ALPHA BANK

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Greece and Southeastern Europe Economic & Financial Outlook

Executive Summary

1. Greece

- Following national elections on June 17, 2012, a pro-reform 3-party coalition government has managed to bring Greece back to full compliance with the Troika's Memorandum. In the process, Greece adopted measures of €13.5 bn (of which €11.5 bn in spending cuts) over the period 2013-14 with a view to reach a primary budget surplus position of 4.5% of GDP by 2016, and not by 2014 as previously agreed, in an effort to spread adjustment costs over a longer period. Implied additional funding requirements have been financed through substantially reduced or deferred interest payment and extending the maturities of official lending. Moreover, in combination with a debt buyback operation reducing the debt to GDP ratio by about 10 percentage points successfully completed, debt sustainability has been restored. This has unlocked the disbursement of €49.1 bn of aid, of which €34.3 bn in December 2012 and the remainder in installments during the Q1 2013, paving the way for the recapitalization of Greek banks and restoring confidence. This eliminates any risks of Greece exiting the Euro and allows for the timely resumption of growth.
- Greece has endured an unprecedented 18% cumulative GDP decline since 2008. With the program of adjustment back on track, privatization accelerated, major infrastructure projects restarting and liquidity conditions easing, positive yoy growth could resume from Q4 2013.
- Internal devaluation since 2009 has restored 2/3 of competitiveness lost during the 2000s, while the restoration of flexibility and economic performance in the labour market implies further gains in competitiveness in the following years. In this context, the net exports of goods and services deficit has shrunk by -17.1% in 2010, -16.3% in 2011 and -66% in the 9-month period to September in 2012. The substantial improvement in 2012 reflects primarily the severe liquidity constraints prevailing in the economy which led, on the one hand, to a collapse of non-oil imports and, on the other hand, to shrinkage in the deficit of ships trading transferred outside of Greece. As a result, the current account deficit (including net capital transfers) is expected this year to drop to about 3.5% of GDP, from 8.8% in 2011 and 10.3% of GDP in 2009. On the basis of unfolding trends, the current account will be balanced by 2014, substantially improving confidence and facilitating Greece's return to the markets.
- The performance in fiscal consolidation is impressive. In fact, there was a significant improvement in the General Government primary balance, which in fact recorded a surplus of €2.3 bn in Jan.-Oct. 2012, from a deficit of € 4.2 bn in Jan.-Oct. 2011. In the ten-month period Jan.-Oct. of 2012, revenue is up by 1%, compared with a target of -2.4% for the year as a whole and primary spending is down by -8.4% compared with a target of -5.1%. Moreover, it is now officially projected that the current state budget primary deficit will be balanced in 2012. Nevertheless, actual performance over the period Jan.-Nov. 2012, points to an even better outcome, as official projections imply a -22.7% decline in revenue and an 8.9% increase in primary spending in December 2012 vs a -2.3% decline in revenue and a -9.5% decline in primary expeditions in Jan.-Nov. 2012 respectively. Therefore, it is highly likely that a general government primary balance may emerge even from this year, as compared with an officially projected general government primary deficit of 1.2% of GDP in 2012.

2. Romania

- GDP contracted by 0.6 y/y in Q3 2012, following an increase by 1.1% y/y in Q2 2012 and is now expected to increase by 0.6% in 2012 as a whole, following the 2.5% growth in 2011. A higher growth reaching 2.5% is now projected for 2013 (IMF).
- A strong commitment is required by the new government in order to meet the budget deficit target of -3.0% of GDP this year, as spending control might ease as we approach national elections scheduled in December 9, 2012.
- Recent developments on the political front, as well as the coming elections remain an upside risk for the exchange rate, with liquidity in the money market remaining a major issue.

3. Bulgaria

- GDP grew by 0.5% y/y (flash estimates) in Q3 2012 the same as in Q2 2012. For 2012 as a whole GDP growth is now expected to slow to 0.6%, from 1.7% in 2011. A higher growth reaching 1.5% is now projected for 2013 (IMF).
- As exports are affected by the European economy's slowdown, domestic demand remains the major driving force of economic activity, boosting also imports of goods and services.
- Fiscal policy is on track to meet the fiscal deficit target of -1.9% of GDP in 2012, from -2.1% of GDP in 2011. Moreover, the deficit is targeted to fall to -1.5% of GDP in 2013.
- Inflation declined to 4.4% y/y in October 2012 from 4.9%y/y in September 2012; inflation pressures will remain relatively contained for the rest of 2012 due to high unemployment and expected stabilization of commodity prices.

4. Cyprus

- The Cyprus economy is in recession, as GDP fell by -2.2% y/y in Q3 2012, following its fall by -2.3% y/y in Q2 2012 and it is now expected to fall by -2.3% in 2012, following its growth by a moderate 0.5% in 2011.
- However, a lot will depend on the successful conclusion of the negotiations, which are currently under way between Cyprus authorities and the Troika, for agreement on a comprehensive Financial Support Package from the EFSF and the IMF covering the recapitalization needs of Cyprus's banks and the refinancing of the country's sovereign debt.
- The current account deficit stood at -4.6% of GDP in January-June 2012. The widening of the current account deficit is due to a weakening of the service balance surplus and the notable increase of the income balance deficit due to lower income from direct and portfolio investment of Cyprus' citizens abroad.
- The fiscal performance so far indicates that the government will miss the target of budget deficit in 2012, thus making more obvious the need for additional fiscal adjustment measures, which will be prescribed in cooperation with the troika.

