of Greece's adjustment program. Consumer sentiment is still abnormally low (to -76.6 in August 2013, compared with a Eurozone Average of -15.6) but this is bound to also improve in the last four months of 2013 and most importantly in 2014, following the expected clearing up of the existing doubts concerning the perceived gaps in Greece's financing in 2014. b) Economic sentiment will also be boosted from the notable q/q increase in employment in Q2 2013 and the good prospects that now exist for this increase to continue in Q3 and Q4 2013 as well. The expected continuation of these newly observed favourable trends in the labour market can contribute to a considerable bend of the still high political risk in the country, further improving its recovery prospects. c) Of considerable importance is the fact that the falling trend of Greece's GDP decelerated to -3.8% in Q2 2013, on the back of the admirable recovery of tourism and exports of goods, the deceleration of the falling trend of domestic demand and in particular the acceleration of the falling trend of imports of energy products. This development, which is expected to continue in a more impressive way in Q3 2013, where the fall of GDP is not expected now to exceed -2.5%, will be an additional factor improving economic sentiment and contributing to the better than expected implementation of the budget 2013. Overall, the prospects for a real recovery of the Greek economy from early 2014 are now much better than ever before. On the other hand, with this expected robust recovery of the economy, the political risk, in whatever way this can be conceived, is bound also to abate gradually. We turn now to a more detailed analysis of Greece's inroads in the fields of fiscal adjustment, structural reform and competitiveness improvement, which are going to determine the pace of the recovery of its economy and increase in employment and disposable income.

Drastic fiscal adjustment

Greece has achieved an unprecedented fiscal adjustment over the period 2010 - 2013, as shown in Table 5 below, under extremely adverse economic conditions. Its GG primary balance has reached a better than planned deficit of -1.3% of GDP in 2012, from a deficit of -10.5% of GDP in 2009. Moreover, the implementation of the 2013 budget in January – August 2013 is compatible with a GG primary surplus of the order of 0.7% of GDP for 2013 as a whole. This constitutes a fiscal adjustment of 11.2

percentage points of GDP within 4-years, an outcome that was considered impossible by international analysts in early 2010[1]. Total GG deficit reached -6.3% of GDP in 2012 from its abnormally high level of -15.8% of GDP in 2009. Moreover, this deficit is now estimated to fall to less than -3.5% of GDP in 2013. More importantly, the stage is now set (the measures needed are already in place) for a GG primary surplus of 0.7% of GDP in 2013 and for an even higher surplus of the order of 2.5% of GDP in 2014, 4.0% of GDP in 2015 and 4.5% from 2016 onwards.

In fact, the final outcome of the 2012 budget published by the Hellenic Statistical Authority (ELLSTAT) on 10 April 2013 has indicated an even lower GG primary deficit of € 1.96 bn (1.0% of GDP) in 2012, compared with a planned GG primary deficit of € 2.9 bn (1.5% of GDP). This compares with a GG primary deficit of € 5.57 bn (2.7% of GDP) in 2011, € 11.82 bn (5.3% of GDP) in 2010 and € 24.53 bn (10.6% of GDP) in 2009.

Table 5. Fiscal Adjustment in Greece in 2010-2013

	GG Pripary Expenditure (€ Billion)	GG Revenues (€ Billion)	GG Expentidure on wages and pensions (€ Billion)	GG Primary Balance (% of GDP)	GG Deficit (% of GDP)
2008	105,8	94,9	28,0	-4,8%	-9,8%
2009	113,1	88,6	31,0	-10,6%	-15,8%
2010	101,1	90,2	27,8	-4,9%	-10,8%
2011	93,3	88,4	25,9	-2,4%	-9,6%
2012	87,9	85,5	23,9	-1,3%	-6,3%
2013	80,5	81,8	22,0	0,7%	-3,4%

Source: IMF Country Report No. 13/241, July 2013, Greece. 2013: Estimates EAD Alpha Bank.

It should be noted here, that the GG deficit and the GG primary deficit of 2012 appear in the ELLSTAT and in the Eurostat's (22 April 2013) statistics to be 9.0% and 4.0% of GDP respectively. These figures are 4.0 pps of GDP higher than the corresponding figures presented by the Troika and in Table 5 above. The difference is explained by the inclusion in the Eurostat's figures of an additional expenditure, amounting to € 7.73 bn (4.0% of GDP), which was used in 2012 in the process of restructuring and recapitalization of the domestic financial institutions. This capital was provided by the HFSF to the banks and it was added to the Eurostat's definition of the GG government deficit and the GG primary deficit of 2012. However, this is not included in the Troika's definition of the target Total GG deficit and Primary GG deficit, which also does not include in 2013 Greece's revenues from the return of profits of NCBs from GGBs purchased by the ECB under the SMP program. The € 7.73 bn in 2012 was a part of the € 50 billion financial support provided for the recapitalization of Greek banks by the EFSF to the HFSF, following the loss of capital that Greek banks suffered due to the PSI plus in March 2012. An additional financial support to domestic financial institutions of the order of € 33 bn will also appear in 2013 Eurostat's definition of the Total GG deficit and the primary GG deficit.

Excluding the above one-off financial support, the result for 2012 was GG primary deficit of the order of the -1.0% of GDP (ELSTAT), or -1.3% of GDP (IMF, July 2013). This substantial fiscal adjustment was achieved in 2012 despite the fact that ***the GG revenues underperformed again widely in the previous year. In fact, these revenues*** registered a fall of -3.3% in 2012, despite the application in that year of revenue increasing measures amounting to € 11.0 bn. The substantially higher yoy revenues expected in August – December 2012 did not actually materialize. The implied shortfalls were the most prominent in the following tax categories: (i) It was expected that the increase in revenues from the income tax on Individuals (ITI) would reach € 4.5 bn in H2 2012, given the personal tax assessment in 2012 on incomes earned in 2011, but actually the yoy increase in these revenues from ITI did not exceed € 1.76 bn (+36.4%) in H2 2012. This implies that revenues of about € 2.2 bn failed to materialize in 2012 and were transformed to either overdue tax liabilities or were scheduled to be paid in trances in 2013. (ii) From the equalization of the excise tax on heating oil to the much higher excise tax on diesel, an additional revenue of the order of € 250 million was expected in 2012 and more than € 600 million annually from 2013 onwards. This additional revenue did not materialize in 2012 mainly due to the exceptionally good weather conditions, which led to a substantial fall of sales of heating oil. The same happened to a great extent in H1 2013 as well. In particular heating oil consumption in the period 15 October 2012 to 28 February 2013 was drastically down by -67.3%, compared with the same period of the previous year. Nevertheless, revenues from the excise tax on heating oil reached the € 244 million in the above 5-month period, compared with targeted revenues of more than € 650 million, but also with revenues of only € 141.5 million in the corresponding 5-month period of the previous year. (iii) From the collection of additional revenues from 2012 property taxes of the order of € 1.5 bn in 2012 and an additional € 1.0 bn in 2013. In fact, revenues from property taxes reached € 2.86 bn in 2012, from € 2.1 bn in Jan.-July 2012. The main part of the revenues from the special levy on buildings connected to the electricity grid (EETHDE) of the year 2012 was actually paid in instalments in 2013.

Table 6. Implementation of the B2013 in Jan.-October 2013

	Jan-Oct. 2011	Jan-Oct. 2012	Jan-Oct. 2013	% Δ 10μηνο 2012	% Δ 10μηνο 2013	%Δ B2012	%Δ B2013
Current Budget							
Net Current Revenues	39.271,0	39.133,0	37.436,0	-0,4%	-4,3%	-3,5%	-3,3%
Tax rebates	4.235,0	2.786,0	2.048,0	-34,2%	-26,5%	-40,0%	-8,5%
Current Primary Expentiture	41.573,0	38.424,0	35.835,0	-7,6%	-6,7%	-8,6%	-4,2%
Other Current Expentiture	1.659,0	846,0	1.200,0	-49,0%	41,8%		
Interest Payments	15.226,0	11.119,0	5.548,0	-27,0%	-50,1%	-25,2%	-47,6%
Current Primary Balance	-3.961,0	-137,0	401,0				
Public Investment Budget							
Εσοδα	1.888,0	2.646,0	4.013,0	40,1%	51,7%	4,5%	42,6%
Δαπάνες	3.786,0	3.277,0	3.324,0	-13,4%	1,4%	-7,5%	12,0%
Cen Gov. Primary Balance	**-5.859,0**	**-768,0**	**1.090,0**				
Total Cen Govern. Balance	-21.085,0	-11.887,0	-4.458,0				

Source: Ministry of Finance

Nevertheless, net current revenues in the 2012 budget reached € 48.33 bn, compared to planned revenue of € 47.7 bn. This, however, cannot be taken as a consolation and neither can blur the fact that 2012 net current revenues registered an unwarranted fall of -3.3% from

[1]. Even more impressive is the fact that , as Martin Wolf points out using IMF data (FT, May 7, 2013), between 2009 and 2012 the structural fiscal deficit shifted by 15.4 per cent of potential GDP in Greece, 5.1 per cent in Portugal, 4.4 per cent in Ireland, 3.8 per cent in Spain and 2.8 per cent in Italy. Despite of that, Moody's (18 April 2013) indicates that in order to upgrade Greek GGBs from the current C-rating-with no outlook, "fiscal consolidation …. would need to proceed much faster than is currently expected".

their 2011 level, despite the fact that additional revenue increasing measures undertaken and implemented within 2012 exceeded the € 11.0 bn (5.2% of GDP).

On the other hand, fiscal adjustment in 2012 was mainly due to ***the new substantial fall of the GG primary expenditure*** by -5.8%, following its fall by -7.7% in 2011 and by -10.6% in 2010. This extraordinary falling trend on the GG primary expenditure is the most prominent characteristic of Greece's spectacular fiscal adjustment. It has contributed to the fall of Greece's GDP in 2010-2013 not only through the required fall of excessive government consumption, but mainly through the substantial continuous fall of government investment in a period in which it was most needed in order to regain some control in the accelerating falling trend of economic activity in the country. Finally, it is also of particular importance the fact that even in 2013, following its dramatic fall in the previous years, the GG primary expenditure is again turning out to be the primary contributor to Greece's further fiscal adjustment.

The better than planned implementation of the 2013 budget in Jan-October 2013 points to a GG primary surplus of more than € 1.3 billion, compared with Troika's projections for a deficit of € 0.2 billion and the Budget 2014 projection for a GG primary deficit of € 0,85 billion in 2013. Developments in the Central Government in Jan-Oct.2013 are presented in Table 6 below. An estimated implementation of Budget 2013 is presented in Table 7.

Table 7. Estimated Implementation of the B2013

	Budget 2011	Budget 2012	Budget 2013 as in B2014	%Δ B2013	B2013 EAD Alpha Bank	%Δ B2013
Central Government (CG) Current Budget						
Net Current Revenues	50.091,0	48.173,0	45.424,0	-5,7%	46.000,0	-4,5%
Tax rebates	5.283,0	3.172,0	2.901,0	-8,5%	2.850,0	-10,2%
Current Primary Expentiture	51.548,0	47.529,0	44.831,0	-5,7%	44.500,0	-6,4%
Other Current Expentiture	2.239,0	1.747,0	1.746,0	-0,1%	1.746,0	-0,1%
Interest Payments	16.348,0	12.224,0	6.100,0	-50,1%	6.100,0	-50,1%
Current Primary Balance	-3.696,0	-1.103,0	-1.153,0	4,5%	-246,0	-77,7%
CG Public Investment Budget						
Εσοδα	3.770,0	3.601,0	5.136,0	42,6%	5.136,0	42,6%
Δαπάνες	6.608,0	6.114,0	6.650,0	8,8%	6.650,0	8,8%
CG Balances without revenues from European NCBs under the ANFA & SMP						
CG Primary Balance	**-6.534,0**	**-3.616,0**	**-2.667,0**	**-26,2%**	**-1.760,0**	
Total CG Balance	**-22.882,0**	**-15.840,0**	**-8.767,0**		**-7.860,0**	
CG Balances with revenues from European NCBs under the ANFA & SMP						
CG Primary Balance	**-6.534,0**	**-3.616,0**	**15,0**		**922,0**	
Total CG Balance	**-22.882,0**	**-15.840,0**	**-6.085,0**		**-5.178,0**	
CG Nat. Account Adjustments		**2.611,0**	**-6.714,0**		**-6.714,0**	
Primary Surplus of other GG	1.634,0	1.425,0	8.839,0		**8.839,0**	
General G Balances with revenues from European NCBs under the ANFA & SMP						
Gen. Gov. Surplus	**-21.248,0**	**-11.804,0**	**-3.960,0**		**-3.053,0**	
Gen Gov. Interest Payments		**9.643,0**	**7.878,0**		**7.878,0**	
GG Primary Surplus		**-2.161,0**	**3.918,0**		**4.825,0**	
Revenues from ANFA & SMP		**653,0**	**3.106,0**		**3.106,0**	
Gen. Gov. Primary Balance	***-4.900,0***	***-2.814,0***	***812,0***		***1.719,0***	
Nominal GDP	208.531	193.749	182.911		183.100	
GG Primary Surplus % of GDP	**-2,3%**	**-1,5%**	**0,4%**		**0,9%**	

Source: Peport of the Budget 2014 , IMF July 2013 and EAD Alpha Bank Estimates

The Greek fiscal adjustment is mainly based on the drastic reduction of current primary expenditure by -6.7% in Jan.-October 2013, on top of its fall by -7.6% in Jan-Oct.2012. This is compared with a projected fall of -4.2% in 2013 as a whole, in the Medium Term Fiscal Strategy (MTFS) 2013-2016 as shown in Table 6. This substantial fall of current primary expenditure is mainly due to the additional fiscal adjustment measures which were undertaken by the Greek government in October – Nov. 2012, while there is not any evidence of back loading of these expenditures to the final two months of the year. In fact, in the Budget 2014 current primary expenditure is projected to fall by -5.7%, while our own estimate is that this fall may actually exceed the -6.4% (see Table 7).

Net current revenue registered a fall by -4.3% in Jan.-October 2013, compared with a projected (MTFS 2013-2016) fall of -3.3% in 2013. However, a substantial backload of revenues from income tax on individuals (ITI) and from property taxes and taxes from previous years are still expected to be collected in the final 2-months of the year. On the other hand, in the 2014 Budget Report the government has estimated that tax rebates will indeed reach the € 2.9 bn from € 2.05 bn in Jan.-October 2013. On these grounds in the Budget 2014 is projected that net current revenues will actually register a fall of -5.7% in 2013, compared with a projected fall in the MTFS 2013-2016 of -3.3%. In fact, our awn estimate is now for a fall of these revenues by -4.5%.

With these assumptions concerning current primary expenditure and net current revenues and assuming that all other items of the budget, including interest payments and revenues and expenditure of the PIB will be implemented as in the Budget 2014, we have projected that the primary deficit of the central government budget will be contained to the € 1.76 billion, compared with a planned deficit of € 2.04 billion. With this projection and assuming that National Accounts Adjustments and the budgets of local government organizations, of social securities organizations and of government entities included in the general government will also be implemented as indicated in the Budget 2014 (as also the implementation of the budgets of these organizations in Jan.-September 2013 indicate), then we could estimate an economic policy relevant GG primary surplus reaching easily the € 1.7 billion, or 0.9% of GDP in 2013, as shown in Table 7 above. In fact, in the Budget 2014 the corresponding deficit is estimated to reach € 0.81 bn or 0.4% of GDP in 2013. Also, the Budget 2014 projects a GG primary surplus of € 2.96 bn (1.6% of GDP) in 2014 (Table 7a), which is compatible with the requirements of the MTFS 2013 -2016, as follows.