5. Serbia

- The Serbian GDP fell by -2.2% y/y in Q3 2012 after decreasing by -0.8% y/y in Q2 2012 and it is expected to drop by 1.6% in 2012 despite the government's policies to boost growth.
- The big challenge which the three-party coalition government and the Central Bank are facing is: (i) to stabilize the exchange rate of Dinar (RSD), which has depreciated against euro by about 6.0% so far in 2012, with substantial loss of FX reserves, and b) to curb the fiscal deficit, probably trough the introduction of new effective fiscal consolidation measures on top of those already taken in March. The government is already acting towards this objective, trying also to strike a new agreement with the IMF.
- In order to finance the 2012 budget deficit and also improve its FX reserves position the Government proceeded with a successful issuance of a $ 1.0 billion Eurobond with a yield of 6.625%.
- The National Bank of Serbia (NBS) raised its key policy rate by 20 bps to 10.95% for the 5th time (November 8, 2012) this year after its first hike by 50bps in June 2012, with the purpose to constrain further depreciation pressures on RSD.

6. ALBANIA

- Despite a deteriorating external environment due to the Eurozone sovereign debt crisis the economy of Albania has been relatively resilient. GDP rose by +2.0% y/y in Q2 2012 following a contraction by -0.2% y/y in Q1 2012. The IMF is forecasting a 0.5% GDP growth in 2012, while the EBRD forecasts a 0.6% growth in 2012 and a 1.3% growth in 2013, from a 2.0% growth in 2011.
- The Bank of Albania cut its key repo rate by 25 bps in July 2012, to a record low level of 4% in order to stimulate domestic demand amidst weak inflationary pressures.
- The current account deficit reached $ 578 million in H1 2012, compared with $ 742 million in H1 2011. It is estimated that this CAD would gradually decrease further during the next years on the back of continued buoyant exports and moderate import growth.

7. FORMER YUGOSLAV REPUBLIC OF MACEDONIA

- In Q1 and Q2 2012, the economy contracted by -1.3% and -0.9% y/y, compared to a growth of 6.4% y/y and 3.7% y/y respectively in Q1 and Q2 2011. National Bank of FYROM forecasts a 1.0% GDP growth in 2012.
- Inflation surged to 5.3% in October 2012, while on average is now expected to fall to 3.5%, from 3.9% in 2011.
- The current account deficit in the first 8-months of the year shrank to € 121 million or -1.6% of projected GDP for 2012 from € 283 million or 3.8% of GDP the same period in 2011. This improvement was mainly due to the 21% y/y increase of the net current transfers surplus. The trade deficit increased by 1.0%.

8. UKRAINE

- Ukraine's GDP dropped by -1.3% from +3.0% y/y in Q2 and +2.0% y/y in Q1 2012. For 2012 GDP growth is now expected to fall to 0.7%, while it is expected to pick up to 2.5% in 2013.
- Even though the state budget revenues had a relatively good performance in the first half of 2012, election promises had impact negatively on the budgetary outcome.
- Given strong depreciation expectations and negative external trade developments the NBU may allow a gradual hryvnia weakening.

9. TURKEY

- Economic activity eased substantially in H1 2012 due to weak performance of the industrial sector. GDP growth fell to 3.3% and 2.9% in Q1 and Q2 2012 respectively, from 12.1% and 9.1% respectively in Q1 and Q2 2011.
- Although the slowdown of the economic growth helped to reduce the current account deficit notably in H1 2012, it has put budget execution at risk.
- Inflation declined to 7.8% in October 2012, after reaching a 3-year high of 11.1% in April 2012. The Central Bank expects inflation to end 2012 at 7.4%, supported by lira's relative stability or appreciation against the Euro.

1. GREECE

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

	2009	2010	2011	2012	
					available period
Retail sales volume	-9.3	-6.9	-8.7	-11,6	Jan-Sept
Automobile sales	-17.4	-37.2	-29.8	-38.6	Jan-Oct
Tax on mobile telephony	13.2	37.1	-16.8	-7.2	Jan-Sept
VAT revenue	-9.1	4.8	-2.8	-11.1	Jan-Oct
Consumption tax on fuels	18.6	30.3	-18.3	-3.7	Jan-Oct
Private Consumption	-1.3	-3.6	-7.1	-8,86	Jan-Sept
Government Consumption	4.8	-7.2	-9.1	-3,98	Jan-Sept
Private building activity (volume, according to permits)	-26.5	-23.7	-37.7	-23.0	Jan-Aug
Cement production	-21.4	-14.3	-37.8	-16.2	Jan-Sept
Public investment expenditure	-0.4	-11.3	-21.8	-13.4	Jan-Oct
Fixed investment	-11.1	-15.0	-20.7	-20,59	Jan-Sept
Change in Stocks and Stat. Dis. (Billion €)	-3,76	-0,63	0,60	-2,72	Jan-Sept
Unemployment	9.5	12.5	17.7	25.4	Aug
Manufacturing production	-11.2	-5.1	-9.5	-6.0	Jan-Sept
Economic sentiment indicator	79.7	79.3	77.6	79,0	Nov
-Industry	72.1	75.8	76.9	75.7	Sept
-Consumer confidence	-45.7	-63.4	-74.1	-74.8	Nov
PMI (manufacturing)	45.3	43.8	43.6	41.0	Oct
Exports of goods - excluding oil (El.Stat.)	-15.9	9.3	9.4	5.3	Jan-Sept
Exports of goods (El.Stat.)	-18.2	11.6	37.0	…	…
Imports of goods - excluding oil (El.Stat.)	-20.2	-10.7	-13.2	-8.7	Jan-Sept
Imports of goods (El.Stat.)	-24.1	-1.9	-6.9	…	…
Tourist arrivals (airports)	-7.4	-0.7	8.7	-3.4	Jan-Oct
Tourism receipts (BoP)	-10.6	-7.6	9.5	-2.7	Jan-Sept
Exports goods & services	-18.3	3.8	-0.3	-1,92	Jan-Sept
Imports goods & services	-18.6	-4.8	-8.1	-17,40	Jan-Sept
GDP growth	-3.1	-4.9	-7.1	-6,63	Jan-Sept
Inflation (CPI)	1.2	4.7	3.3	1.6	Oct
Current Account (% of GDP)	-10.3	-9.2	-8.6	-1.0	Jan-Sept

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

Resilient Greece

Greece has already carried out a remarkable adjustment and has been functioning with primary surpluses in the General Government (GG) from middle 2012. Moreover, the fast implementation of drastic structural reforms and the consequent substantially improved international competitiveness has fundamentally changed incentives and the driving forces of its economy. Thus it has laid the foundations for its recovery from the greatest economic crisis of its post-war history.

Greece has managed to put in place the painful policies of the 1st and 2nd Memorandums of Economic Policy (MOUs), agreed with its official lenders through the Troika (the European Commission, the ECB and the IMF) in May 2010 and in February 2012 respectively. Moreover, in November 2012 the Greek Parliament ratified the 3rd MOU and the 2013 budget comprising an extensive array of additional drastic and painful for the Greek people fiscal measures for the implementation of the budges for 2013 and 2014 in accordance with the Medium Term Fiscal Strategy 2013-2016 agreed between the Greek government and the Troika.

The widely held views, both in Greece and internationally, that Greece has failed to implement the agreements with its creditors are not supported by actual developments. It is true that Greece's adjustment has been achieved at an excessively large cost, measured by the abnormal fall of its GDP and the dramatic increase in unemployment and social discontent in the country. Nevertheless, the (fiscal and structural) adjustment that has been achieved is real and valuable, implying that in the end of 2012, Greece's overall prospects for recovering from its sovereign-debt and broader economic crisis, while remaining a full and uncontested member of the Eurozone, are now much more robust than ever. More specifically, in the last two-and-a-half years, Greece has achieved:

a) An unprecedented fiscal adjustment, turning a general government (GG) primary deficit of 10.4% of

GDP in 2009 to an estimated small primary surplus of 0.2% of GDP in 2012 (Table 1). In fact, as pointed out by the European Commission, "the fiscal effort undertaken by Greece since the start of the adjustment programme is actually much bigger than anticipated in the initial Council decision in May 2010. At that time, the required improvement in the structural budget balance was 10% of GDP over the period 2009-14. However, Greece has already improved its structural budget balance by more than 13% of GDP at the end of 2012". Moreover, with the implementation of the additional large package of measures foreseen for 2013-14, which have been legislated in November 2012, Greece would fulfill the requirement by an even larger margin.

Table 1. Fiscal Adjustment in Greece in 2010-2012

	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	112,9	88,5	31,0	-10,5%	-15,7%
2010	101,4	90,2	27,8	-5,0%	-10,7%
2011	93,0	88,2	25,9	-2,3%	-9,4%
2012 (2013 Budget)	88,0	85,2	23,4	-1,2%	-6,6%
2012 (EAD Alpha Bank)	88,0	88,2	23,4	0.2%	-5,2%

Source: a) European Commission (10/11/2012), "The Second Economic Adjustment Programme for Greece - Fisrst Review", November 2012. b) EAD Alpha Bank estimates for 2012

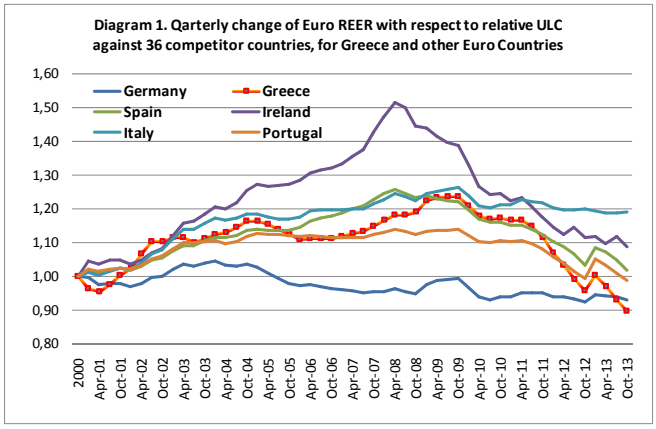


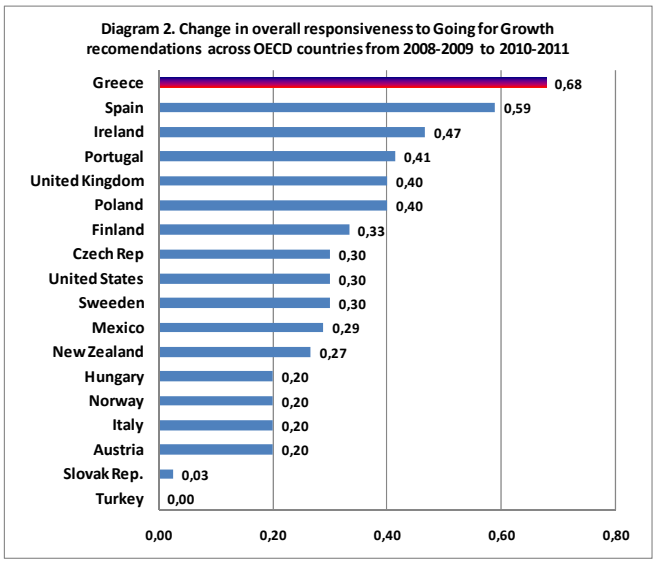
Table 2. Unit Labour Cost based REER appreciation (against 35 countries examined by the European Commission)

	Germany	Greece	Spain	Ireland	Italy	Portugal
Q4 2009/2000	-0,7%	23,7%	22,1%	38,7%	26,3%	13,7%
Q4 2011/Q4 2009	-4,4%	-9,8%	-8,0%	-15,3%	-3,6%	-5,0%
Q4 2012/Q4 2009	-4,8%	-22,7%	-11,2%	-19,4%	-5,6%	-7,5%
Q4 2013/Q4 2009	-6,3%	-27,5%	-16,7%	-21,7%	-5,8%	-13,1%
Q4 2011/2000	-5,1%	11,7%	12,4%	17,5%	21,7%	8,0%
Q4 2012/2000	-7,6%	-4,3%	3,3%	11,3%	19,9%	-0,7%
Q4 2013/2000	-7,0%	-10,3%	1,7%	8,6%	19,0%	-1,2%