Regarding the planned fiscal adjustment for the period 2014-2017, Troika's July 2013 projections, presented in Table 8 below, point to a possible fiscal gap of the order of € 3.4 bn in 2015, € 0.7 bn in 2016 and € 0.2 bn in 2017 in order for Greece to be able to achieve the planned primary surplus of 3.0% of GDP in 2015 and 4.5% of GDP in 2016 and 2017. Moreover, recently, in October 2013 they have discovered also a possible fiscal gap, of undisclosed magnitude, even for 2014 contributing again to considerable turbulence and to procrastinations towards the finalization of October 2013 review of progress in the implementation of the adjustment program. In this Report we point out, first than there no way to estimate in an unbiased way a fiscal gap for 2014, where, taking into account the existing developments, rather the opposite is true, that is the primary surplus will be most possibly higher than planned, reaching the 2.0% of GDP, and, second, that the way in which the Troika projects a fiscal gap for 2015-2017 is by assuming a real disaster in GG revenue collection in the country in this period. More specifically:

Table 7a. Estimated Implementation of the B2013						
	Budget 2011	Budget 2012	Budget 2013 as in B2014	%Δ B2013	Budget 2014	%Δ B2014
Central Government (CG) Current Budget						
Net Current Revenues	50.091,0	48.021,0	45.424,0	-5,4%	47.052	3,6%
Tax rebates	5.283,0	3.172,0	2.901,0	-8,5%	2.789	-3,9%
Current Primary Expentiture	51.548,0	47.529,0	44.831,0	-5,7%	41.946	-6,4%
Other Current Expentiture	2.239,0	1.747,0	1.746,0	-0,1%	1.352	-22,6%
Interest Payments	16.348,0	12.224,0	6.100,0	-50,1%	6.150	0,8%
Current Primary Balance	-3.696,0	-1.255,0	-1.153,0	-8,1%	3.754,0	-425,6%
CG Public Investment Budget						
Έσοδα	3.770,0	3.601,0	5.136,0	42,6%	5.002	-2,6%
Δαπάνες	6.608,0	6.114,0	6.650,0	8,8%	6.800	2,3%
CG Balances without revenues from European NCBs under the ANFA & SMP						
CG Primary Balance	**-6.534,0**	**-3.768,0**	**-2.667,0**	**-29,2%**	**1.956,0**	
Total CG Balance	**-22.882,0**	**-15.992,0**	**-8.767,0**		**-4.194,0**	
CG Balances with revenues from European NCBs under the ANFA & SMP						
Revenues from ANFA & SMP		**303**	**2.682**		**2.641**	
CG Primary Balance	**-6.534,0**	**-3.465,0**	**15,0**		**4.597,0**	
Total CG Balance	**-22.882,0**	**-15.689,0**	**-6.085,0**		**-1.553,0**	
General Government						
CG Nat. Account Adjustments		**2.460,0**	**-6.714,0**		**-5.119**	
Primary Surplus of other GG	**1.634,0**	**1.425,0**	**8.839,0**		**2.407**	
General Gov. Balances with revenues from European NCBs under the ANFA & SMP						
Gen. Gov. Balance	**-21.248,0**	**-11.804,0**	**-3.960,0**		**-4.265,0**	
Gen Gov. Interest Payments		**9.643,0**	**7.878,0**		**9.665,0**	
GG Primary Surplus		**-2.161,0**	**3.918,0**		**5.400,0**	
General Gov. Balances without revenues from European NCBs under the ANFA & SMP						
Total revenues from ANFA & SMP		**653,0**	**3.106,0**		**2.443**	
Gen. Bovernment Balance		**-12.457,0**	**-7.878,0**		**-6.708**	
Gen. Gov. Primary Balance	***-4.900,0***	***-2.814,0***	***812,0***		***2.957,0***	
Nominal GDP	208.531	193.749	182.911		183.200	
GG Primary Surplus % of GDP	**-2,3%**	**-1,5%**	**0,4%**		**1,6%**	
Source: Peport of the Budget 2014 , IMF July 2013 and EAD Alpha Bank Estimates						

To start with, we should remember that in order to achieve the 0.0% of GDP GG primary surplus target in 2013 and the 1.5% of GDP GG primary surplus target in 2014 the Greek government was obliged to legislate in advance, from August-November 2012 additional fiscal measures of the order of 7.15% of GDP, of which 5.1% of GDP were expenditure reducing measures and 2.06% of GDP were revenue increasing measures (including a mere 0.34% of GDP in additional revenues from improving tax administration). These measures are already applied from the beginning of 2013, but their full effect on the GG budget will not be registered until 2016 or even until 2018. As it was pointed out above it is now very possible that 2014 will start with a primary surplus of the order of € 1.3 bn from 2013, compared with a planned deficit of € 0.2 bn. Therefore, the needed fiscal adjustment in 2014 has already been reduced by € 1.5 bn. Finally, it is now considered with increased certainty that from 2014 onwards fiscal adjustment in Greece will continue taking place in a growing economy and not in an economy forced to contract at abnormally high rates, as happened in 2012-2013. In fact it is now expected that real annual rate of growth of GDP may exceed the 1.1% in 2014 and 3.0% from 2015 onwards.

In this rapidly improving economic environment for Greece, the Troika (Table 8) assumes that the GG revenues will continue trailing behind nominal GDP growth in the following years, thus falling to 42% of GDP in 2016 and in 2017 from 44.1% of GDP in 2012 and from an estimated 44.5% of GDP in 2013 (Troika: 42.9%).

However, as will be analyzed below, the situation in the Greek economy is substantially different in 2013, as compared with 2011 and 2012. The remarkable success of the Greek banks in implementing the program of their recapitalization and attracting more that € 3.2 bn of private capital was a real game changer. This successful stabilization of the Greek banking system against all odds, was complemented by the equally remarkable determination of the Greek government to implement the budget and the needed structural reforms even better than planned, again under widely adverse circumstances.

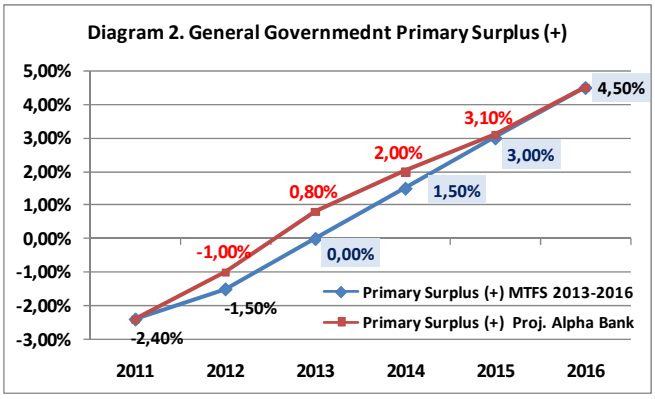
Table 8. Troika's projections for Greece's fiscal adjustment.							
	2011	2012	2013	2014	2015	2016	2017
GG Revenues	88,4	85,5	78,8	80,2	80,6	83,8	87,9
GG Primary Expenditure	93,3	87,9	79,0	77,4	78,3	78,9	82,7
GG Primary Balance	-4,9	-2,4	-0,2	2,8	2,3	4,9	5,2
Nominal GDP	208,5	193,7	183,5	184,0	190,2	199,5	209,1
%Δ GDP	-6,1%	-7,1%	-5,3%	0,3%	3,4%	4,9%	4,8%
Additioal fscal measures (cum)					3,4	4,1	4,3
New GG Primary balance	-4,9	-2,4	-0,2	2,8	5,7	9,0	9,5
% of GDP							
GG Revenues	42,4%	44,1%	42,9%	43,6%	42,4%	42,0%	42,0%
GG Primary Expenditure	44,7%	45,4%	43,1%	42,1%	41,2%	39,5%	39,6%
GG Primary Balance	***-2,3%***	***-1,2%***	***-0,1%***	***1,5%***	***3,0%***	***4,5%***	***4,5%***
Source: IMF Country Report: Greece (July 2013).							
Alpha Bank Projections							
Nominal GDP	***208,5***	***193,7***	***183,5***	***185,2***	***192,6***	***202,0***	***212,1***
GG Revemues	88,4	85,5	81,7	82,4	85,7	89,9	94,2
GG Revenues % of GDP	42,4%	44,1%	44,5%	44,5%	44,5%	44,5%	44,4%
GG Primary Expenditure	93,3	87,9	80,2	78,7	79,7	80,8	84,4
GG Primary Exp. (% of GDP)	44,7%	45,4%	43,7%	42,5%	41,4%	40,0%	39,8%
GG Primary balance (Bn €)	-4,9	-2,4	1,5	3,7	6,0	9,1	9,8
GG Primary balance (% of GDP)	***-2,3%***	***-1,2%***	***0,8%***	***2,0%***	***3,1%***	***4,5%***	***4,6%***

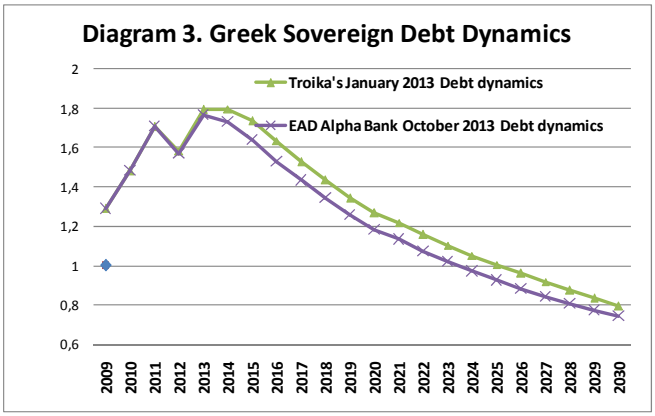
These unprecedented breakthroughs have created the conditions which lead to the substantial improvement of the economic climate in the country and are enabling Greece to succeed a fast deceleration of the falling trend of GDP in 2013 (to a fall of less than -3.7%) and an early recovery of the economy, on yoy basis, from Q1 2014, with expected overall real GDP growth in 2014 exceeding the 1.1%. Moreover, these same developments will enable Greece to return to an expected GDP growth path from 2015 onwards exceeding 3.5% annually.

These favourable developments cannot now be shaken by adverse projections for the economy by Troika or the Rating Agencies (which have already upgraded Greece), or by Grexit expectations, as happened in 2011 and in 2012. On these grounds, contrary to the Troika's assumption, GG revenues may increase faster in 2014-2017, maintaining their level to 44.4% of GDP, as in 2012, both because of the expected positive GDP growth from 2014 onwards and also due to the measures applied for combating tax fraud and arresting tax evasion, which will start eventually paying off, securing additional revenues in the following years. Therefore, the lower (by about € 1.0 billion) deficit in 2012 and the additional fiscal adjustment measures legislated in November 2012 and applied from 2013 are already leading to a positive GG primary surplus of more than 0.8% of GDP in 2013 and are expected to lead to a higher than planned surplus of 2.0% of GDP in 2014. Also, with normal assumptions about revenue collections, the GG primary surplus is expected to exceed 3.1% of GDP in 2015 and 4.5% of GDP from 2016 onwards. With these developments in the economy and tax collection administration there is not need for any additional fiscal adjustment measures in 2015-2017, except of the implementation of the already legislated measures to adequately and justly collect tax and social security contributions revenues, to secure additional savings through the better management of GG primary expenditure, and to implement the privatization program in the much improved now economic environment.

Overall, Greece is now well positioned for the successful completion of its fiscal adjustment program in 2013-2016, with GG primary surpluses of about 4.5% of GDP and GG deficits below 2.0% of GDP from 2016 onwards. With these developments in the fiscal front and a healthy recovery of the economy and with eventual nominal GDP growth averaging 3.9% annually in 2014-2020, ***the GG debt*** may still be reduced to levels even below 116% of GDP in 2020, even without any additional debt relief measures from Greece's Eurozone partners.

The expected more favourable GDP recovery and fiscal adjustment trends in 2013-2014, which lead unambiguously to Greek GG debt sustainability, are mainly based on the developments in the Greek economy analyzed in the previous and in the following chapters of this Report. On these grounds, Greece is now well positioned to achieve the following in 2015-2016:





a) A GG primary surplus of more than 3.0% and 4.5% of GDP in 2015 and 2016 respectively, as shown in Diagram 2. This will be based on the projection that GG revenues will be maintained at the level of 44.5% of GDP in 2016 onwards, compared with Troika's depressing assumptions for their fall to 42% of GDP in 2015-2016. This will be achieved through the gradual reduction of tax evasion, while there is also great potential to secure sizable additional revenues from the implementation of the privatizations program.

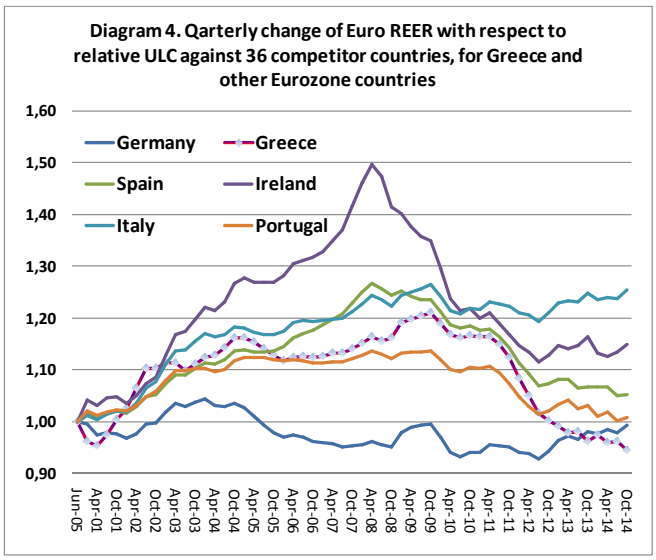
b) A substantial improvement in its international competitiveness, through an internal devaluation of its ULC based REER, which is expected in 2013 to exceed 25% in comparison with 2009 (see Diagram 4) and a consequent surplus in the current account of its balance of payments (Diagram 4).

The above constitute the strong basis which indicates why Greece's GG debt may be considered now, in early 2013, as unambiguously sustainable, reaching at levels below the 115% of GDP in 2020 and bellow the 60% of GDP in 2030 (see Diagram 15), notwithstanding Moody's C-rating. These developments are expected to gradually enable Greece to a timely re-entry to the international money and capital markets, a development which may further increase its growth potential and prospects in the period 2015-2020.

Greece's substantial internal real devaluation within the Eurozone.

Based on data from the European Commission (Price & Cost Competitiveness and European Economic Forecast, September 2013), the relative (against 35 trading partner countries) Unit Labour Cost based real effective exchange rate (REER) of the Euro for Greece had appreciated by 21.2% in Q4 2009, versus 2000 (Diagram 4).

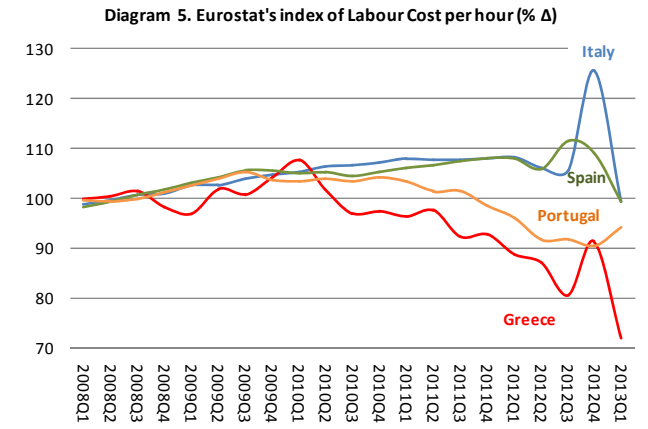
Internal devaluation, implemented through the application of Greece's adjustment program (the fall in wages and structural reforms) reached -17.3% in Q4 2012, compared with Q4 2009 and led to a complete reversal of Greece's REER appreciation from 21.2% in Q4 2009, compared with 2000, to a small appreciation of 0.3% in Q4 2012/2000 and to a substantial depreciation of -3.7% in Q4 2013/2000. This is the result of the additional internal devaluation by -5.7% in 2013, as projected by the European Commission (Autumn 2013).



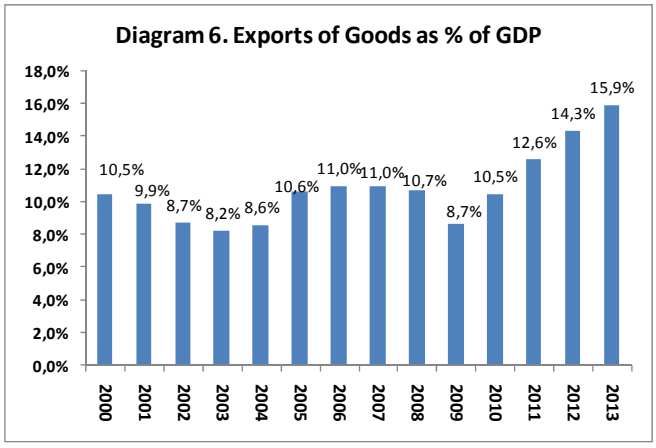
However, in an alternative scenario with lower fall of GDP in 2013 and more pragmatic assumptions concerning the rate of change (fall) of employment and of increase in productivity in 2013 and in 2014, internal devaluation of ***the Euro REER for Greece*** may reach -8.0% in 2013 with an additional fall -6.0% in 2014. In this scenario, the cumulative internal devaluation of ***the Euro REER for Greece will reach -24.5% in Q4 2013/2009 and to -8.0% in Q4 2013/2000.*** In any case, internal devaluation with respect to the relative ULC between Greece and its 35-competitor countries will have reached near -30% in Q4 2014 from Q4 2009 and more than -10% from 2000.

This is a huge adjustment, which could not easily be achieved even if Greece had its own currency and had the ability to apply its own independent monetary and exchange rate policies. Therefore, the main argument of the doomsayers predicting Grexit, that is, the presumed inability to devalue without nominal devaluation of the country's own currency, was simply not valid.

This significant improvement of Greece's international competitiveness in 2010-2013 has taken place in a period in which Greek labour productivity is substantially underestimated by official GDP data, which have been depressed by the surge of economic activity in the unofficial economy in the last 2-years, as well as the destructive impact of a loss in confidence affecting the economy. Therefore, productivity appears to register negative change in 2011 or a very low positive increase in 2012 and 2013, despite the substantial yoy fall in employment in these 2-years.

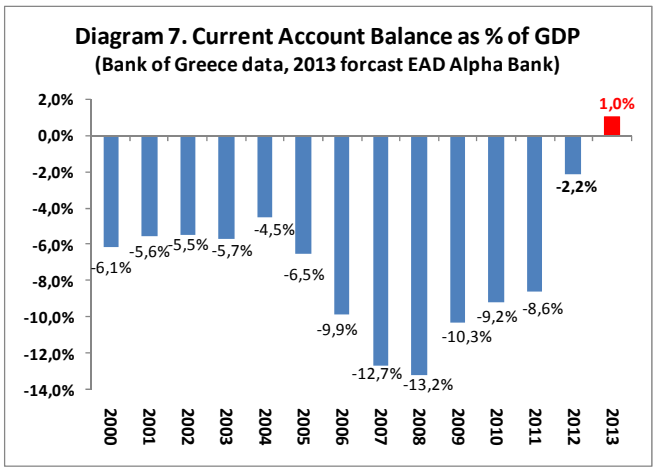


On the other hand, ***the improvement of competitiveness in Greece has already contributed substantially to the impressive increase of exports of goods*** by 16.1% in 2010 and by 12.6% in 2011 and by 5.6% in 2012. In fact e***xports of goods (on national accounts basis) amounted to € 27.76 bn (14.3% of GDP) in 2012,*** compared to € 20.1 bn (8.7% of GDP) in 2009 (See Diagram 6). Also, the sharp fall in imports of goods and services is now partly attributable to a gradual process of import substitution.



Remarkable was also the decrease of the current account deficit of the Greek Balance of Payments, to -2,2% of GDP in 2012, from -8.6% of GDP in 2011 and -10.4% of GDP in 2009. Moreover, the current account has already registered a substantial surplus of € 3.84 bn (2.0% of GDP) in Jan.- September 2013 and is expected to reach a surplus of about 1.0% of GDP in 2013, on the back of better than expected surge of revenues from foreign tourism and improved revenues from international transportation (Diagram 7). The capital account will mostly remain in deficit due to the repayment of Greece's debt, to the extent that these outflows are not compensated by the inflow official financial support capital to the general government by the ESM and the IMF and also from net inflow of FDI and other portfolio and bank capital. This means that Greece's current account may remain in surplus in 2014 as well.

Finally, developments in the external sector of Greece have implied a substantial positive impact of net exports to GDP growth of the order of 3.7 percentage points in 2012, 1.8 pps in Q1 2013 and 3.6 pps in Q2 2013, compared with 2.4 pps in 2011.

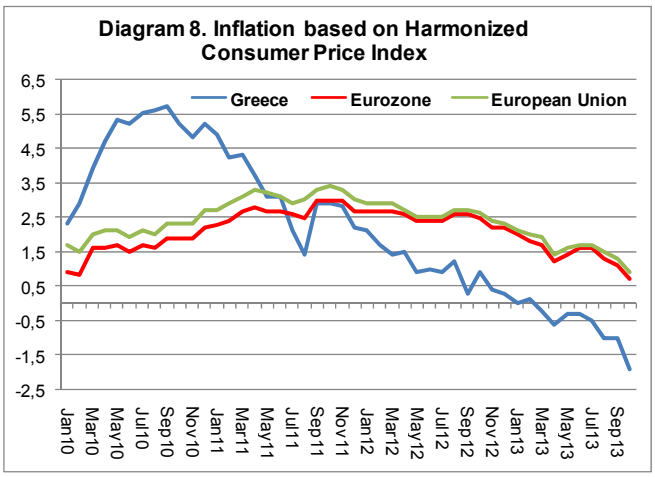


The case of Greece has proved beyond doubt that restoring competitiveness sustainably by way of internal devaluation is possible, even under the most unfavourable economic and political conditions. This is in contrast to IMF's view (IMF Country Report No.12/57, March 2012, page 49) that "despite deep nominal declines in wages and pensions, real effective exchange rate depreciations have been regularly only modest due to only limited pass-through to prices", citing Greece as evidence. This conclusion is reached by using not the ULC based REER but the Consumer Price Index (CPI) based REER for the first 11 quarters of Greece's adjustment. However, the high CPI inflation in Greece in 2010 and in 2011 was mainly due to the fiscal adjustment effort and had nothing to do with "limited pass-through".

In fact, Greek CPI inflation remained high in 2010-2011 due: a) to the 5 pps increase of VAT rates (12 pps increase for restaurant services and other products), which however do not affect exports. b) to the explosive increase of the prices of the services of administered prices of state-controlled entities for the purpose of trimming their deficits and turn them into surpluses, c) to the explosive increases of excise taxes on fuels, electricity, car circulation fees, taxes of local government and a multitude of other surcharges, most of which had indeed a limited pass-through to retail market prices, d) to the substantial upward trend of the international prices of

oil and other commodities and raw materials (most of which are main Greek exports) in 2010 and in 2011, affecting domestic prices in Greece. In fact, inflation of Import price index in industry reached 6.6% in 2010, 7.6% in 2011 and 5.1% in May 2012.

Despite the above excessive price movements, the prices of the main non-traded goods and services in Greece are being reduced to levels substantially lower than in 2009 and this fall has started being recorded in the CPI inflation, implying that harmonized CPI inflation in Greece (-1.9% in October 2013) is now and since July 2012, the lowest than in any other Eurozone country and also the lowest from all EU-28 member states (Diagram 8). In any case, ***Greece's international competitiveness is now improving fast even in terms of the CPI based REER,*** with devaluation of -5.6% in Q4 2012, compared with Q4 2009. Moreover, this devaluation process has accelerated in 2013 and it is expected to be present even in 2014, with cumulative devaluation with respect to the relative CPI expected now to exceed the -10% at the end of 2013 and -15% at the end of 2014.



However, it should be noted that ***CPI based REER is an inappropriate and misleading indicator of competitiveness in very small completely open economies like Greece, which are price takers in the international markets.*** The relevant competitiveness indicator for such countries is the relative price between traded and non-traded products (goods and services) and the most relevant proxy for this price is the ULC based REER. Moreover, the CPI based REER becomes an even more misleading indicator when used in periods in which administered prices in a country are forced upwards through extensive increases in excise tax rates and in the VAT rates in order to reduce fiscal deficits and to clear up existing imbalances in the public and the private sector created mainly by very low (disequilibrium) administered prices in previous periods.

Remarkable progress in structural reforms

Greece has made significant progress in structural reforms, which has contributed greatly to both the remarkable fiscal adjustment effort and to the huge (by any international standards) improvement of its international competitiveness presented above. In fact, Greece's implemented reforms in 2010-2013 have been by far the greatest ever attempted (let alone materialized) by any democratic country in the post war period. Greece has fundamentally overhauled the institutional and organizational structure which makes possible the operation of the economy and society. The Greek economy and society operate smoothly today, following the forced cut of its domestic expenditure for private consumption and fixed investment by more than € 73 bn (or by 40% of its 2013 GDP). This adjustment became possible mainly through drastic, but also to a great extent successful, structural reforms.

Much needed reforms were implemented remarkably fast in Greece and this was the catalyst to achieve the above mentioned breakthroughs in the fields of fiscal adjustment and international competitiveness. Fiscal adjustment would never have happened without the drastic and fundamental reforms of labour relations and levelling the playing field in product markets, of the social security and health systems, of local government organizations and of public entities, etc. On the other hand, the spectacular improvement of the international competitiveness of the country would never have been possible without the drastic market reforms, which indeed were imposed on the Greek government by the Troika itself.

Nevertheless, there has been an apparent failure to contain tax evasion and the refusal by a growing number of taxpayers to meet their tax obligations. As the IMF correctly points out "the rich and self-employed have continued to evade taxes on an astonishing scale", taking into account the bleak performance of the Greek tax collection services in collecting tax revenues and the further bloating of overdue tax and social security contribution liabilities by more than € 11 bn in 2012 and by another € 5.0 bn in January – July 2013. The IMF attributes the apparent failure of the Greek governments in this crucial sector: a) to "the slowness of reforms" in the public sector b) to "susceptibility of revenue administration to political interference", because of "the still insufficient autonomy of this administration" and c) to the negative impact on the payment culture of the repeated extensions of filling deadlines, modifications to differed payments schemes and suggestions of tax amnesties. The IMF seems to allude that had these things been taken care of, then tax evasion would have been significantly curtailed and the payment culture would have been reconstituted. However the substantial cut of public and private sector incomes and expenditure had by itself a depressing effect on tax and social security contributions revenue. On the other hand, the drastic cut of payrolls (both of wages and the number of employees and of specialized personnel) in crucial public administration sectors, and more importantly in the services responsible for the assessment and collection of state revenues, resulted to an additional loss of revenue due to increased tax evasion and led to a further exacerbation of the " won't pay" culture regarding tax and social security contributions liabilities.

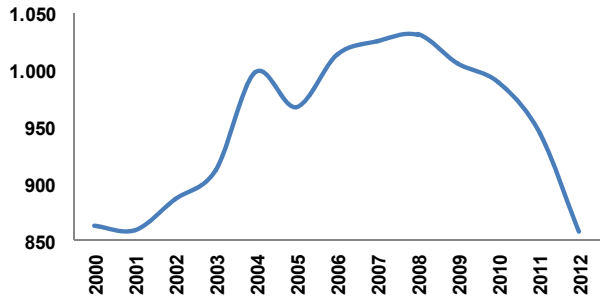
Of course, in the field of public administration, ongoing reforms are much needed in order to facilitate fiscal adjustment and the efficient functioning of the public sector. In particular:

a) Public administration reforms have been implemented at a shockingly fast pace, implying a fundamental overhauling of labour market relations in

the public sector. Moreover, public procurement processes have substantially improved while restructuring and evaluation initiatives are undertaken in the Greek universities as well as in state controlled hospitals and other health care institutions. ***These reforms have made possible*** the drastic decrease of expenditure on wages and pensions and other operational costs in the public sector. Thus, compensation of employees in the general government is estimated (IMF July 2013) to fall to € 21.5 bn (11.7% of GDP) in 2013, from € 24.2 bn (12.5% of GDP) in 2012, from € 31.0 bn (13.4% of GDP) in 2009. An outright reduction of the wage bill in the general government by € 9.5 bn in 4-years is not a minor development in the Greek public sector. Moreover, the Greek government has undertaken to reduce further the GG wage bill to € 21.1 bn (11.1% of GDP) in 2015 and to maintain it fixed at the level of € 21.0 bn in the following years, despite the increase of GDP by more than 3.0% annually from 2015 onwards. These future targets are set to be achieved mainly through the implementation of ***the target for the reduction of the general government employment by at least 150.000 in the period 2010-2015.***

b) The target set for drastically reducing employment in the Greek public sector until 2015 has already been achieved from 2013. Concerning this target, it became relatively quickly evident from 2012 that employment in the wider public sector had already been reduced by 147.5 thousand persons in July 2012 compared with July 2009, registering an 87.8 thousand fall in July 2012 from July 2011. Moreover, the fall of public sector employment in Q2 2013, compared with Q2 2010 has already reached the 146.3 thousand (Diagram 9). This implies that the requirement for the reduction of public sector employment by 150 thousand in the period 2010-2015 will be widely surpassed. In fact, the Ministry of Administrative Reform and Electronic Governance has estimated that, under current trends, the number of employees that are estimated to leave the public sector until the end of 2015 will probably reach 180,000, while 34.000 public sector employees retired only in 2012.

Diagram 9. Number of employees in the wider public sector (in thousands)



Source: ELSTAT, Labour Force Survey.

c) On the back of above developments in cutting wages, employment and administration costs in the public sector, the Troika proceeded to substantially broaden the nature of its requirements for a more fundamental reform of labour relations in the public sector. From March 2012 the Troika has been demanding that the reduction of employment in the public sector should be achieved not merely through natural attrition but also through a significant number of mandatory redundancies and consequent layoffs.

To this end, the Greek government had agreed in March 2012 to transfer 27.000 employees to a new mobility scheme until the end of 2014. Taking into account the 2.000 employees that had been transferred to this scheme until the end-2012 (which was then called labour reserve scheme), in the April 2013 negotiations with the Troika the Greek government has accepted the target that another 25.000 **public sector employees** will be transferred to the mobility scheme until the end of 2013. Moreover, the government also agreed that ***15.000 of these or other employees will be laid off by the end of 2014*** - about 4,000 employees by the end of 2013 and another 11,000 in 2014. In a constructive move, ***the Troika also accepted the demand of the Greek government according to which for each worker that will be laid off as a mandatory redundancy, a new employee may be hired in order to prevent shortages of employment to arise in the public sector.***

The Greek government delayed the final decisions concerning the 4.000 mandatory redundancies and layoffs until the end of 2013. This process has been accelerated in recent months, especially following the decision in June 2013 to close down the state run television and radio broadcaster, the Hellenic Broadcasting Corporation (ERT), laying off 2.6 thousand employees in one major action. Moreover, recently it was announced that 226 public sector employees have been laid off in July 2012 – September 2013 due to violation of the criminal and disciplinary procedures and laws in their line of work. Overall, 2,113 employees are currently under investigation through the disciplinary councils around the country and 960 of them have been suspended from their work pending on the final decision of the disciplinary councils. There is an acceleration of disciplinary council decisions in the last quarters, where 1.015 such decisions have been issued in Jan-September 2013, compared with 500 decisions issued by the end of June 2013. This shows that processes in this sector are moving now fast, at last. What is probably needed is that these processes will continue at an even faster pace in the following quarters and years in order to free public services from redundant and un-cooperative personnel and improve the operation and efficiency in the sector.

d) However, the above requirements for reform in the public sector tend to neglect the most important reforms needed for increasing efficiency in the production and supply of services offered by this sector. More specifically: Notwithstanding the substantial inroads achieved in the field of wage determination and the drastic reduction of personnel in this sector, the real problem is that under the new realities facing the Greek economy and the public sector in particular, peculiarities, such as the immobility of employees and the de facto permanent contractual employment still plaguing the Greek public sector, simply cannot continue to exist and must be appropriately adjusted. For example, mobility of employees between sectors must now be a permanent institution in the Greek public sector for all employees. In this regard, targets set from outside for transferring a particularly small number of employees into a mobility

state may prove counterproductive. All employees in the public sector should be in a potential mobility state should need arise. Moreover, mandatory redundancies and layoffs should also be possible under specific - well determined - circumstances and efficient procedures. However, contrary to these basic principles which should have been applied in prescribing measures aiming to fundamental public sector reform, until now Troika's policy prescriptions appear to have been directed mainly to expenditure and personnel reductions, both in central and local government and in public entities and these demands are presented as self contained goals. This was done without due consideration to the need for efficient management and performance in terms of services offered by these central and local government departments and public sector entities.

e) Most importantly, there was no due consideration to the requirement that these organizations should increase their own revenues as well, instead of only cutting current and investment expenditure. In fact, many central government departments and entities have suffered a substantial loss of valuable specialized personnel in tandem with the redundant low efficiency personnel, which in the case of some critical public sector departments, organizations and entities have caused significant impediments in the implementation of the adjustment program. e.g., substantial loss of GG revenues, or unprecedented deterioration of services offered. The conclusion is that even justified demands for closing down, downsizing and outsourcing services in a multitude of GG operating units should be pursued rationally and should not be forced on an unattainable scale upon the present underpowered management to be implemented as self-contained objectives. It is imperative that from now on the emphasis must turn to the needed effort for the proper - and where possible autonomous managerial and entrepreneurial - functioning of government services entities and organizations and to a boost in their own revenues of these organizations.

Conclusively, Central Government primary expenditure has already registered an estimated € 17 bn fall to € 43.8 bn in 2013, from € 60.67 bn in 2009, with an 8.6% fall in 2012 and a -8.5% fall in 2013. This indicates that the Government has done excessively well in achieving its GG expenditure and personnel cuts in the public sector and there is no ground for the contention of "slowness of reforms" in this sector. ***Efforts to forcibly reduce public sector personnel crudely and summarily now are not going to have any positive fiscal adjustment effect and also do not constitute any rational structural reforms in the public sector.*** Such efforts create only undue turbulence and work stoppages and loss of revenues in crucial services in the public sector. For example, of particular importance is the dramatic fall of own revenues of local government organizations and of the legal entities included in the general government in August 2013, in the wake of the transfer of thousands of employees (e.g., local police) from these organizations into the mobility scheme. Even if it may help to reduce expenditure in these sectors currently or in the near future, it may also destroy any chance to increase net current revenues of the same sectors. This means that the fall of the expenditure side of the budget is usually accompanied with an inability to increase the own revenue side of the budget.

Regarding the privatization program, certain delays ensued by the failure to attract a bidder for the natural gas company (DEPA), at the end of May 2013. This failure has caused a shortfall of 2013 privatization receipts, which are now expected to reach € 1.1 bn, compared with a program target of € 1.67 bn. This shows that if DEPA privatization had been implemented in 2013 as planned then privatization revenues would have exceeded € 2.5 bn in 2013. In fact, the revenues of more than € 1.5 bn from DEPA and DESFA will be received in 2014. Nonetheless, the HRADF has pressed forward with sales of other privatization (including real estate) assets, and has prepared itself for a much better outcome in terms of privatization revenues in Q4 2013 and in 2014. For now the sale of OPAP and of the State Lotteries has been finalized, while the HRADF is also going ahead with the implementation of several smaller corporate transactions and also with several sales of real estate assets. In fact, in August – September 2013, in a completely depressed domestic real estate market, the HRADF has succeeded to conclude the sale of several real estate assets with revenues exceeding € 11.5 million.

Table 9. Share prices of companies under privatization

Share	Share Price (EUR) 3/10/2013	Share Price (EUR) 30/9/2012	% Change
Hellenic Tel. Organ. (HTO)	7,70	2,91	164,6%
Public Power Org.(PPC)	8,49	3,64	133,2%
Hel. Football prognostic (OPAP)	8,85	4,00	121,3%
Water Supply Comp. (EYDAP)	8,51	4,06	109,6%
Thes. Port Athority (OLTH)	24,21	14,20	70,5%
Thes.Water Supply (EYAPS)	6,21	3,95	57,2%
Pireaus Port Athority (PPA)	18,60	11,99	55,1%
Hellenic Petroleum (ELPE)	8,05	6,50	23,8%
ASE	1033,25	739,1	39,8%
FTSE-20	346,90	267,9	29,5%

Source: Bloomberg

In June 2013 it was officially announced that the consortium operating the Shah Deniz II natural gas reserve in Azerbaijan ***had chosen the Trans Adriatic Pipeline (TAP), that will run across northern Greece, in order to transport Azeri gas to Central Europe.*** This has formally laid the groundwork for the creation of the South Stream project that the European Union has been discussing for over 10 years. ***The significance of this substantial project for Greece is multiple and far outweighs any loss that may have been suffered due to the small delay of the privatization of DEPA.*** While DEPA remains an asset of great value in the ownership of the Greek state, the pipeline will bring foreign direct investment (FDI) to Greece of some 1.5 billion in the following years and will also set Greece firmly on the map of gas pipelines and energy supply across Europe. In fact, the significance of this development was even greater due to the time in which it was announced. It represented a significant vote of confidence in Greece and its prospects.