Source: a) European Commission (Price & Cost Competitiveness and European Economic Forecast, Autumn 2012).

b) A striking improvement in competitiveness of its internationally-traded products, measured by an internal devaluation of the unit labour cost (ULC) based real effective exchange rate (REER) of 22.7% between Q4 2009 and Q4 2012 (Diagram 1 and Table 2). As it is pointed out by the European Commission (27/11/2012, page 2) and as indicated by the figures presented in Table 2 above, "by the end of 2012, all of the 2001-2009 competitiveness loss will have been recouped". In fact, Greek cost competitiveness at the end of 2012 will be by 4.3% better than in 2000. Moreover, "by the end of 2013, all of the loss (of competitiveness in 2001-2009) will have been recouped and competitiveness levels will have improved". In fact the Greek ULC based REER will have depreciated by 10.3% at the end of 2013, compared with the year 2000 and by 27.5% compared with Q4 2009. Finally, Greece's gains in cost competitiveness at the end of 2013, comparing with either 2000 or 2009 will be by far better than those of any other country included in Table 2, including Germany.

c) The implementation of an extensive array of fundamental structural reforms (Diagram 2), which are fast changing-improving the functioning of its economy and have already facilitated a 1.9% growth in labour productivity in 2012, in the midst of an extremely adverse economic environment. This robust productivity growth is expected to continue unabated in 2013 and in the following years and to constitute the main factor contributing to the early recovery of the Greek economy. Thus it will also secure Greece's substantial gains in fiscal adjustment and international competitiveness.



This impressive adjustment was achieved by Greece on the back of extremely adverse economic, political and social conditions, which include, inter alia,

(1) Inadvertent tax policy measures introduced with the tax law 3842 of April 2010, in combination with the failure to re-organize and strengthen the revenue collection mechanism, which led to an exacerbation of tax and social security contributions fraud and evasion in 2011 and in 2012, with substantial negative effects on budget implementation, especially in 2011.

(2) Widespread reactions from organized interest groups and some political parties, hurting the implementation of significant structural reforms and fiscal adjustment measures, exerting additional disruptive effects on tourism and other important economic sectors and, therefore, contributing to the deepening of recession.

(3) Stifling liquidity and economic pressure based in times on the unwarranted and prolonged delay in the disbursement of the official financial support trances to Greece and, even more importantly, the unprecedentedly negative Troika predictions for the growth prospects of the Greek economy, not only in the immediate future but

also for the period 2015-2030, which contributed to the depressing fall of economic confidence and the exit of capital from Greece and put in play even the possibility of an end of Greece's membership in the Eurozone.

(4) Dramatic multi-notch debilitating downgrades of the Greek economy and of the Greek banks by credit rating agencies, starting from May 2010.

(5) Political uncertainty, also took hold of the country, especially in the periods October – November 2011 and May-Jun 2012, following the above negative developments and the unrelenting pressures for even more and more austerity measures between June 2011 and November 2012, hurting social cohesion and diminishing popular support for the adjustment program. This political uncertainty has constituted a basic factor in increasing the costs for the country arising from its unprecedented fiscal adjustment. It was caused to some extent by Troika's abnormal pressure and its overall stance against Greek Government's which were obliged to spent any political clout they had in order to implement (even with mistakes, delays and misapprehensions) the prescribed fiscal adjustment and structural reforms. This political turmoil in relatively short periods in Greece had an effect on economic developments in the country and caused substantial brakes to the adjustment effort as well. Nevertheless, in the most crucial elections in June 2012 the pro adjustment parties have won a great majority of 176 MPs in the 3000 MPs parliament and carry on the adjustment effort with considerable effectiveness and success. In fact, the political situation today in Greece constitutes an asset for the country and not a liability, especially compared with the political situation in other European countries.

This extremely negative operating environment led to a collapse of confidence and an outflow of deposits, especially in the period between September 2011 and June 2012 that, in combination with the virtual freezing of official financing to Greece in June – December 2012, dried up domestic liquidity, exacerbating the negative effect on Greek GDP emanating from drastic fiscal adjustment and structural reform measures.

As a result, GDP fell by -7.1% in 2011 and by -6.6% in Jan.-September 2012, notwithstanding the positive effect on GDP growth from the rapidly rising net exports, expected to reach +4,3 percentage points in 2012, from 2.4 pps in 2011 and 3.0 pps in 2010 and in 2009. Moreover, the dramatic fall of economic activity, the fall of employment in the public sector (by -150,000 people), the drastic reform of the labour market and, in particular, the early abolishing of costs of firing employees in the private sector and, most importantly, the almost complete stoppage of both public and private investment have led to a surge in unemployment to 23.8% of the labour force in 2012, with youth unemployment exceeding 55%.

The extension of the duration of the fiscal adjustment programme, Greece's financing needs in the period 2013-2020, and perceived sustainability of Greece's Sovereign Debt.

The 2nd Adjustment & Financial Support Program for Greece and its implementation in 2012.

The 2nd Adjustment & Financial Support Program (2nd A&FSP) for Greece, which was approved by the Heads of State Summit of the Eurozone on February 20th, 2012, awarded additional financial support to Greece amounting to € 130 bn. This, combined with undisbursed financing from the 1st A&FSP to Greece of May 2010, of € 37 bn in February 2012, implied that total financing which was available to Greece to be disbursed in 2012-2014 amounted to € 167 bn. This financing was planned to be disbursed as follows: € 120 bn in 2012, € 24 bn in 2013, and € 23 bn in 2014. An additional € 8 bn was also scheduled to be disbursed by the IMF in 2015.