Even in this uncertain and to a great extent negative economic environment, the Hellenic Republic Assets Development Fund (HRADF) has completed, in January-November 2013 substantial privatization projects and have proceeded with the preparatory actions for many other projects, which are going to be implemented in Q4 2013 and in 2014.More specifically:

a) The re-launching of DEPA transaction will take place in Q3 2014 aiming at a quick conclusion of its sale, and this will be followed by lunching of the Hellenic Petroleum company (HELPE).
b) To compensate for some of the delays in January – September 2013, the HRADF is intending to increase the stakes to be sold in the ports (OLTH and PPA) and to accelerate their tenders.
c) The HRADF will continue to take actions to prepare assets for sale, including putting all regulatory frameworks in place, taking all necessary steps to complete the clearance for state aid.
d) The transfer of the quarterly batches of 250 real estate assets (ready to be privatized) to the HRADF will be implemented sooner. In fact, the Joint Ministerial Decision has been issued to shift the 2nd parcel of 250 real estate assets to the HRADF.
e) To minimize further delays in privatization and liquidation of entities that cannot be privatized, the HRADF has taken steps as a **prior action and has** announced formally a restructuring or resolution of ELVO, HDS, and LARCO, with a view to completion by December-2013.
f) Moreover, HRADF is going to proceed early with: (i) the issue of the five year pricing policy (for the period 2014-18) for EYATH (water tariffs); and (ii) adopt legislative acts permitting the payment of arrears owed to EYDAP and EYATH directly from the arrears clearance program. Then the Expression-of-Interest for EYDAP privatization will be issued in Q4 2013. In addition, and subsequent to meeting the prior action the HRADF has validated the amount of payment arrears to the two water companies from the end-Aug.2013, and has cleared these arrears from the end of Sept.2013,

Overall, with economic climate improving, the implementation of the privatization program is gaining traction, contributing to the timely recovery of the Greek economy from Q1 2014. The IMF assumes privatization revenues of the order of € 3.5 bn 2014 which may easily be surpassed, as the revenues from DEPA and DESFA are transferred in 2014, and 2014 will be a year of positive growth and lower cost of money in the economy. For the following years, privatisations and the recovery of the real estate market will be two of the main drivers of growth for the Greek economy.

In addition to the above, fundamental ***reforms have been implemented in many sectors, especially in the field of opening up formerly closed professions and more importantly in the health care sector. These reforms are still in the process of consolidation and institutionalization, with their results on the efficiency of operation and growth of the economy expected to be felt gradually in the following years. Nevertheless, substantial progress has been achieved in drastically reforming the following sectors of the economy:***

In the labour market, the reform program has overhauled labour relations in the private sector, as well as in major state controlled businesses. This program has already been completed and is in the process of its institutionalization – its acceptance and application by all concerned parties. The new legal and institutional settings of the labour market already contribute to a more efficient functioning of this market (both in the private and in most public sector entities), a fact that is also reflected in the surge of unemployment and increasing labour strife. However, this reform also contributes to the rapid improvement of Greece's international competitiveness, both through the drastic reduction of statutory minimum salaries and wages and the abolition of rigidities in the wage setting process, and also through the established full flexibility of management of human capital in domestic businesses, leading to increases in labour productivity. Finally, the substantial cut in severance payments is an important step towards reducing nonwage costs, which are still relatively high in Greece. From the reports of the IMF and the European Commission, it is easy to conclude that labour market reforms in Greece were drastic and far reaching, both in 2011 and in 2012.

The drastic fall of wages and salaries in the public and the private sectors and of the ULC in the economy as a whole, are the real evidence of the magnitude and importance of the labour market and product markets reforms in Greece. ***These reforms imply that the falling trend of ULC in Greece is bound to continue in the following years as well, mainly through increases in labour productivity at a relatively high rate (2012: +2.1%),*** in an environment of stable, after 2014, wages and salaries and of plentiful supply of low cost labour (960.000 unemployed personnel is less than 44 years old and about 410.000 of them is less than 29 years old).

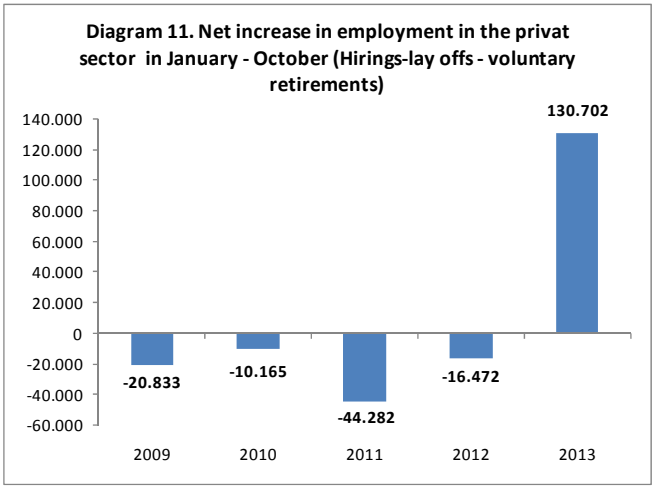
In fact, the establishment of full flexibility in the Greek labour market has already led to a substantial yoy increase in the number of monthly hirings of new personnel by domestic businesses in the last 15-months, from July 2012 to September 2013.

Thus, the number of new hirings in the 10months Jan.-Oct.2013 reached 941.3 thousand, compared with 731.8 thousand in the corresponding period of 2012 (see Diagrams 10). Most of these hirings use flexible labour contracts and offers low wages and salaries. Hiring and firing has become substantially easier and less costly in Greece contributing to the fundamental improvement of the functioning of the reformed Greek labour market in resent months. Also, in Jan.-October 2013 an increase of employment in the private sector of 130.7 thousand was registered, compared with a negative net change in employment in the same period of the previous years (Diagram 11).

Sixth, there is the drastic reform of the social security system and the reform of the health sector. The social security reform effort had been initially mainly directed

towards the rationalization and equilibration of Greece's long term fiscal finances. These reforms have secured that social security expenditure will not increase (due to population ageing) from its 2008 level by more than 2.5 pps of GDP by 2060, compared with a projected increase by 12.5 pps of GDP before the reforms.

However, in 2011 and in 2012 the Government was obliged to apply new drastic cuts on pensions and other social benefits on the back of an impossible task that it was facing in its effort to reduce drastically pension expenditure under a rush to early retirements both in the public and the private sector.



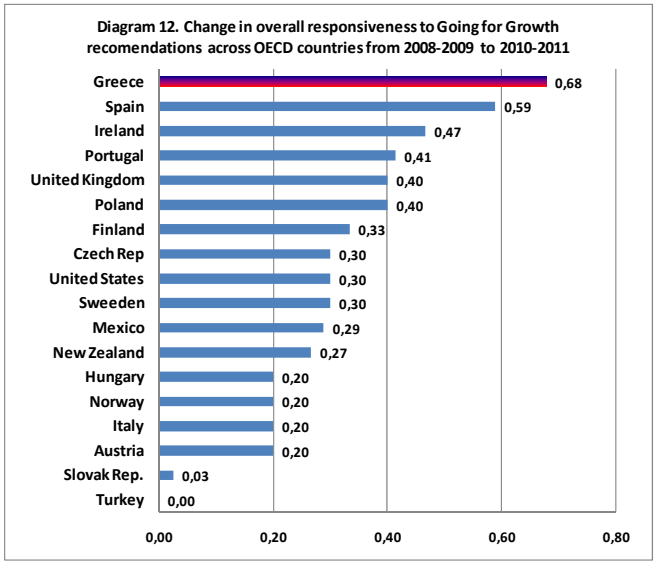
On the other hand, current budget contributions to the financing of social security funds remain high, reaching € 14.47 bn in 2012, from € 15.15 bn in 2011 and from € 10.12 bn in 2010, as revenues from social security contributions fell substantially (-7.3% in 2012), due to increased evasion and unemployment and the substantial fall of wages and salaries in the private sector. Thus, mainly due to the drastic fall of current pensions and the substantial health sector expenditure savings achieved in 2010-2012, GG social transfers have fallen to € 45.1 bn in 2012, from € 46.2 bn in 2011 and € 49.0 bn in 2009. However, this expenditure increased to the level of 23.1% of GDP in 2012 (public health expenditure: 6.0% of GDP), from 20.8% of GDP in 2010. Thus, for 2013-2014 the Government has already specified measures amounting to the realization of further savings in social expenditure to the order of 1.8 pps of GDP, following the cuts set to be legislated in September – November 2012. Therefore expenditure for social benefits is expected to fall to € 39.2 bn (21.3% of GDP) in 2013 and to € 38.7 bn (20.9% of GDP) in 2014. The new measures drastically cutting social benefits have been designed appropriately so that the needed savings may be achieved while at the same time improving social protection programs for those who are most in need.

Moreover, extensive reforms have been implemented, or are in progress, in many other sectors of the Greek economy, which gradually change the whole institutional and organizational structure of the country. These may be summarized as follows:

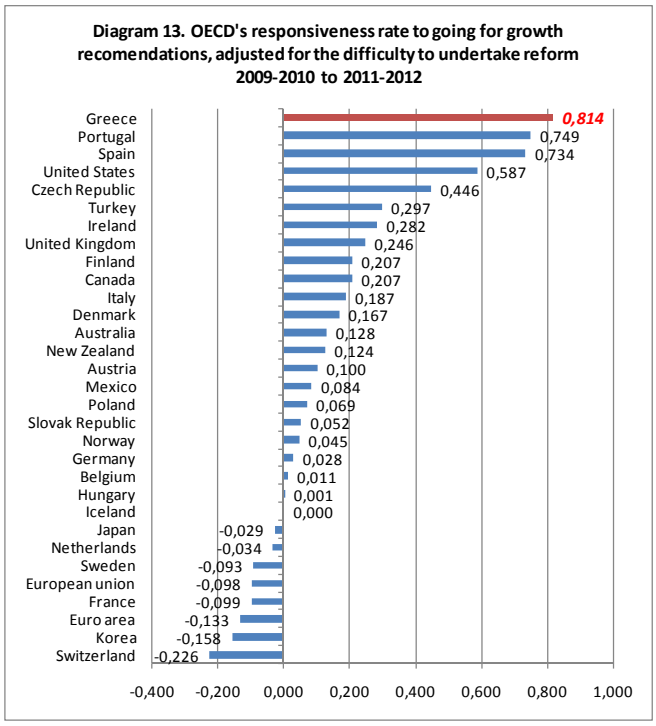
In the field of product market reforms, substantial progress has been achieved in Greece in increasing competition in transport and network industries by reducing barriers to entry in road and maritime cruises, in phasing out regulated tariffs in electricity and gas, in drastically reducing barriers to entry in professional services (the new lawyers code of practice has been legislated in September 2013, further facilitating the full liberalization of lawyers fees), in strengthening the effectiveness of the competition authority and in a multitude of other reforms, especially the process of facilitation of the implementation of the privatization program, in which important sectors as energy, water supply, air and sea transport (airports and sea ports) are being cleared of public sector prerogatives and practices characterizing their operation until now. Important developments are the substantially extended opening hours of pharmacies during the week and the much lower drag prices and the fast increasing entrepreneurial practices of TAXI drivers aspiring to attract more clients.

In the field of growth-enhancing structural reforms, particular reference should be made to the newly legislated Law 4146/2013 for the "***creation of a development-friendly environment for strategic high value investments and private investments in general***" in Greece. The new law contains provisions for improving liquidity of investing businesses in the present crisis environment, through, for example, an acceleration of the investment grants disbursement procedures. Also, the low provides for procedures aiming to enable the immediate closure of pending audits and the disbursement of outstanding instalments. In fact, the Law provides for interim and final audits performed by certified private sector institutions, such as banks and accounting firms. Moreover, to enhance transparency for large investment projects, the budget of projects that need to be ratified by Parliament is reduced to € 50 million, from € 150 million. Finally, the law provides for the establishment of an independent Auditing Department of Private Investments to continuously monitor compliance with the procedures governing the grants of business plans, and to combat both delinquent and unlawful behaviours. The Department, which will report directly to the Minister for Development, Competitiveness, Infrastructure, Transport and Networks, will also have a consulting role, since through its findings any malfunction of procedures will be identified. Overall, the new investment law, in combination with substantially improved economic sentiment in the country may contribute to a gradual revival of private investment.

Overall, there are certainly delays in the reform implementation process, as well as in the process of institutionalizing and obtaining the required results from the reforms in many sectors in Greece. In particular, substantial delays are observed: i) in the implementation of the reforms in the judicial system in Greece, where the main target was the gradual clearance of the huge backlog of tax and non-tax cases, ii) in the field of tax and social insurance administration and collection, iii) in the reorganization of central and local government and state controlled entities and, also, iv) in the implementation of Greece's extensive privatization program.



The OECD has now published its ongoing research (Economic Policy Reforms 2012 and 2013: Going for Growth), in which it estimates the degree of responsiveness of OECD and other countries to its recommendations for undertaking economic growth friendly structural reforms by these countries. OECD' results for the periods 2008-2009 to 2010-2011 and 2009-2010 to 2011-2012 are presented in the Diagrams 10 and 11 above. Greece is the undisputed champion in the field of implemented structural reforms in both periods, despite the fact that the dramatic reforms undertaken by Greece in November 2012 – October 2013 are not obviously included in the calculations of the OECD, as these are presented in the two Diagrams 12 and 13.



Another effort to estimate the magnitude of structural reforms in Europe was undertaken recently by Berenberg Bank and The Lisbon Council, which in their report "Euro Plus Monitor, Spring 2013 Update, present The Adjustment Progress Indicator which "tracks the progress countries are making on the most important short-to medium term adjustment criteria". In fact, this study focuses on three measures of adjustment: 1) the reduction (or increase) in the fiscal deficit, adjusted for interest payments and cyclical factors, 2) the rise (or fall) in exports relative to imports in the external accounts, and 3) changes in unit labour cost. In addition the results of the OECD's 2013 annual assessment of pro-growth structural reforms are also taken into account in this second study. The main results of the study are presented in Table 10 below.

Table 10. Adjustment progress of European Union countries in reducing fiscal and external deficits, in improving international competitiveness and in structural reforms

	Overall adjustment score	Fiscal adjustment	ULC adjustment	External Adjustment	Progress in structural reforms
Greece	**8,2**	**8,7**	**7,4**	**6,6**	**10,0**
Ireland	7,6	4,6	8,5	8,5	8,9
Spain	6,5	4,5	5,8	7,4	8,5
Portugal	6,4	6,2	5,2	6,6	7,8
Esthonia	6,4	2,9	8,2	7,9	…
Slovakia	5,5	4,4	5,8	6,5	…
Poland	4,9	8,3	2,4	4,5	4,3
Italy	4,8	7,2	2,9	4,1	5,0
Malta	4,5	2,6	3,7	7,1	…
United Kingdom	4,4	4,2	3,0	3,9	6,4
Slovenia	4,2	3,7	3,0	5,8	…
EU-17	3,9	4,6	2,6	4,2	4,2
Cyprus	3,8	3,5	2,4	5,5	…
France	2,8	4,4	1,9	3,1	1,9
Netherlands	2,7	2,6	2,8	4,4	0,9
Finland	2,5	0,3	3,5	1,9	4,3
Sweeden	2,5	4,0	1,9	2,9	1,0
Germany	2,3	3,9	1,0	3,7	0,8
Belgium	2,0	2,0	1,8	3,4	1,0
Αυστρία	1,8	1,1	1,8	2,8	1,4

Πηγή: Berenberg Bank, The LisbonCouncil, The Euro Plus Monitor Spring 2013 Update

Greece is among the top 10 economies, out of 185, that improved the most in the Doing Business measures in the 12 months period to May 2012, ranking 78th in the Doing Business 2013 report (see Table 11), from 89th in the previous report. The improvement will be even more impressive in the Doing Business 2014 report, due to the extensive reforms, which were mostly implemented in H2 2012.

Table 11. Ranking countries on the ease of doing business

	Overall Rank	Construction Permits: Cost (% of Income per Capita)	Starting a business (Days)	Protecting Investors (0-10)	Getting credit (rank)	Paying Taxes (total tax rate % of profit)	Enforcing Contracts (Cost % of claim)	Cost to Import (US $ per container)	Cost to export (US $ per container)	Resolving Insolvency: Recovery rate (cents on the $)
Singapure	1	15,7	2,5	9,3	3	27,1	25,8	440	460	89,4
USA	4	16,7	5,0	8,3	3	46,3	18,4	1.315	1.090	81,5
Malaysia	6	14,7	6,0	8,7	1	36,3	27,5	485	450	48,9
Korea, Rep.	7	123,9	5,5	6,0	13	27,9	10,3	695	670	82,3
Un. Kingdom	10	66,0	12,0	8,0	1	34,0	39,9	1.050	1.005	88,6
Finland	12	43,3	14,0	5,7	42	39,8	17,4	1.445	1.335	48,3
Ireland	15	446,3	10,0	8,3	13	25,7	26,9	1.121	1.160	87,5
Thailand	18	8,3	27,5	7,7	73	29,8	15,0	760	595	42,2
Germany	21	46,9	14,5	5,0	28	49,4	14,4	940	905	82,9
Japan	27	28,1	22,0	7,0	28	49,7	32,2	970	890	92,8
Portugal	31	374,9	2,5	6,0	109	42,3	13,0	925	780	71,6
France	38	244,4	6,5	5,3	55	64,7	17,4	1.445	1.335	48,3
Spain	52	172,9	23,0	5,0	55	58,6	18,5	1.350	1.310	72,3
Mexico	53	353,1	6,0	5,7	42	53,7	31,0	1.740	1.450	67,3
Hungary	54	9,2	5,0	4,3	55	49,7	15,0	845	885	38,3
Poland	45	10,6	30,0	6,0	3	41,6	19,0	1.025	1.050	54,8
Bulgaria	58	222,9	18,0	6,0	28	27,7	23,8	1.375	1.375	32,6
Italy	65	186,4	6,0	6,0	109	65,8	23,1	1.145	1.195	62,7
Turkey	69	142,5	6,0	6,3	86	40,2	24,9	1.235	990	22,3
Greece	***72***	***27,1***	***14,0***	***5,3***	***86***	***44,0***	***14,4***	***1.135***	***1.040***	***34,0***
Romania	73	71,2	8,5	6,0	13	42,9	28,9	1.495	1.485	30,0
China	96	344,7	33,0	5,0	73	63,7	11,1	615	620	36,0
Brazil	116	34,8	107,5	5,3	109	68,3	16,5	2.275	2.215	19,5
Indonesia	120	87,2	48,0	6,0	86	32,2	139,4	660	615	139,4
India	134	2640,4	27,0	6,3	28	62,8	39,6	1.250	1.170	39,6

Source: The World Bank and IFC, Doing Business 2013.