The implementation of the 2nd FSP started with the successful completion of debt exchange program of GGBs held by the private sector (PSI Plus), which has reduced the par value of the privately held debt of Greece by € 100 bn and has significantly lengthened the maturities of the remaining privately held outstanding debt. Moreover, the remaining debt carries low interest rates of 3.5% on average. The completion of the PSI Plus opened the way for full implementation of the 2nd A&FSP, which also includes the provision of € 50 bn to replenish the Greek banks' capital which was substantially reduced due to their involvement in PSI Plus. In fact in H1 2012 Greece received € 75.62 bn, of which € 25 bn for the financing of the Hellenic Financial Stabilization Fund (HFSF) to be used for the recapitalization of banks.

Greece was to receive an additional amount of € 44.4 bn until the end of 2012, of which € 31.5 in June 2012 (of which the € 25 bn were assigned to be used to increase the resources of HFSF and complete the recapitalization of banks), € 5.0 billion in Q3 2012 mainly in order to facilitate the repayment of a € 3.2 bn Greek bond held by the ECB maturing in 20 August 2012 and, finally, € 8.3 bn were scheduled to be received in December 2012.

By the end November 2012 none of these trances had been released by Greece's lenders, obliging Greece to issue the needed amounts of costly treasury bills, with the consent of the ECB, in order to cover its financing needs, at the expense to a great extend of the banks, the Greek economy and the fiscal adjustment effort.

This painful freezing of official financing to Greece occurred despite the fact that ***Greece from its part has implemented much better than planed not only the PSI Plus (mainly at the expense of its banks) but also, and more importantly, the 2012 Budget*** (with substantial GG primary surpluses in August-October 2012) and has successfully concluded negotiations with the Troika and legislated the adoption of additional fiscal adjustment measures of € 13.8 bn in order to secure beyond any doubt the exact implementation of the budgets for 2013 and 2014 as well. Moreover, it has also adopted additional structural reform measures consolidating previous reforms and aiming to boost productivity and international competitiveness growth and facilitate the early recovery and eventual healthy growth of its economy. In fact, the much better than planned fiscal adjustment in 2012 was achieved despite the withholding of the much needed financial support by Greece's lenders and the consequent deeper recession.

The unwillingness to authorize the disbursement of the important financial support trances to Greece was

justified by its lenders pointing to the political uncertainty that prevailed in Greece in May-June 2012, the period of the two parliamentary elections, were the risk that an anti-adjustment political party would win the election became real. However, the disbursement of the crucial financial support trances was unjustifiably delayed even in the period after the formation in June 2012 of the strong pro reform government, which declared from the very beginning its intentions to apply fully and effectively the adjustment program. It is characteristic that the 1st assessment of the 2nd A&FSP by the Troika took four months to be completed.

At the end of this Troika's assessment, Greece's plights rested again on Troika's estimation of its financing needs in the period 2013-2022 and also on Troika's new Debt Sustainability Analysis taking into account the new developments in the Greek economy. More specifically:

The February 2012 Debt Sustainability Analysis (DSA) and Greek financing needs analysis by Troika were calculated, taking into account the terms of the 20 February 2012 2nd A&FSP and under relatively pessimistic assumptions concerning nominal GDP growth and fiscal performance in 2012-2020 and in 2021-2030. With these assumptions the Troika estimated in March 2012 that Greece's financing needs were fully covered and that the Greek GG debt would register a gradual fall to 116.5% of GDP by 2020 and a further fall to 88.0% of GDP in 2030s. This GG debt/GDP path was considered by Troika as sustainable.

This scenario was based on the following assumptions:

Real GDP would register a -4.8% fall in 2012 and 0.0% growth in 2013 wile an average 2.3% and 3.2% real and nominal GDP growth respectively was estimated for the period 2013-2020 (Table 3). Then annual real GDP growth would average 1.4% in 2021-2030.

Table 3. Projections for Greek GDP growth in the period 2012-2020

	Real GDP			GDP Deflator			Nominal GDP		
	Τρόικα			Τρόικα			Τρόικα		
Year	March 2012	November 2012	EAD Alpha Bank	March 2012	November 2012	EAD Alpha Bank	March 2012	November 2012	EAD Alpha Bank
2010	-3,5	-4,9	-4,9	1,7	1,0	1,0	-1,9%	-3,9%	-3,9%
2011	-6,8	-7,1	-7,1	1,6	1,0	1,0	-5,3%	-6,2%	-6,1%
2012	-4,8	-6,0	-6,2	-0,7	-0,5	-0,5	-5,5%	-6,5%	-6,7%
2013	0,0	-4,2	-2,0	-0,5	-1,2	-1,0	-0,5%	-5,3%	-3,0%
2014	2,5	0,6	1,8	-0,1	-0,4	0,0	2,4%	0,2%	1,8%
2015	3,1	2,9	2,9	0,8	0,3	0,5	3,9%	3,2%	3,4%
2016	3,0	3,7	3,5	1,0	1,1	1,3	4,0%	4,8%	4,8%
2017	2,8	3,5	3,7	1,3	1,3	1,4	4,1%	4,8%	5,2%
2018	2,6	3,0	3,5	1,6	1,6	1,7	4,2%	4,6%	5,3%
2019	2,5	3,0	3,5	1,8	1,8	1,8	4,3%	4,9%	5,4%
2020	2,2	3,0	3,5	1,9	1,9	1,9	4,1%	5,0%	5,5%
2010-2020	0,3%	-0,3%	0,1%	0,9%	0,7%	0,8%	1,2%	0,4%	0,9%
2013-2020	**2,3%**	**1,9%**	**2,5%**	**1,0%**	**0,8%**	**0,9%**	**3,3%**	**2,7%**	**3,5%**
2021-2030	**1,4%**	**1,4%**	**1,9%**	**1,4%**	**1,4%**	**1,9%**	**1,4%**	**1,4%**	**1,9%**

The general government (GG) primary balance would register a -1.0% of GDP deficit in 2012 and a surplus of 1.8% of GDP in 2013, and 4.5% of GDP yearly in the period 2014-2017, and 4.3% of GDP in 2018-2020.