Financial sector reforms and prospects: The reform program in financial sector has been implemented according to the book and in time. In the wake of the Cyprus debacle, the four core Greek banks have been fully recapitalized in a much more successful way than the Troika had expected. Moreover, the drastic restructuring of the ATEbank and of the branches of the

Cyprus banks in Greece and their acquisition by Piraeus Bank, the smooth acquisition of Emporiki Bank by Alpha Bank and the acquisition of the Post Savings and Proton Bank by Eurobank and of Geniki Bank and Millennium BCP by the Piraeus Bank, have concluded the restructuring and consolidation of the Greek banking system as a whole with the creation of the four systemic banks, as envisioned by the adjustment program. These systemic banks then proceeded to implement, all simultaneously, their recapitalization in one month, which was indeed finalized, attracting also substantial amounts of capital from abroad, in the middle of June 2013.

The shareholder structure and the capitalization of the four core banks on 4 October 2013 is shown in Table 12 above. Injection of private capital in the four core banks in the process of their recapitalization reached € 3.1 bn, while additional private capital amounting to € 3.9 bn was injected to Emporiki Bank (€ 3.0 bn, Millennium BCP (€ 0.41 bn) and Geniki Bank (€ 0.29 bn) in the process of their acquisition by the core banks and another € 0.2 bn was raised by Attica Bank.

Table 12. The new Greek Banking System

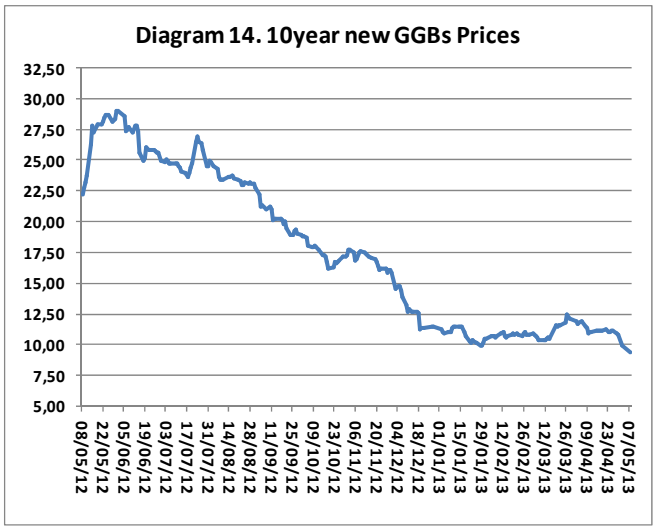
	Number of Shares	Share Price in 4.10.2013	Capitalization: Total 4.10.2013	Capitalization: Private Sector Million €	Capitalization: Private Sector %
Alpha bank	10.922,9	0,59	6.444,51	1.050,5	16,3%
Piraeus Bank	5.072,6	1,33	6.746,56	1.464,0	21,7%
National Bank	2.396,8	3,28	7.861,50	1.210,7	15,4%
Eurobank	4.050,4	0,52	2.085,96	29,2	1,4%
	Capital injection by HFSF	**HFSF Capitali-zation (4.10.2013)**	**Deposit Market Share**	**Capital Injection by the private Sector**	
Alpha bank	4.021,0	5.394,1	22%	550,0	
Piraeus Bank	6.415,0	5.282,6	30%	1.444,0	
National Bank	8.677,0	6.650,8	25%	1.079,0	
Eurobank	5.839,0	2.056,8	19%	0,0	
Total	24.952,0	19.384,2	96,0%	3.073,0	

Sourse: Bloomberg, IMF (July 2013)

The above recapitalizations and restructurings of non-core banks have absorbed much less capital than anticipated, as the assessed by Black Rock and the Bank of Greece capital gap was lower than anticipated and the capital injections by the private sector were also higher than expected. Moreover, most of the core banks have additional capital buffers, which will secure their endowment with adequate capital, even under a significantly adverse scenario concerning developments in the Greek economy in the following 2-5 years. These capital buffers will thus ensure the safety and soundness of the banking system and of its deposits in the years to come. Moreover, the HFSF is still endowed with surplus funds (not used in the 2013 recapitalization and restructurings), which may also be used in the future in case of need. All these buffers, in combination with the concrete prospects that exist today for an early recovery of the economy and a fast containment of unemployment, imply that the Greek banking system will be ready in time to attract back the deposits and contribute to the proper financing of the economy in the following years. In the following two Boxes in this Report we analyze in more detail developments in the fields of bank deposits and non-performing loans in the Greek banking system, which are of crucial importance for the recovery and development of the Greek economy.

Market developments point to the Greek recovery.

The Greek Bonds Market: Moody's C− rating in March 2012 and Greece's own political risks implied a fall of the price of 10-year new GGBs (obtained through the PSI Plus) to a low of 14.7 in 31 May 2012. However, ***the election of the new pro-reform government in the June 17, 2012 elections and the successful implementation of the Budget in 2012,*** which led to the decisions of the Eurogroup on November 26, 2012, implied the fast increase of the price of the new 10-year GGBs to 38.9 on 5 December 2012. Around this price the private sector debt – buyback operation was conducted successfully by the Greek government at a price at least 100% higher than Moody's C-rating was prescribing. The funds that disregarded Moody's rating and bought GGBs in the period between March 2012 and August 2012 were rewarded with substantial capital gains. And this was not enough. Despite the existing C− rating by Moody's, a number of funds and banks abstained from selling their GGBs to the Greek government in the buy-back price and other investors and banks continued buying GGBs in early 2013. All these were again rewarded with a further GGBs price increase of more than 65% in the following months, when the price of the 10-year GGBs reached 64.7 on 15 May 2013. It is indicative that even the Cyprus debacle had only a minor short term effect of Greek GGBs. Moreover, the market was hardly affected even by the new bout of baseless rumors which appeared again in July-August 2013, alluding to another possible restructuring of the Greek sovereign debt. As shown in Diagram 14 below the price of 10-year GGBs was still fluctuating at the level of 67.43 on 18 October 2013. In fact the markets are emphatically pricing out default risks, which only Moody's considers now to be very high.



Box 1: Prospects of Deposits

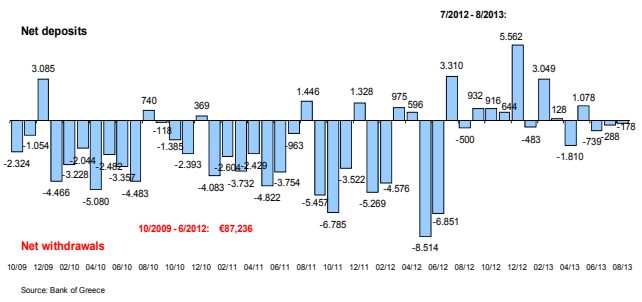
Greek banks' liquidity was negatively affected by the reduction of deposits during the crisis period 2010-2012. Deposit outflows from Greek banks were the result of two main factors; the increased uncertainty associated with the risk of "Grexit" and the severe drop of domestic incomes and economic activity.

Depositors started withdrawing funds to send abroad or to keep in safes, at first cautiously from April 2010, when Greece applied for support through the Eurozone-IMF financial mechanism and then more decidedly from October 2011, with the onset of discussions on Greek public debt restructuring, which culminated to the adoption of the PSI (Private Sector Involvement) in February 2012. The deposit outflow peaked during the period of elections (June 2012), due to fears that an anti-reform party could gain enough power to form a government, which never happened.

Deposits had reached a historical high of €237.8 billion in September 2009. During the period from October 2009 to June 2012 deposit outflows amounted to €87.2 billion. After July 2012 and the formation of a stable coalition government confidence began to rise significantly. Deposits started returning to the Greek banks, despite the considerable delay of the Eurogroup's decision for the continuation of financing of the Greek adjustment program and the consequent delay in the recapitalization of the banks. This continued unabated until the Cyprus bailout in March 2013, when bank customers were forced to participate in saving the banking system from bankruptcy. This has raised concerns for potentially generalized use of bail-in practices.

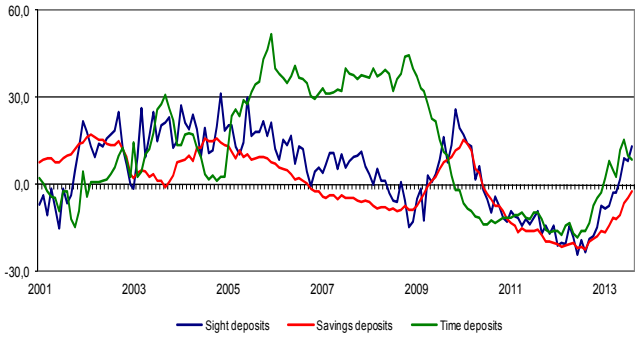
From middle-June 2012, deposit reflows in Greek banks amounted to about €15 billion, despite higher tax obligations of households and the liquidity constraints of enterprises in this period (see Chart 1), and despite the downward trend of interest rates during the same period (see Charts 2 and 3). Since the Cypriot crisis, private sector deposits have stabilized at a level of about € 162 bn.

Chart 1.1: Deposit flows in € millions (October 2009 - August 2013)



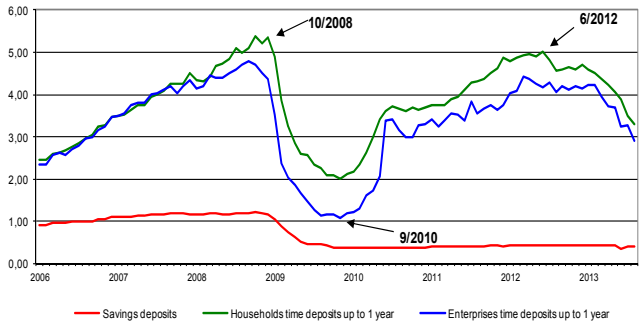
Source: Bank of Greece

Chart 1.2: Categories of deposits (annual growth rates %)



Source: Bank of Greece

Chart 1.3: Deposit interest rates (%)

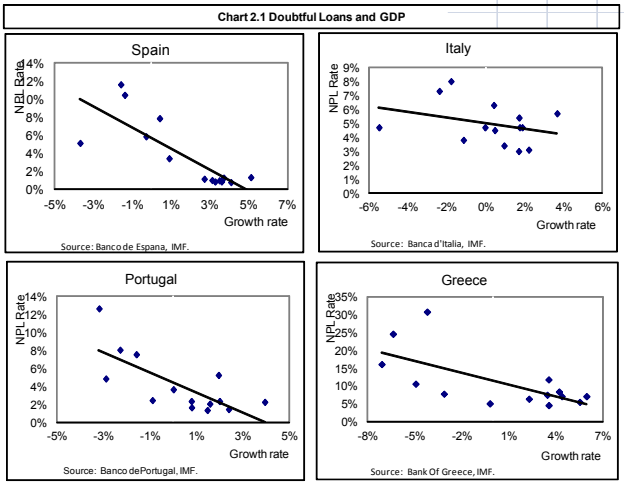


Source: Bank of Greece

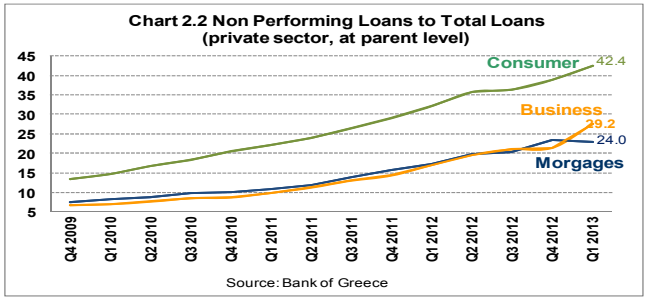
However, following the aforementioned successful completion of the bank recapitalization and restructuring program, a robust four-pillar banking sector has been formed in Greece safeguarding financial stability and able to facilitate a gradual restoration of growth-conducive liquidity conditions in the domestic economy. Macroeconomic fundamentals are rapidly improving and the Greek economy is expected to recover from 2014 onwards. Moreover, the first signs that Greece has overcome its sovereign debt crisis are visible. The further improvement in market conditions is expected to facilitate the steady return of deposits to the Greek banking system, which – in conjunction with the restoration of the Greek banks' access to international money markets – will support the provision of additional liquidity towards Greek firms and households. The pace of the return of Greek deposits might be conditioned by the substantial reduction of political risks, b) by the recovery in economic activity and c) by the full implementation of the structural reforms and privatizations which will strengthen economic sentiment and also help to attract much needed foreign direct investment.

Box 2: Greek Banks Loan Portfolios and NPL management

The big challenge for the Greek banking system, after the successful completion of the recapitalization of the four systemic banks, is the development of a clear banking strategy securing financial stability as well as adequate liquidity for the economy. The four banks are in the process of formulating their restructuring plans and strengthening their non-performing loans (NPL) management procedures. Moreover, Blackrock is currently conducting a diagnostic stress test and an asset quality review.



.After the Greek debt crisis in 2010, the severe contractionary fiscal policy combined with fast internal devaluation and the dramatic deterioration of households and business confidence to generate an unprecedented fall of domestic incomes and expenditure. This led to a significant increase in the NPL ratio, and to a corresponding increase in bank provisions for bad debts, both in corporate and retail business portfolios. Chart 2 exhibits the negative relationship between the growth rate and the non performing loans ratio prevailed during the period 2000-2013 in four countries of Southern Europe. It is worth noting that the sensitivity of the NPL ratio to changes in the growth rate was a bit higher in Spain and Portugal than in Italy and Greece. However, Greece experienced the largest decline in GDP during the crisis.



The NPLs (in arrears more than 90 days) in Greece increased from 5% in 2008 to 24.5% at the end of 2012. Moreover, NPLs in Q2 2013 reached 29.3%. More specifically, the NPLs in the mortgage portfolio have increased from 5.3% in 2008 to 24% in June 2013, the NPLs in the consumer credit portfolio rose from 8.2% in 2008 to 43.8% in June 2013 and the NPLs in business loans portfolio rose from 4.3% in 2008 to 29.2% at the end of June 2013. According to the latest European Commission report on Greece, the coverage of NPLs, including restructured loans, by provisions increased slightly from 39.7% at end 2012, to 40.4% in March 2013. However, existing cash and collateral is enough to provide more than 100% coverage.

The strategy pursued by banks in order to face NPLs relies upon a program of loan restructurings, e.g. adjustments in loan terms tailored to the needs of each client, (such as lengthening of the repayment period, change in interest rate and longer grace periods). However, the deepening of the crisis, accompanied, by successive reductions in total spending as a result of the unprecedented fiscal consolidation in a very short period of time, caused repeated shocks to loan restructuring programs. As indicated by the Blackrock diagnostic study in 2011, the re-delinquency rate following loss mitigation of highest quality lenders in residential mortgage loans portfolio was more than 20% after five months from the date of restructuring, and nearly 60% in the first year. This result refers to the period of 2011-H1 2013 where the crisis had been accelerating. Moreover, the initial terms of loan restructurings had not taken into account the dramatic fall of incomes and the increase in unemployment, which actually occurred.

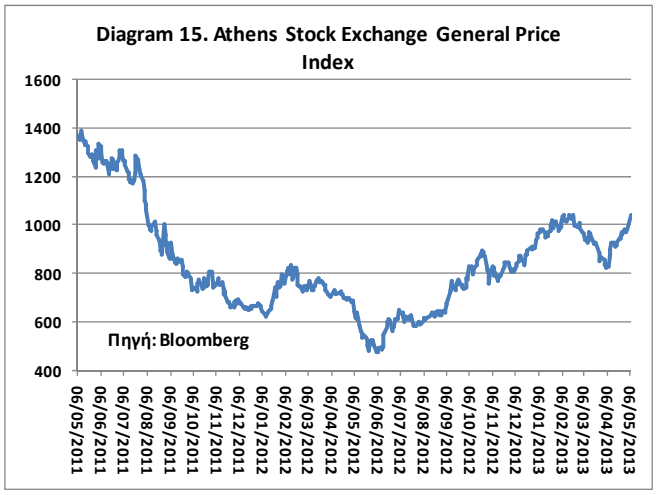
Moreover, one of the most distortive effects of the crisis is related to the collateral damage caused to payment culture, increasing significantly the moral hazard in lender/borrower relationships. Banks do not simply manage shareholder funds but also the deposits of households and firms, and in fact the damage caused by those defaulting on their payments is ultimately borne by good customers and savers.

The gradual lifting of the ban on property foreclosures - which was initially applied in 2009 and renewed each year since then - is of great significance for the restoration of efficient NPL management and of an orderly payment culture. The management of collateral property from the part of the banks does certainly take into account the current sore state of the real estate market, which, however, is expected to improve in the following years with the recovery of the economy.

In any case, the targeted improvement in the payment culture might be an extra tool in NPL management for the banks. It seems that the government intends to lift gradually the ban on foreclosures. The most vulnerable social groups - such as the long term unemployed and the households with more than 2 or 3 children – are to be exempted while additional criteria (for example, loan outstandings and the clients' willingness to agree on a new payment plan) will be considered as well.

Overall, NPLs formation has already been on a falling trend, following its peak in Q1 2013, in the wake of substantial restructuring in the Greek banking system. This is expected to continue in the following quarters as the economy is stabilizing and employment is increasing. The NPL ratio is expected to stop increasing for Q42014 onwards, in tandem with the beginning of the re-leveraging of the private sector expected to take place around that time, culminating in a positive credit expansion growth from 2015.

The Stock Market: The positive performance of the Greek stock exchange, especially in the period between November 2012 and May 2013, took place despite the uncertainty that surrounded bank recapitalizations and with the banks operating under the negative reminder of the Caa2 rating by Moody's. In fact, developments in the Greek stock exchange have now show unambiguously the market's firm perception that something fundamental has changed in the Greek economy, following Greece's structural reforms and fiscal adjustment implemented in 2012 and after the Eurogroup's decisions in November-December 2012. From then on the better than expected implementation of the 2013 Budget in January – August 2013 have not prevented the fall of ASE general index in July 2013, when the revived Grexit rumors were supported by the example of the unprecedented bail in of Cyprus depositors as a prerequisite for the financing of the Cyprus adjustment program. However, the robustness of adjustment of the Greek economy and the unambiguous signs pointing to its healthy recovery from 2014 onwards have boosted stock prices and the ASE general index to a post crisis record of 1166 in 18 October 2013.

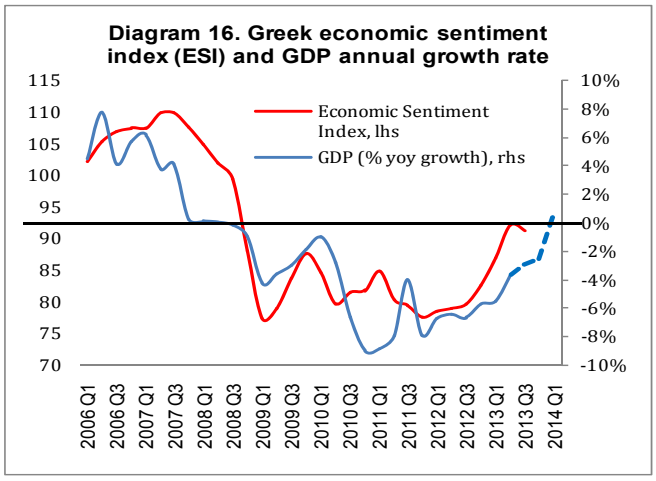


Greece's GDP growth prospects in 2013-2014

According to the Troika's estimates (IMF, January 2013 and July 2013) Greek GDP was projected to fall by -4.2% in 2013 and to register a positive growth of 0.6% in 2014. In fact, this was a rather optimistic projection compared to the much more pessimistic projections for 2013 of The Bank of Greece (-4.6%), of the OECD (-4.8%) and of Moody's (-5.3%), as well as of the domestic Institute of Industrial Studies or IOBE (-4.8% to -5.0%). In contrast to all these projections, we maintained from early 2013 that economic developments and prospects pointed out to a real GDP fall of even less than -3.7% in 2013 and to a real recovery, with a positive yoy GDP growth from Q1 2014, leading to a more than 1.0% GDP growth in 2014 as a whole. More specifically, the healthy deceleration of GDP fall in 2013 has been positively affected by the following developments in important sectors of the economy:

a) From the substantive improvement of the economic climate in Greece, as indicated by the upward surge of the index of Economic Sentiment (ESI) compiled by the Institute of Industrial Studies in Greece (IOBE) and published by the European Commission, from its abnormally low levels in 2011-2012 (See Diagram 16). It is also important that the component consumer sentiment index, which had been fluctuating at substantially low levels until September 2013, has recorded a notable improvement in October 2013, still implying the continuation of the falling trend of private consumption, but at a fast decelerating falling pace.

b) From an estimated 14.8% increase in revenues from external tourism in 2013 (January-September 2013: +14.4%), with a corresponding fall of payments for tourism abroad by about -4.0%. This has already contributed to the reversal of the falling trend of the turnover in tourist activities, to a positive 5.3% increase in Q2 2013, from -16.9% in Q1 2013 and -20.8% in Q2 2012. Moreover, the falling trend of gross value added in tourist activities and retail and wholesale trade decelerated to -7.5% in Q2 2013, from -12.1% in Q1 2013 and from -14.8% in Q2 2012. For 2013 as a whole the fall of value added in this sector is now expected to -5.8%, from -13.3% in 2012.



c) A substantial deceleration of the falling trend of gross value added in construction to a fall of about -6.5% in 2013, from -15.6% in 2012. In fact, with this fall in GVA in construction, its share in GDP will fall to 2.4% in 2013 from 8.0% in 2006. In particular we expect full absorption of PIB expenditure in 2013 which will imply an increase of this expenditure by 12% from 2012. The re-activation of works in the 4-big highways of the country will contribute to increasing activity in the construction sector from October 2013 onwards. Recovery of housing construction, from its abnormally low level of 2012 and 2013, may also be expected from H2 2014, in combination with the expected recovery of also depressed in 2013 transactions in housing. Recovery of transactions in the real estate market may also arise following the expected substantial fall in real estate prices in 2013 and the rationalization of the system o housing taxation.

d) Gross Value Added (GVA) in agriculture is expected to register a small fall of -2.5% in 2013, following its fall in 2012 and in 2011 by -3.2% and -5.4% respectively. Also, GVA in industry (manufacturing, mining and quarrying,

electricity and water supply) has actually stabilized since Q3 2012, registering a positive 1.3% increase in Q2 2013, from a fall by -0.7% in Q1 2013 and an increase by 2.4% in Q4 2012. It is, therefore expected to register positive growth of the order of 1.0% in 2013 as a whole, following its fall by -1.7% in 2012. In fact, manufacturing production registered a small fall by -0.8% in Jan.-August 2013, compared with -5,7% in Jan.-August 2012 and -7.8% in Jan.-August 2011.

e) On the demand side the falling trend of private consumption is expected to decelerate to -6.0% in 2013, from -9.1% in 2012 and the fall of investment to -6.1% in 2013, from -19.2% in 2012, while net exports are expected to contribute 2.2 pps on GDP growth in 2013, from 3.7 pps in 2012.

These positive developments in 2013 should by enough to facilitate the required deceleration of the fall of real GDP in the current year (Diagram 1.) and to produce a positive GDP growth from 2014 onwards.

In fact, real GDP fell in Q3 and Q2 2013 by a much lower than expected -2.96% and -3.67% respectively, following its fall by -5.49% in Q1 2013 and by -5.7% in Q4 2012. This was the effect of the substantial deceleration of the falling trend of private consumption to -6.3% in Q2 2013, from -8.7% in Q1 2013, following its fall by -9.6% in Q4 2012. Moreover, the fall of fixed investment decelerated to -10.9% in Q2 2013, from a fall by -11.4% in Q1 2013 and 21.5% in Q2 2012.

Table 13. GDP, Fixed 2005 prices

	2007	%Δ'09	%Δ'10	%Δ'11	%Δ'12	%Δ'13	%Δ'14
Total Consumption	***184,2***	**-0,3%**	**-6,8%**	**-7,2%**	**-8,1%**	**-5,7%**	**-2,0%**
Private Consumption	145,6	**-1,6%**	**-6,3%**	**-7,7%**	**-9,1%**	**-5,9%**	**-1,9%**
Government Consumption	38,6	**4,9%**	**-8,7%**	**-5,2%**	**-4,2%**	**-5,0%**	**-2,5%**
Fixed Investment	***56,5***	**-13,7%**	**-15,0%**	**-19,6%**	**-19,2%**	**-6,1%**	**7,9%**
Housing	26,1	**-20,7%**	**-21,6%**	**-18,0%**	**-32,9%**	**-32,0%**	**8,0%**
Other Construction	7,9	**1,6%**	**-15,7%**	**-25,1%**	**-7,9%**	**6,5%**	**12,0%**
Equipment	20,1	**-18,4%**	**-8,2%**	**-18,1%**	**-17,4%**	**1,2%**	**5,8%**
Other Investment	***2,4***	**10,2%**	**-18,6%**	**-16,7%**	**-2,9%**	**1,2%**	**5,5%**
Change in stocks (billion €)	0,0	**-3,5**	-0,6	0,6	1,1	**4,2%**	**12,5%**
Total domestic demand	***240,7***	**-3,0%**	**-8,5%**	**-8,7%**	**-9,4%**	**-5,7%**	**-0,6%**
Exports of goods and services	50,0	**-19,4%**	**5,2%**	**0,3%**	**-2,4%**	**1,8%**	**4,6%**
Imports of goods and services	79,819	**-20,2%**	**-6,2%**	**-7,3%**	**-13,7%**	**-6,1%**	**-2,0%**
Balance of goods and services	***-29,8***	**-21,6%**	**-26,3%**	**-26,6%**	**-52,7%**	**-61,8%**	**-128,8%**
GDP, Fixed 2005 prices	***210,9***	***-3,2%***	***-4,9%***	***-7,1%***	***-6,4%***	***-3,7%***	***1,1%***
% of GDP							
Fixed Investment		20,5	18,3	15,9	13,7	13,3	15,4
Investment in Housing		6,8	5,6	4,9	3,5	2,5	3,0
Total Consumption		92,7	90,9	90,8	89,2	87,3	82,5
Gross Saving		7,3	9,1	9,2	10,8	12,7	17,5
Private Consumption		73,3	72,3	71,8	69,8	68,2	64,8
Balance of goods & services		-11,4	-8,9	-7,0	-3,5	-1,4	1,3
Exports of goods & services		20,1	22,2	24,0	25,1	26,5	27,9
Imports of goods & services		31,5	31,1	31,0	28,6	27,9	26,6
Contribution to GDP growth (percentage points)							
Net Exports		**3,04**	**3,00**	**2,35**	**3,69**	**2,18**	**1,78**
Private Consumption		-1,13	-4,58	-5,58	-6,51	-4,14	-1,30
Government Consumption		0,87	-1,67	-0,96	-0,80	-0,96	-0,48
Fixed Investment		-3,16	-3,08	-3,59	-3,05	-0,83	1,08
Housing Investment		-1,70	-1,46	-1,00	-1,62	-1,13	0,20
Change in stocks		-2,77	1,41	0,64	0,30	0,03	0,09
GDP, Fixed 2005 prices		***-3,1***	***-4,9***	***-7,1***	***-6,4***	***-3,7***	***1,1***

Source: ELL.STAT, Projections EAD Alpha Bank for 2013-2014 (May 2013)

From Q4 2013 onwards the falling trend of real GDP is expected to decelerate further on the back of substantial economic sentiment and liquidity improvement and of a much better than expected performance of the tourist sector even in Q4 2013 and in Q1 2014. Therefore, GDP fall is now expected to less than -2.5% in Q4 2013 (with the fall of private consumption decelerating by -3.4%, also assisted by substantial base effects and the boost of confidence). Overall, growth in Q4 2013 has been boosted the still much better performing tourist sector, compared with Q4 2012, and the intensifying recovery of state controlled investment. The first positive yoy GDP growth quarter is expected to be Q1 2014. ***Positive real GDP growth is also expected in 2014-2015,*** with the rate of growth exceeding 1.1% in 2014 and 3.0% in 2015.

Recent Economic Developments and prospects

We turn now to a more detailed analysis of developments in the main sectors of the Greek economy:

Tourism: External tourists arrivals reached 15.53 million in January – September 2013, from 13,48 million in January – September 2012, registering a 15.2% yoy increase, following their fall by -5.2% yoy in Jan.-Sept.2012. Moreover, according to the Association of Tourism Enterprises (SETE), the number of tourist arrivals (by charted flights) recorded a strong growth of +21.5% yoy in October 2013, following their increase by +12.96% in September 2013 (see Table). In the 10months of Jan.-Oct..2013 tourist arrivals by charter flights have risen by +10.93% yoy. Tourist performance in 2013 was a remarkable development for Greece in view of the lingering economic difficulties still plaguing the Greek economy. All main Greek airports recorded high yoy growth of arrivals in 2013. Even the Athens International Airport experienced an increase in arrivals of +13.2% yoy in October, from +1.8% in September 2013 following a long stagnation period.

Table 14. Tourist arivals in Greece with charter flights

	2011	2012	2013	2012/2011	2013/2012
Jan	215.754	191.416	166.780	-11,28%	-12,87%
Febr	171.184	149.828	140.107	-12,48%	-6,49%
March	217.936	215.424	215.215	-1,15%	-0,10%
Apr.	525.732	538.256	484.983	2,38%	-9,90%
May	1.303.006	1.207.183	1.424.918	-7,35%	18,04%
June	1.818.411	1.779.473	2.038.973	-2,14%	14,58%
July	2.332.296	2.289.568	2.492.446	-1,83%	8,86%
August	2.249.466	2.260.704	2.503.490	0,50%	10,74%
September	1.726.873	1.730.816	1.955.109	0,23%	12,96%
October	780.086	697.227	847.247	-10,62%	21,52%
Σύνολο	**11.340.744**	**11.059.895**	**12.269.268**	**-2,48%**	**10,93%**

Source: SETE

Tourism activity was kept high even in the relatively off-season months of September and October. Hotel occupancy in the main Greek destinations reached 90%-95% in September, while occupancy in October and November is now expected to increase by 15%-20% compared to the corresponding months of 2012. For the first time from many years Greece's objective of prolonging the tourism season looks to have been achieved, a fact that promises a good outlook for external tourist performance in 2014 as well. Prospects of healthy growth in tourism in 2014 are now supported by data concerning pre-bookings, which are exceeding their level for 2013.

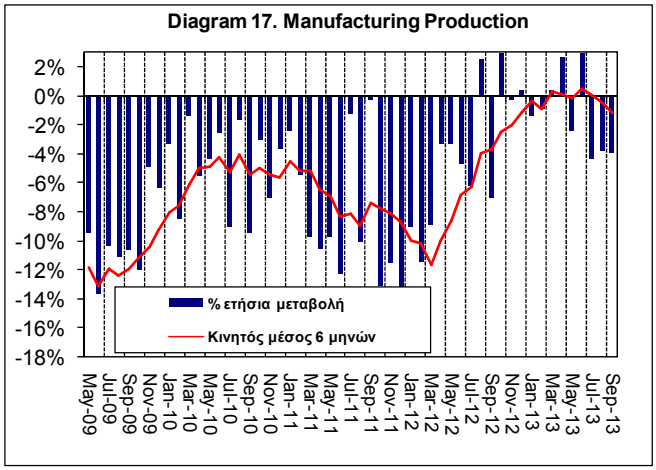
Tourism receipts registered a 14.4% increase in Jan.-September 2013, compared with a 0.28% increase in Jan-Sept. 2012 and a 9.8% increase in Jan.-Sept. 2011. ***Therefore, these revenues are expected to grow by more than +14.8% in 2013, reaching € 11.5 bn.*** This will be the result of the expected substantial growth of international tourist arrivals to about 18.5 million visitors in 2013 (an increase by 13.0% in 2013 as a whole from +15.2% yoy in January-September 2013) from 16.3 million visitors in 2012. The contribution of the cruise industry is also estimated to be significant in 2013, elevating tourist receipts from this source to the level of € 0.80 bn, from € 0.52 bn in 2012 (Bank of Greece data).

There are three major factors that have shaped this new expansionary trend of Greek external tourism in 2013. The first is the solid comparative advantages, tourist assets and the inviting image that Greece is projecting abroad. The second is the clear improvement of hotel (and other tourist establishments) infrastructure and the advancement in the quality of service they provide. The last factor is the

competitiveness of the Greek holiday packages establishing the country as an attractive and world class destination.

Shipping: Contrary to tourism, receipts from international transportation (mainly shipping) registered a substantial fall by -11.1% in Jan. -Sept.2013, compared with their fall by -3.4% in Jan.-Sept. 2012. Correspondingly, outflows from shipping firms established in Greece for international payments fell by -11.9% in Jan. – Sept.2013, following their fall by -114.5% in Jan. – Sept.2012. Therefore, the surplus of the shipping account fell by -10.5% yoy in Jan. – Sept.2013, following its increase by 8.9% in the 9months of 2012. These developments indicate that the fall of the surplus revenues from shipping had a negative effect on Greece's GDP in Jan. – Sept. 2013 of the order of -0.4 pps, compensating partly the substantial positive effect on GDP growth from the substantial increase of external tourist revenues. In fact, the Greek net surplus revenue from shipping had increased by 1.42% in 2012, following its fall by -5.5% in 2011. Therefore, in 2012 net shipping revenues had a small positive effect on GDP growth, failing, however, to reverse the negative effect on growth of these revenues in 2011. Then, in 2013, the effect of international shipping on Greece's GDP growth has been again negative. A further increase in confidence in the stability of the Greek economy in the following quarters will most possibly imply stabilization and then a renewed increase in shipping revenues and a significant improvement of the shipping contribution in the country's economic development.

Industrial Production: Production of the manufacturing industry registered a small -1.2% yoy fall in Jan. – Sept.2013, on top of a -5.8% fall in Jan.-Sept. 2012. This fall was exacerbated in July-Sept. 2013 (September 2013: -4.0%, Aug.2013: -3.8%) due to the exodus from the market of an important food industry. However, in many manufacturing sectors production is now on an increasing trend, while in other sectors production has stabilized, albeit at a significantly low level.