Revenues from privatization would reach € 44.9 bn in 2012-2020 and there would be another € 4.0 bn until 2020 from the recovery of funds used in 2012 for the recapitalization of the Greek banks (€ 50 bn).

The November 2012 Troika's DSA and financial needs analysis: By November 2012, however, the March 2012 assumptions of Troika have changed materially as follows:

To start with, nominal and real GDP growth in 2012 is now expected at -6.5% and -6.0% respectively, with a fall of GDP deflator by -0.5%, compared with the March 2012 assumptions for a -4.8% fall of real GDP and a -5.5% fall of nominal GDP). ***This much worse than expected GDP fall was mainly the result of the freezing of the official financial support for Greece in June – December 2012, which meant that Greece's pressing financing needs in 2012, were not covered.*** Therefore, Greece was left without funds for the: a) financing of the early recapitalization of Greek banks, as was needed following the PSI Plus, b) provision of the needed liquidity in the Greek economy (e.g., in order to pay out the overdue government liabilities), or even in order to redeem maturing sovereign debt to the ECB in August 2012, amounting to € 3.2 bn, c) provision of the funds needed to restart important public investment projects co-financed with funds from EU structural funds and the European Investment Bank. As a result of these developments, and the huge politically driven capital flight from bank deposits in May-June 2012, Greece suffered a dramatic liquidity shortage in 2012, which maintained the economic climate of the country at abnormally low levels and led to the dramatically increased GDP fall.

Second, on 5 October 2012, completely unexpectedly, ***Greece suffered another drastic intervention of the independent ELSTAT. The statistical agency of the country came out with another extraordinarily big downgrade of Greece's nominal GDP.*** According to this uncontested verdict, the 2010 and 2011 nominal GDP of Greece fell to € 222.15 bn and € 208.53 bn respectively in September 2012, from € 227.3 bn and € 215.1 bn respectively in March 2012. This new huge downgrade of the official nominal GDP levels in Greece, implies to a great extent an equal increase of the already big gap between the officially recorded and the real GDP level in Greece, especially in recent years in which more than 50% of relatively high value economic transactions in the country are taking place without the issuing of any receipt or indication that actually took place. On the other hand, this drastic GDP downgrade constitutes an important component in the calculations according to which the Greek sovereign debt which was sustainable in March 2012, became again unsustainable in November 2012, with the main effect of this unassailability the further delay of the disbursement of the designated 2nd A&FSP trances of financial assistance to Greece.

Third, taking a cue from the existing excessively pessimistic projections of domestic and foreign analysts for GDP growth in Greece in 2013 and 2014, ***the Troika came out with its own depressing projections of nominal GDP growth in the following two years (Table 3).*** As will be analyzed in the following chapters of the Report, these projections, especially for the years 2013 and 2014, are based mainly on false assumptions about a huge recession deepening effect of fiscal adjustment and about a dramatic fall of Greece's labour productivity in 2013 and in 2014, in the wake of its important increase by 1.9% in 2012. In fact, these Troika's projections for a dramatic deepening of Greece's recession in 2013 and 2014 constitute an insurmountable impediment to the much needed recovery of the Greek economy and are absolutely critical in determining the negative results of

the analysis of Greece's financial needs and debt sustainability in 2013-2022.

Forth, given the above depressing GDP growth assumptions, ***in Greece's Medium Term Fiscal Strategy 2012-2016***, published recently by the European Commission (Table 4), ***the Troika has included even more depressing projections concerning the effectiveness of Greece's huge fiscal adjustment effort.*** In fact, the Troika seem to believe that fiscal adjustment and structural reform effort in Greece are mainly exerting an abnormally heavy toll in terms of GDP fall and increasing unemployment, while it has a miniscule effect on reducing fiscal imbalances. For example, with very painful and direct fiscal measures amounting to € 9.6 bn in 2013, the troika projects a fall of GDP by € 10.5 bn and a fall of the GG primary deficit by a mere € 2.9 bn. Moreover, the GG primary balance will register a small surplus of 1.5% of GDP in 2014 and in 2015 and a surplus of 2.7% of GDP in 2016. In order to achieve the targeted surplus of 3.0% of GDP in 2015 and of 4.5% of GDP in 2016 new fiscal adjustment measures are required, which, according to the European Commission, must be specified until March 2013. That is, fiscal measures which are supposed to be needed for 2016 are required to be specified in early 2013. In fact, it is more possible that these measures are going again to be used as a mechanism to further delay the release of the additional financial support trances to Greece in the following year, setting the stage for the realization of the dramatic Troika's projection for a -5.3% fall of nominal GDP in 2013 as well.

Table 4. Greece's fiscal adjustment in 2012-2016: Troika Projections

% of GDP	2008	2009	2010	2011	2012	2013	2014	2015	2016
GG Total Revenue	40,7	38,3	40,6	42,3	43,9	43,8	44,3	43,8	43,7
GG Total Expenditure	50,5	54,0	51,3	51,7	50,8	49,2	48,9	48,7	47,7
GG Primary Expenditure	45,4	48,8	45,6	44,6	45,4	43,8	42,8	42,2	41,1
GG Deficit	9,8	15,7	10,7	9,4	6,9	5,5	4,6	4,8	4,0
GG Primary Deficit	-4,7	-10,5	-5,0	-2,3	-1,5	0,0	1,5	1,7	2,6
Billion Euros	2008	2009	2010	2011	2012	2013	2014	2015	2016
GG Total Revenue	94,9	88,5	90,2	88,2	85,2	80,1	80,9	82,3	85,9
GG Total Expenditure	117,8	124,8	114,0	107,9	98,5	90,1	89,3	91,4	93,7
GG Primary Expenditure	105,8	112,9	101,4	93,0	88,0	80,1	78,2	79,2	80,8
Interest Payments	12,0	11,9	12,6	14,9	10,5	10,0	11,1	12,2	12,9
GG Deficit	22,9	36,3	23,8	19,7	13,3	10,0	8,4	9,1	7,8
GG Primary Deficit	-10,9	-24,4	-11,2	-4,8	-2,8	0,0	2,7	3,1	5,1
Nominal GDP	233,2	231,1	222,2	208,5	194,0	183,0	182,7	187,8	196,5
Annual % Δ	2008	2009	2010	2011	2012	2013	2014	2015	2016
GG Total Revenue	94,9	-6,8%	1,9%	-2,2%	-3,4%	-5,9%	1,0%	1,7%	4,4%
GG Total Expenditure	117,8	5,9%	-8,6%	-5,4%	-8,7%	-8,5%	-0,9%	2,4%	2,5%
GG Primary Expenditure	105,8	6,7%	-10,2%	-8,3%	-5,4%	-9,0%	-2,4%	1,3%	2,0%
Interest Payments	12,0	-0,7%	5,7%	18,3%	-29,6%	-4,6%	11,0%	9,9%	5,7%
GG Deficit	22,9	58,3%	-34,4%	-17,3%	-32,3%	-25,1%	-15,8%	8,3%	-14,3%
% Δ Nominal GDP	4,7%	-0,9%	-3,9%	-6,1%	-7,0%	-5,6%	-0,2%	2,8%	4,6%

The above new dimensions of Troika's overly pessimistic assumptions about GDP growth and the effectiveness of fiscal policy in Greece, in combination with ELSTAT's drastic new downgrade of Greek GDP levels in 2010 and 2011, were enough to establish once again substantial new financing needs of Greece of the order of € 32.5 bn in 2013-2016 and also, and more importantly, the un-sustainability of Greek sovereign debt.

Considering the November projections of Troika for real and nominal GDP growth (Table 3) and for the progress expected to be achieved in the field of fiscal adjustment (Table 4) and also assuming that privatization revenues plus bank capital recovery revenue will fall to € 40 bn (from € 48.9 bn expected in February 2012), then the GG Debt/GDP ratio would still reach the 144.0% of GDP in 2020 and the 113% of GDP in 2030 (under the Troika's depressing assumption for an average 1.4% real GDP growth in the period 2021-2030).

Eurogroup's decisions of 26 November 2012 and their effect on debt sustainability in Greece:

Troika's depressing assumptions for a further extreme deepening of recession in Greece in the period 2013-2014 and for an exorbitantly low effectiveness of its drastic fiscal adjustment measures applied by the Greek government, led to the alleged un-sustainability of Greece's debt under full implementation of its Second Economic Adjustment program, with debt/GDP ratio reaching 144.0% of GDP in 2020.

Therefore, the Eurogroup of 26 November 2012 decided to offer Greece additional debt – relieving facilities in order to make its debt sustainable, reaching to 124% of GDP in 2020 and bellow 110% of GDP in 2022, even under the above depressing Troika's assumptions. These facilities are the following:

a) A lowering by 100 bps of the interest rate charged to Greece on the loans provided in the context of the Greek Loan Facility (GLF). These are bilateral loans provided to Greece by EU member countries under the 1st Adjustment and Financial Support Package (1st A&FSP) of € 110 bn, of which disbursements amount only to € 52.9 bn. Therefore, Greece's interest payments will be reduced by € 529 million yearly and by € 4.23 bn (2.0% of GDP) in the period 2013-2020.

b) A lowering by 10 bps of the guarantee fee costs paid by Greece on the EFSF loans. Total loans from EFSF will reach the € 108.4 bn at end 2012, the € 134.4 at end 2013 and, finally, the € 149.3 bn at end 2014. Therefore, the lowering borrowing cost from the EFSF by 10 bps implies a saving in interest payments amounting to € 110 million in 2013, € 135 million in 2014 and € 150 million from 2015 onwards. Due to this measure, Greek sovereign debt will be lower in 2020 by about € 1.14 bn (0.6% of GDP).

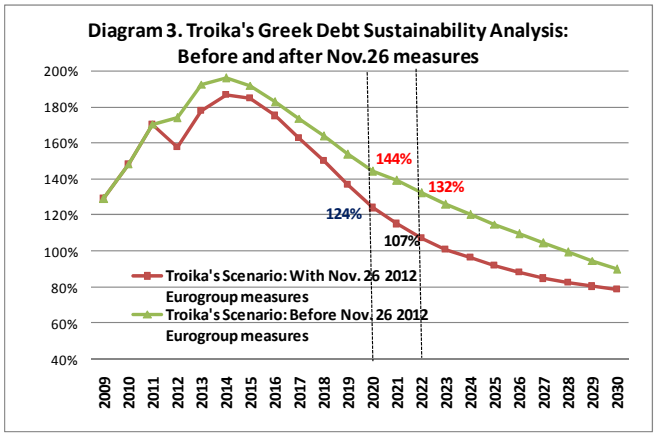
c) An extension of the maturities of the bilateral and EFSF loans by additional 15 years. In fact repayment of these loans will now take place in the 2030's. d) A deferral of interest payments by Greece on EFSF loans by 10 years. This measure implies a reduction of interest payments by about € 2.3 bn in 2013, € 2.8 bn in 2014 and € 3.14 bn from 2015 onwards. Total interest non-payment in the period 2013-2020 amount to € 24.0 bn, which increases to € 30.0 bn until 2022. This measure reduces the financing needs of the Greek Government in the period 2013-2022, but not the debt.