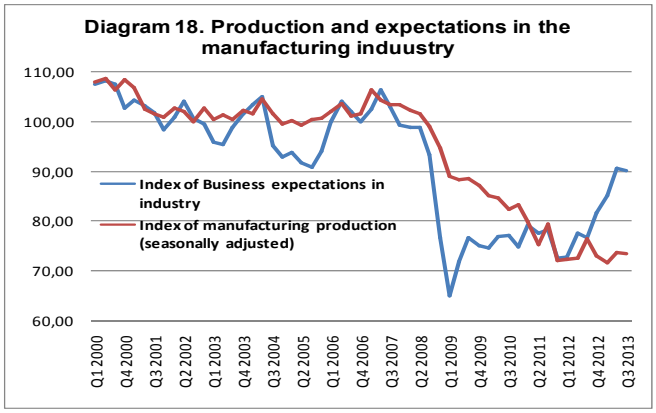
Among the sectors which have entered an upward trend in their production activity, as shown in Table 15 bellow, are: Coke and refined petroleum products, chemical products, pharmaceutical products, machinery and equipment, paper and paper products, tobacco, non-metallic minerals, footwear and leather products and clothing products. On the other hand, it is noteworthy the substantial fall of production of the important for Greece food industry due to the drastic restructuring of the sector in 2013, while on a decelerating falling trend is still the production of the beverages sector. Also, electrical equipment production and production of metallic and of furniture products registered substantial fall of production in 2013 mainly due to the continuing depression of activity in Greece's real estate sector in combination with problems faced by these industries in exporting markets.

Table 15. Basic sectors of the Greek manufacturing industry

	Weights	Jan.-Sep. 2013	2012	2011	2009	Level Sep.2013 (2005=100)
Food	18,2	-5,4%	-3,8%	-4,3%	-2,7%	91,6
Beverages	6,0	-3,1%	-8,3%	-9,3%	-4,8%	85,1
Tobacco	1,9	2,7%	-8,9%	10,5%	-2,7%	77,8
Oil (refineary) products	11,3	11,3%	24,3%	-14,5%	-0,1%	124,3
Chemicals	5,3	2,5%	-11,9%	-4,7%	-14,6%	75,2
Pharmaceuticals	2,5	11,5%	-5,5%	-0,6%	18,3%	158,3
Basic metalls	8,0	-7,4%	-6,1%	6,5%	-17,9%	86,7
Manuf. of metall products	5,1	-13,6%	-9,8%	-5,4%	-17,7%	59,4
Machinery and equipment	2,1	5,5%	-13,3%	-6,3%	-27,0%	50,2
Wood and cork products	1,2	-24,5%	-11,1%	2,8%	-27,3%	39,9
Plastic products	4,2	0,3%	-9,5%	-7,3%	-13,7%	72,8
Non-Metallic Minerals	10,3	-0,4%	-15,8%	-35,9%	-24,2%	32,2
Electrical equipment	3,0	-9,3%	-6,0%	-13,6%	-20,1%	59,6
Textiles	3,1	-10,8%	-17,4%	-22,0%	-27,8%	22,8
Clothing	3,4	-1,3%	-7,0%	-25,4%	-23,6%	33,1
Other transport equipment	1,6	-12,5%	-26,5%	-37,1%	-18,6%	17,4
Vechicles, trailers and others	0,8	-13,3%	-14,7%	-28,8%	-13,3%	38,1
Repair &machinery instalation	4,1	-12,8%	-14,6%	-2,6%	-15,2%	40,0
Manufacturing Industry	**100,0**	**-1,2%**	**-6,7%**	**-9,5%**	**-11,2%**	**73,0**

Source: ELL. STAT.

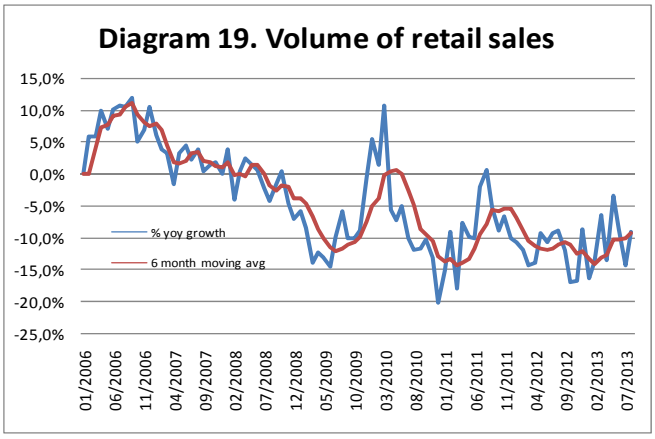
Finally, the General Index of Industrial Production fell in January – August 2013 by -3.6% yoy, compared with a fall of -4.3% yoy in the corresponding period of 2012. This fall was the result of: (1) the above reported fall in manufacturing production by -1.2%, (2) the fall in coal and lignite production by -8.8%, due to the significant rainfall and subsequent increased electricity production from hydroelectric dams, (3) the decrease of electricity production by -9.5%, also due to the good weather conditions that reduced the use of electricity for heating, (4) the fall of water supply by -2.5% and (5) the decline of production of crude oil and of natural gas by -8.0%.



Manufacturing production is expected to enter a positive growth path in the following quarters, as it is indicated by the substantial improvement of business expectations in the manufacturing industry and also by the notable improvement of the PMI indicator in recent months. The business expectations indicator surged to 96.1 in Sept. 2013, from 88.0 in August 2013 and 80.9 in September 2012. Industrial production has not yet responded to this substantial improvement in the economic climate of the sector, as shown in Diagram 18, a development which is expected to happen in Q4 2013 and in 2014.

This is also expected following the substantial increase of the PMI index in manufacturing to 47.5 in Sep. 2013 from 48.7 in Aug. 2013 and around 42 in 2012 and at the beginning of 2013. The positive effect from the dynamic increase in exports of goods and export orders has been over-compensated from the persistently low level of domestic demand. Now the PMI index is poised to reach higher levels, even above 50. This will reflect the significant improvement of business expectations in industry and, therefore, the expected positive growth of manufacturing production in 2013 as a whole.

PRIVATE CONSUMPTION: In 2012, the fall of the volume of retail sales accelerated to -11.8%, compared with the fall by -8.7% in 2011. In 2013, the falling trend of this index decelerated to -8.7% in Q2 2013, compared to an abnormally big fall by -12.4% in Q1 2013. However, in July 2013 retail sales recorded a big fall by -14.4% yoy in order to decelerate again to the still high -9.1% in August 2013. It is evident that consumer spending has weakened significantly despite a modest improvement in consumer confidence in Q3 2013, with a more encouraging improvement of confidence in this sector in Oct.2013 (Oct.2013: -66.2, Sept.2013: -72.2, Aug.2013: -76.6). Overall, fiscal austerity and high unemployment have taken their toll until Q3 2013, but success in fiscal adjustment and increasing employment in April-October 2013 may eventually help to further improve consumer confidence and may contribute to stabilize private consumption in 2014. On the other hand, the substantial fall of the volume of retail sales in July-August 2013 has also been affected by the fact that two sizable groups of department stores (Alex Pak and Spider Stores) filed for bankruptcy and exited the market in this period. This development has implied an abnormal fall of the volume of retail sales of big department stores by -28.8% in August 2013. In fact, the fall of the volume of sales in other sectors has decelerated to around -6.5% as expected. In the 8month period of Jan.-August 2013 the fall of the index was -10.9%, compared with its similar fall by -11.0% in Jan.-August 2012.



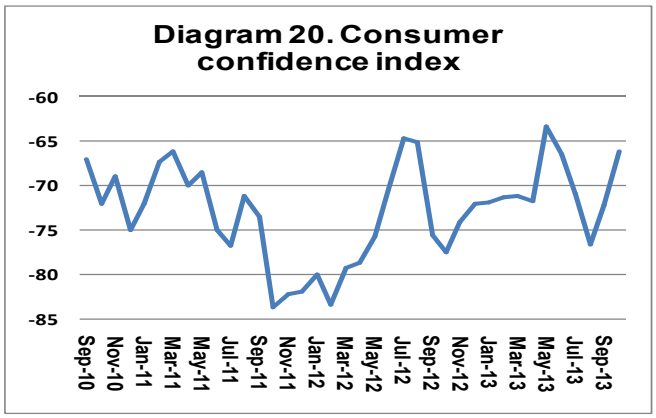
On these grounds, private consumption fell by -6.3% yoy in Q2 2013, as compared to a fall by -8.7% in Q1 2013 and -8.6% in Q2 2012. The above developments in the volume of retail sales indicate that the fall in private consumption was also high (of the order of -5.5%) in Q3 2013 as well averting an even smaller fall of GDP than the recorded -2.96%). However, the deceleration of the fall of the volume of retail sales is expected to be much more obvious in Q4 2013, with the fall of private consumption expected to no more than the -3.0%

Table 16. Index of the Volume of Retail Sales

2005=100	Index		yoy %	
	Jan.-Aug. 2013	Jan.-Aug. 2012	Jan.-Aug. 2013	Jan.-Aug. 2012
Supermarkets	81,3	91,7	-11,3	-6,4
Departments stores	82,5	94,6	-12,8	-6,5
Food-beverages-tobacco	62,4	65,9	-5,2	-15,6
Pharmaceautical products, cosmetics	74,9	88,1	-15,0	-10,1
Clothing and footwear	53,9	58,0	-6,9	-21,5
Furniture, electrical equipment	56,1	62,4	-10,2	-16,6
Books, stationery, other goods	61	62,4	-2,1	-12,1
Overall Index	67,2	75,2	-10,6	-11,5
Index (except automotive fuel)	67,3	75,5	-10,9	-11,0
Source: ELL.STAT.				

In the 8months to August 2013 the volume of retail sales fell by -12.8% in the big department stores, from -6.5% in the corresponding 8m period of 2012, while in the big supermarkets the fall in the volume of retail sales accelerated to -11.3% in the 8 months 2013, compared to a fall by -6.4% in the same period 2012. On the other hand, the volume of sales in the multitude of small shops (of food-beverages and tobacco, or clothing and footwear, furniture and electrical equipment appliances, etc) has decelerated more emphatically (Table 16) in Jan.-August 2013, compared with Jan.-August 2012. This development is completely opposite to the previous trend, which was observed until the end of 2012, when the volume of retail sales in the small shops and durable goods sectors was registering double digit falls, while big supermarkets and department stores were performing much better, with moderate falls.

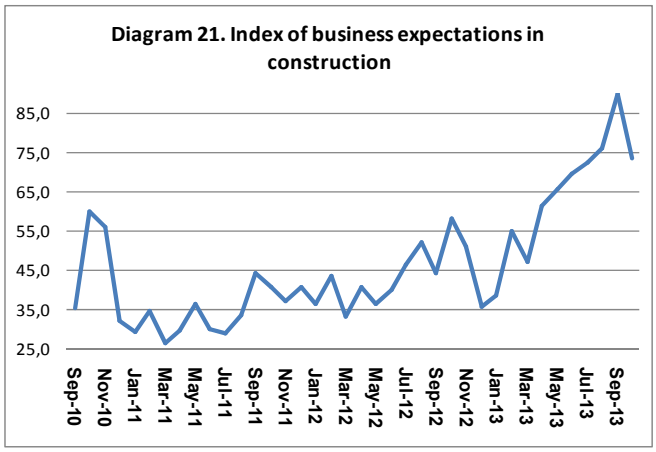
Overall, the continuing fall of overall retail sales and in particular of durable goods sales in Jan-August 2013 is related to the substantial fall of disposable income in this period but also to the still depressed consumer and business confidence in the Greek economy until August 2013. However, an upside trend is expected in coming months, as the index of consumer confidence started to improve with its falling trend decelerating to -66.2 in Oct.2013, from -72.2 in Sept.2013, -76.6 in Aug.2013 and -75.6 in Sep.2012, as shown in the Diagram 20.



Other sectors to gradually gain momentum are the car industry and the housing marker. New passenger cars registrations dropped only by -2.4% in 9 months 2013, against a dramatic fall by -44.2% in the same period 2012. Thus, the car market appears to stabilize in 2013 to about the same levels as in 2012, i.e., around 62 thousand new car registrations. Finally, expenditure on imported cars is currently at € 538 mln in 8 months 2013, from € 505 mln in 8 months 2012.

Concerning investment in housing, the falling trend of residential construction activity – as measured by the volume (m^3) of building permits – continued unabated with a new -30.6% fall in 2012, on top of its fall by -37.7% in 2011. In fact, the volume of residential construction fell to 15.7 million m^3 in 2012, from 22.6 million m^3 in 2011. These developments led to residential investment falling in real terms by -32.9% in 2012, following its fall by -18% in 2011. Moreover, an additional fall of residential investment of -35.0% yoy is expected in 2013. This level is extraordinarily low for Greece, falling to 3.0% of GDP in 2013, from 12.4% of GDP in 2007 and a gradual recovery of residential investment due to demographic and other reasons may be expected from H2 2014.

In the current period, the aforementioned developments in consumer and business confidence have started to lead to the revival of both residential investment and economic activity in this sector. In fact, the index of business expectations in construction registered a substantial improvement to 89.7 in Sep.2013, from 72.3 in July 2013 and 44.4 in Sep.2012 (Diagram 21). However, the index fell again to 73.6 in Oct.2013, as the expected revival of activity in important public investment projects failed to materialize from Oct.2013, as it had been expected by the business community in the sector.



INFLATION: CPI Inflation in Greece fell to -2.0% in Oct.2013, from -1.1% in Sep.2013, -1.3% in Aug.2013 and +0.9% in Sep.2012. Average CPI inflation is expected to fall to -0.8% in 2013, from 1.5% in 2012, 3.4% in 2011 and 4.7% in 2010. Therefore, Greece has now the lower inflation in the EU-27, while it is true that it remained elevated until December 2012. This evolution of inflation until 2012 was mainly due to the fact that fiscal adjustment in Greece initially took the form of raising VAT and excise taxes, as well as through tariff hikes by deficit-ridden public sector entities. Overall, inflation is expected to remain negative in the last months of 2013 and even in 2014. Harmonized inflation reached also -1.9% in Oct.2013, from -1.0% in Sept.2013 and in Aug.2013 and it is expected to average at -0.7% in 2013. Core inflation reached -1.8% in Oct.2013, from -1.9% in Sept.2013 and also -2.1% in August 2013 and is expected to reach an average of -1.3% in 2013.

IMPLEMENTATION OF 2013 BUDGET: The Central Government (GG) Budget deficit fell to € 4.46 bn in Jan. - Oct. 2013, against a deficit of € 12.26 bn in Jan. – Oct. 2012 and the target for a deficit of € 8.73 bn in the 10month period to October 2013.

In addition, ***the Central Government Primary Balance*** amounted to a surplus of € 1.09 bn in the 10 months of 2013, compared to deficit of € 1.14 bn in the same period of 2012 and against the target for primary deficit of € 3.04 bn for the 10-month period of 2013. For 2013 as a whole the target set by the Troika was for a CG primary deficit of € 2.0 bn, while the most probable outcome, following the implementation of the Budget in Jan. – Oct.2013, is for a deficit of about € 0.7 billion.

This result was achieved despite the still substantial fall of net current revenues (before tax refunds) by -6.1% yoy in Jan.-Oct. 2013, which, however reached the € 39.4 bn, surpassing the target set for this period by € 53 million. Also, net current budget revenues (after tax refunds) registered a fall by -4.3%, compared with -0.4% in Jan.-Oct.2012. However, these revenues were also better than the target set for the same period by € 346 million. This result was achieved with tax refunds lagging by € 259 bn from the target set for Jan.-Oct. 2013.

In the Budget 2014, net current budget revenues are estimated to fall by -6.6%, assuming that tax refunds will reach the level of € 3.62 bn, compared with a budgeted level of € 2.9 bn. However, an amount of € 723 million refers to overdue state liabilities from previous fiscal years, which will be paid from a special account formed for the payment of such liabilities and it will not affect the Budget 2013. Therefore, excluding these tax refund payments, net current budget revenues in 2013 are expected (in the Budget 20140 to register a fall of -5.1%, on top of their similar fall by -5.0% in 2012. However, taking into account the better than expected net current revenue developments in Jan-October 2013, we can reasonably assume that actual fall of these revenues in 2013 will not exceed the -4.0% yoy.

It should be noted that in the above calculations of net current budget revenues, we do not take into account Greece's revenues stemming from European NCBs' GGBs holdings in ANFA portfolios and from the SMP program, amounted to €1.5 bn in Jan.-Oct.2013 and in € 2.62 bn in 2013 as a whole.

Overall, the main problems in the implementation of the 2013 budget in the revenue side appear to be the following: a) Revenues from the income tax on individuals (PIT) registered a big fall by -20.4% in Jan.-Oct 2013, while for 2013 as a whole the MTFS 2013-2016 has projected their fall by -19.9%. This fall should be considered as excessive, although the final outcome for the year as a whole may be better than planned as the filling of tax declarations started in September 2013. b) The substantial fall of the VAT revenue by -9.5% yoy in Jan-Oct.2013, on top of their fall by -11.1% in the 10-months to October of 2012. This VAT fall is to a great extent due to tax evasion, considering also the cut of the VAT rate for restaurants to 13% from 23%. To some extent it is also due to the fall of VAT revenues from heating oil sales due to the exceptionally good weather conditions in January - April 2013, as well as in October-November 2013. In fact, the target set by MTFS 2013-2016 for VAT revenues in 2013, is for a -10.5% fall. This target will be easily surpassed in 2013, where the actual

fall of VAT revenues will not exceed -9.0%. c) The substantial fall of revenue from excise consumption taxes, by -11.1% yoy in Jan.-Oct. 2013, again due to tax evasion in the specific taxes on tobacco and petroleum products and also due to the lower sales attributed to the good weather conditions. The target set by MTFS 2013-2016 for excise consumption tax revenues in 2013, is for a small fall of -5.2%, which is difficult now to be implemented as planned.

However, encouraging developments in the implementation of the revenue side of the 2013 Budget appear to be the following: a) The substantial increase of revenues from direct taxes of past economic years by 54.8% in Jan.- Oct.2013, as a result of the following: (i) Of the ongoing efforts of the reorganized tax administration authorities to collect substantial revenues from the huge stock of overdue tax liabilities of businesses and individuals (exceeding € 62 bn at the end of September 2013, of which more than € 20 bn are collectable), as well as from unaudited tax cases. (ii) Of revenues from the property taxes of the year's 2010, 2011 and 2012 imposed simultaneously during 2013. b) The transfer of profits from the Bank of Greece to the state, which are estimated to be extraordinarily high in 2013 due mainly to the operation of the Exceptional Liquidity Assistance (ELA) to the Greek banks in most of 2012.

On the expenditure side, ordinary budget primary expenditure dropped significantly by –6.7% yoy in Jan.-Oct.2013 and they were lower by € 1.48 bn from the relevant target and by € 2.6 bn from Jan-Oct.2012. In particular, overall salaries and pensions in the public sector were lower by -8.4% yoy in Jan.-Oct 2013, following their fall by -6.9% in the same period 2012. Also, grants to social security funds including subsidies to the Single Health Services Organization (EOPYY) and the Manpower Employment Agency (OAED) were lower by –13.1% yoy in Jan.- Oct 2013, following their sizable fall by -6.6% in Jan.- Oct.2012. In fact, there was overspending in these subsidies in the previous years, which was mainly due to the substantial fall in the revenues of the social security funds (due to the surge in unemployment and the fall in private sector wages, as well as due to increasing social security contributions evasion), and to the increased number of retirees in the period 2010-2012. On the other hand, operational expenditure of the central government registered a small fall by -0.5% in the 10months to October 2013, while it is budgeted to register a -1.6% fall for 2013 as a whole, following their fall by -8.7% in 2012.

Finally, the decrease in the Central Government budget deficit was also due to the substantial improvement of public investment budget (PIB), which actually registered a surplus of € 0.69 bn in the 10 months to October 2013, compared to a deficit of € 0.63 bn in the same period of 2012 and against the target set for a deficit of € 1.35 bn. This result was due to the marginal increase of PUB expenditure by 1.4% yoy in Jan.-Oct. 2013, compared to a fall by -13.4% yoy in Jan.-Oct.2012. On the other hand, PIB revenues reached € 4.01 bn in Jan.-Oct. 2013, when the PIB revenues were only € 2.65 bn in the same period 2012. In fact, PIB expenditure is now expected to reach € 6.65 bn in 2013 (a little lower than budgeted), compared with € 6.11 bn in 2012. On the other hand PIB revenues are now expected to reach the budgeted € 5.14 bn in 2013, from € 3.6 bn in 2012.

Overall, the implementation of ***the 2013 Budget is expected to continue to be better than planned, as is shown in Table 7 above.***

BALANCE OF PAYMENTS: External adjustment is proceeding much faster than anyone had expected. The current account balance is forecast to be in surplus this year by more than 1.0% of GDP, from a deficit of -2.2% of GDP in 2012 and from a still big deficit of -8.6% of GDP in 2011. This adjustment is mainly due to the drastic adjustment of goods and services balance. Looking forward, the factors underlying the substantial reduction in the current account deficit in 2012 and its turn around to sizable surplus in 2013 are expected to continue to a large extent in 2014 as well. Remarkable was in 2013 the positive effects stemming from the surge of receipts from international tourism but increasing exports of goods and falling imports are also responsible for this spectacular adjustment in the external sector in 2013.

Table 13. Greek Balance of Payments (€ billions)

	Jan-Sept.2013	Jan-Sept.2012
Trade Balance (TB)	-12.89	-15.65
Exports	16.84	16.09
Imports	29.74	31.74
Services Balance	14.22	12.92
Tourism Receipts	10.70	9.36
Shipping Receipts	9.05	10.19
Income Balance	-2.43	-1.64
Payment of Interest, Divid. & Profits	4.76	4.15
Transfers' Balance	4.94	3.15
Current Account (CA)	3.84	-1.22
CA (% of GDP)	2.09	-0.63
Capital Account	-4.26	2.58

Source: Bank of Greece

The current account balance with capital transfers (not including an inflow of € 1.5 billion from the profits accruing to the Securities Markets Program portfolio of euro area national central banks, which were disbursed to Greece in late July, upon fulfillment by the Greek side of a number of agreed program milestones) showed a significant surplus of € 3.84 billion in the 9-month to Sept.2013, compared with a deficit of € 1.22 billion in the 9-month to September 2012, and € 13.6 bn in Jan.-Sept.2011. Thus, the current account balance recorded a surplus of 2.09% of GDP in the 9-month of 2013, versus a deficit -0.63% of GDP in the 9-month 2012 and -6.52% of GDP in the 9-month 2011. This surplus in the 9-month 2013 was the first that has been achieved in this period in many decades.

The trade deficit excluding oil and ships decreased to € 5.94 billion, registering a fall by -10.73% yoy in Jan.-Sept.2013, following their fall by -33.18% in Jan.-Sept.2012. This fall was due to the reduction of imports of goods excluding oil and ships by -2.09% yoy in the 9-month 2013, following their fall by -15.7% in the 9-month 2012 and also because of the growth of exports of goods excluding oil and ships by 3.65% in the 9-month 2013, on top of their increase by 2.12% in the 9-months 2012 and by 20.5% in the 9-month 2011.

For the oil balance, payments for oil imports decreased in Jan-Sept.2013 by -11.07% yoy, after their increase by 4.85% in the 9-month 2012. On the other hand, receipts from oil exports rose by 11.7% in the 9-months 2013, after their increase by 19.4% yoy in the 9-month 2012. Consequently, in the 9-month 2013 there was a big fall of the oil account deficit, to € 6.01 bn, from€ 8.17 bn in the 9-months of 2012.

The increase in total exports of goods stood at 4.65% in the 9-months 2013, compared to +6.9% in the 9-months 2012 which is a substantial support for the country's economy during the current recession. Thus, exports of goods amounted to € 16.84 bn in the 9-months 2013, compared to € 16.09 bn in the 9-month 2012 and € 15.05 bn in the 9-months of 2011.

Balance of Services: The surplus of the Balance of Services was higher by 10.05% yoy in the 9 –months 2013 after an increase by 6.5% in the 9-month 2012. The increase in the surplus was due to increased revenues from tourism by 14.5% yoy and the substantial fall for payments for services abroad by -11.8%. There was also a substantial fall of receipts from international shipping by -11.14% and a small fall of revenues from exports of other services by -0.5%.

Balance of Income: A substantial increase in its deficit by 48.6% was recorded in the 9-months 2013, rebounding from its fall by -74.5% in the 9-months 2012. Actually payments for interest, dividends and profits abroad rebounded to an increase by 14.8% in Jan.-Sept.2013 from their substantial fall by -51.3% in Jan.-Sept.2012 (due to the PSI plus).

In the current transfers' balance, the surplus surged upwards by 38.3% in the 9-months 2013, following is also substantial increase by 139.4% in the 9-months 2012. The 2013 increase does not take into account the revenues of € 1.5 bn awarded to Greece by the European National Central banks in July 2013. In fact, the remaining receipts from the EU-27 increased by 7.13% in the 9-months 2013, following their increase by 21.5% in the 9-months 2012. Also, remittances from abroad are higher by 23.4% in the 9-months 2013, after their fall by -9.4% in the 9-months of 2012. Current transfer payments were also lower by -9.44% in the 9-months 2013.

In the capital transfers balance receipts from EU structural funds amounted to € 2.97 bn in the 9- months 2013, versus € 1.69 bn in the 9-months 2012.

The capital account showed a deficit, amounting to € 4.27 bn in the 9-months 2013, compared to a surplus of € 2.58 bn in the 9-month 2012. Developments in the individual categories of capital flows were as follows:

(a) In the field of Foreign Direct Investment (FDI), a net inflow was recorded of € 0.94 bn in the 9 -months 2013, compared to an inflow of € 0.8 bn in the 8-months 2012. In particular, direct investments by non-residents in Greece showed a net inflow of € 233 million, while domestic firms contributed to a net inflow of € 709.2 million.

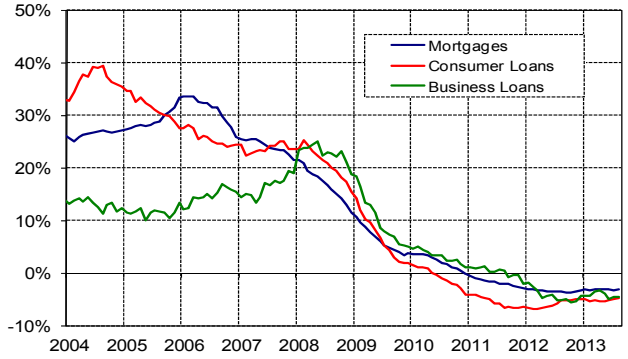
(b) In the field of portfolio investment a net outflow was recorded of € 7.5 bn in the 9-months of 2013, compared a net outflow of € 75.6 bn in the corresponding period of 2012. In particular, an outflow of funds occurred due to the reduction of portfolios of non-residents in Greek bonds and Treasury bills and stocks by € 8.7 bn. On the other hand, domestic residents brought back to Greece an amount of € 1.16 bn from the liquidations of their investments abroad.

(c) In the other investment a net inflow was also recorded of € 2.3 bn versus a net inflow of € 77,3 bn in the 9-months 2012, mainly due to the increase in debt of the public and private sector, but also to the decline in domestic institutional investors' deposit and repos abroad.

Overall, the current account surplus will be around 1.0% of GDP in 2013. This balance will continue to be in surplus in subsequent years to the extent that the capital account of the country will show a deficit. However, when Greece will begin attracting significant capital investments (in the stock market, foreign direct investments, or in real estate) then there will be a change back of the capital account into surplus. This would reflect the most obvious way to improve Greece's competitiveness in attracting foreign investment and contribute to the recovery of domestic demand. These investments will increase the capacity of the sectors that produce internationally tradable products and would generate the necessary conditions for current account surpluses in the future.

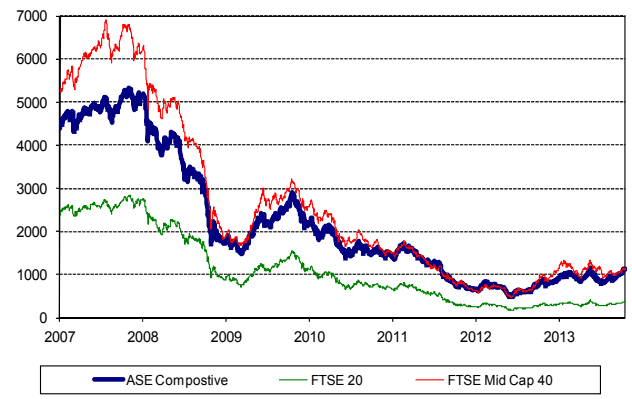
MONEY & FINANCIAL MARKETS: Credit expansion to businesses and households fell by -3.9% at end-August 2013 from -4.0% at end-July 2013, -4.0% at end-December 2012 and -4.8% at end-August 2012. In particular, the annual rate of change of mortgage and consumer lending fell to -3.2% and -4.8% respectively at end-August 2013 from -3.4% and -5.1% respectively at end-December 2012 and -3.6% and -5.3% respectively at end-August 2012. Moreover, lending growth to businesses decreased to -4.5% at end-August 2013 from -4.6% at end-July 2013, -4.4% at end-December 2012 and -5.3% at end-August 2012. Overall, the annual rate of change of credit to the private sector is expected to decelerate further to around -1.5.0% by year-end 2013, from -4.0% at year-end 2012.

Diagram 20. Credit Expansion



The main ASE composite index was up by 11.7% ytd (as of 16.10.2013) on a yoy basis (FTSE-20 stocks: +21.0%, FTSE-40 mid-cap: -0.6%), from an increase of 33.4% at end-2012 (FTSE-20 stocks: -19.8%, FTSE-40 mid-cap: -79.7%). Following these developments, at end September 2013 44.5% of the total stock exchange value of listed firms was in the hands of foreign investors, up from 49.7% at end-September 2012.

Diagram 21. Athens Stock Exchange Indices



9. Economic Data – Greece

Yearly Data	2007	2008	2009	2010	2011	2012	2013
Real GDP Growth	3,5	-0.2	-3,1	-4.9	-7.1	-6.4	-3.7
Gross Fixed Capital Formation	22.8	-14.3	-13.7	-15.0	-19.6	-19.2	-3.2
- Equipment	27.4	-4.8	-18.4	-8.2	-18.1	-17.4	1.5
- Residential	25.6	-33.6	-20.7	-21.6	-18.0	-32.9	-19.0
Unemployment (percent)	8.3	7.7	9.5	12.6	17.7	24.2	27.0
Employment	1.4	1.2	-0,6	-2,6	-5,6	-8,3	-3.5
Consumer Price Index (year average)	3,0	4.2	1.3	4.7	3.3	1.5	-0.5
Unit Labor Costs	3.1	5.1	6.2	-0.1	-1.8	-6.2	-6.3
Credit Expansion (Private Sector)	21.5	15.9	4.1	0.0	-3.1	-4.0	-2.0
Government Deficit (as % of GDP)	-6.5	-9.8	-15.6	-10.7	-9.5	-6.0	-4.1
Current Account (as % of GDP)	-12.4	-13.3	-10.3	-9.2	-8.6	-2.2	1.0

Source: Hellenic Statisticsl Authority (ELSTAT.)

Quarterly Data	2011	2012	2012	2012	2012	2012	2013
	year	Q1	Q2	Q3	Q4	year	available period
Economic Activity (avg)							
Retail Sales Volume	-8.7	-12.1	-11.4	-9.9	-13.8	-11.8	-12.3 (Jan-Mar)
Construction Activity	-37.7	1.9	-26.2	-43.7	-44.1	-30.6	-43.6(Jan.-Mar)
Industrial Production (Manufacturing)	-8.5	-9.6	-3.9	-3.8	1.9	-3.9	-0.7 (Jan-Apr)
PMI (manufacturing)	43.6	40.0	41.3	42.0	41.4	41.2	45,3 (May)
Economic Sentiment Indicator	80.6	78.5	79.0	79.7	82.7	80.0	88.8 (Jan-May)
Index of Business Expectations in Manufacturing	76.9	72.9	77.6	76.7	81.6	77.2	87,6 (Jan-May)
Consumer Sentiment Index	-74	-81	-75	-69	-74,8	-74,8	-69,9 (Jan-May)
Credit Expansion (eop)							
Private Sector	-3.1	-4.0	-4.8	-4.5	-4.0	-4.0	-3.4 (Apr)
Consumer Credit	-6.4	-6.8	-5.3	-5.3	-5.1	-5.1	-5.4 (Apr)
Housing	-2.9	-3.4	-3.6	-3.7	-3.4	-3.4	-3.2 (Apr)
Business	-2.0	-3.3	-5.3	-4.9	-4.4	-4.4	-3.4 (Apr)
Tourism	-2.3	-0.5	-0.2	-0.2	1.1	1.1	-0.1 (Apr)
Prices (eop)							
Consumer Price Index	3.3	-0.9	1.9	-1.5	1.7	1.5	-0.4(May)
Core Inflation	1.5	1.5	1.9	-1.6	1.2	0.3	-1.4 (May)
Interest Rates (eop)							
Savings	0.40	0.41	0.42	0.42	0.42	0.42	0.42 (Apr)
Short-term Business Loans	7.46	7.81	7.67	7.52	7.45	7.61	7.44 (Apr)
Consumer Loans (with charges)	12.37	11.41	11.26	11.22	10.76	11.16	10.07 (Apr)
Housing Loans (with charges)	4.71	4.13	3.78	3.31	3.16	3.60	3.22 (Apr)
3 month Euribor	1.39	1.04	0.74	0.43	0.21	0.57	0.21 (Apr)
10 year Bond Yield	15.75	24.74	25.40	23.69	16.16	16.16	9.19 (May)
National Accounts							
Real GDP	-7.1	-6.7	-6.4	-6.7	-5.7	-6.4	-5.6 (Q1)
Final Consumption	-7.2	-7.4	-7.2	-8.9	-8.7	-8.1	-8.3 (Q1)
Investment	-19.6	-22.8	-21.5	-21.5	-10.3	-19.2	-5.6 (Q1)
Exports of goods & services	0.3	4.2	-3.0	-4.2	-4.8	-2.4	-2.6 (Q1)
Imports of Goods & services	-7.3	-14.9	-12.9	-18.7	-8.1	-13.7	-7.8 (Q1)
Balance of Payments (in € bn - Cumulative)							
Exports of Goods	20.2	4.9	10.4	16.1	22.0	22.0	5.4 (Jan-Mar)
Imports of Goods	47.5	10.8	21.5	31.7	41.6	41.6	9.9 (Jan-Mar)
Trade Balance	-27.2	-5.9	-11.1	-15.7	-19.6	-19.6	-4.5 (Jan-Mar)
Invisibles Balance	8.8	2.2	5.0	13.8	16.3	16.3	3.3 (Jan-Mar)
Invisibles Balance / Trade Account	32.4	37.5	45.5	88.0	83.4	83.4	72.3 (Jan-Mar)
Current Account	-18.4	-3.7	-6.0	-1.9	-3.3	-3.3	-1.3 (Jan-Mar)
Direct Investments	0.03	-0.4	0.3	2.0	2.3	2.3	1.3 (Jan-Mar)
Portfolio Investments	-17.3	-37.0	-72.0	-76.0	-100.5	-100.5	0.5 (Jan-Mar)
Athens Stock Exchange (eop)							
Composite Index	680.4	729.0	611.0	739.0	908.0	908.0	1,014.5 (May)
% change	-51.9	7.1	-10.2	8.6	33.4	33.4	93.1
Market Capitalization ASE (% of GDP)	11.8	13.4	11.5	13.6	17.7	17.7	32.7

Source: Hellenic Statisticsl Authority (ELSTAT.), Bank of Greece