e) A commitment by Member States to pass on to Greece an amount equivalent to the income on their Securities Markets Programme (SMP) portfolio accruing to their national central bank as from budget year 2013. This measure is estimated to lower Greece's financing needs and the debt by about € 4.1 bn in the three year period 2012-2014 and by another € 3.0 bn in the period 2015-2016, while these also contribute to reduce the debt/GDP ratio in 2020 by about 4.6 pps of GDP.

f) The Eurogroup decided to lend Greece, through the EFSF, € 10.2 bn, for the implementation of ***a Greek sovereign debt buyback programme,*** according to which the Greek government will buyback GGBs held by the private sector, worth today € 10.2 bn with face value of € 30.0 bn, thus reducing its sovereign debt held by the private sector to € 32 bn from € 62 bn and increasing its debt to the EFSF by € 10.2 bn. This implies a net reduction of the face value of the Greek debt by € 20 bn in 2020, or by about 10% of GDP.

g) Finally, the Eurogroup is taking into account the following strongly expected developments in the period 2013-2020: (i) It is expected that the measure of increasing to 95% the contribution of the EU co-financing of investment projects in Greece included into the Community Support Framework (CSF) 2007-2013, will be extended until 2015. (ii) The strong possibility that Greece's net receipts from the CSF 2014-2020 will most possibly be € 14 bn or higher, instead of the € 11.5 bn taken into account in the Troika's Debt Sustainability Analysis (DSA). (iii) The possibility for even further reductions of the interest rate of the Greek Loan Facility, or even the application of other needed measures, if necessary, following the achievement by Greece of GG primary surpluses. These additional measures amount to 2.7% of GDP in 2020.

The Eurogroup is confident that "with the above measures Greek debt will be brought back on a sustainable path throughout this and the next decade and that this development will facilitate a gradual return of Greece to market financing". With these measures it is expected that the Greek debt/GDP ratio will fall to 124% of GDP in 2020 and bellow the 110% of GDP in 2022 (see Diagram 3 bellow). This will be achieved even under the Troika's aforementioned depressing assumptions concerning on the one hand the further dramatic fall of Greece's nominal GDP in 2013 and in 2014 and on the other the extreme in-effectiveness of its fiscal adjustment measures in reducing the fiscal deficits and of its structural reforms in increasing productivity, competitiveness and growth.



Doubts about Greece's proper financing and debt sustainability are still present.

The Eurogroup's decision of the 26th of November 2012 has undoubtedly shaken badly the existing international analysts' view pointing to Greece's imminent exit from the Euro. However, after the initial shock of these analysts had expired, they were quick to discover a range of holes and implementation risks to the decision, which would still oblige Greece to leave the Euro. Alternatively, they are with certainty arguing that, without an Official Sector Involvement (OSI), Greek Sovereign Debt is still unsustainable. Most of them are also able to apply convenient interpretations to specific paragraphs of the 26 November Eurogroup's Communiqué, in order to draw the conclusion that the Eurogroup is already considering an OSI (a haircut of Greek Debt held by the Official Sector), most possibly after the German elections, which will take place in September 2013.

The most spectacular characteristic of the above approaches is the fact that all analysts, even the rating agencies, are taking Troika's projections about nominal GDP developments and the effectiveness of Greece's fiscal adjustment measures, as given, or, even worse, as optimistic assumptions about future developments in the Greek economy. No one, not even the Greek Government, has questioned Troika's assumptions as overly pessimistic or even fundamentally false.

Given the paramount importance of nominal GDP assumptions and of fiscal policy performance in determining the accuracy of Greece's financing and DSA in the following 18-years, either under the 26 November decisions of the Eurogroup, or even before of these decisions, in this report we aim to show the following:

First, that there is no point in arguing about whether the Greek debt will be sustainable in the 2020s or the 2030s, if Troika's assumptions about a further dramatic fall of Greek nominal GDP in 2013 and 2014 will be allowed to happen, as indeed happened in 2012. If such a dramatic development would indeed take place, then Greece's main problem would be the explosive increase of its unemployment and the unprecedented destruction of its valuable and internationally competitive domestic economic activity, due to liquidity constraints, while debt sustainability will be in this case of minor importance.

Second, that the aforementioned assumptions of Troika were excessively pessimistic even without the new Eurogroup's measures of 26 November 2012. Troika's assumptions became almost irrelevant in the conducive to recovery and growth economic environment expected to apply in Greece in the wake of the recent Eurogroup's decisions. Assuming that these decisions will be applied as planned, they will contribute to the already expected containment of recession in Greece in 2013 to a fall of nominal GDP by less than -3.0% (instead of Troika's projection for a fall by -5.3%) and a healthy increase of nominal GDP by 1.8% in 2014. Therefore, fiscal performance will also be better than planned (as it is already happening in 2012) and any question about additional financing needs and about debt un-sustainability should be terminated.

The 2012 budget outcome and expected fiscal performance in the period 2013-2016.

Greece has achieved an unprecedented fiscal adjustment over the period 2010 – 2012, as shown in Table 1. To start with, this is shown on the basis of the implementation estimates of the 2012 budget included in

the 2013 budget, which was ratified recently by the Greek Parliament. This budget is based on estimates agreed with the Troika, according to which the GG deficit will reach 6.6% of GDP in 2012, from 9.4% of GDP in 2011 and 15.7% of GDP in 2009 and that the GG Primary Balance deficit will fall to 1.2% of GDP in 2012, from 2.3% of GDP in 2011 and 10.4% of GDP in 2009. This adjustment in 2012, as well as for 2010-2012 is already huge by any standard. And this huge fiscal adjustment, in combination with an extensive array of structural reforms, has been achieved by Greece under the extremely adverse economic conditions, analyzed in the previous chapter of this Report.

However, as is shown in Table 5 below, the actual implementation of the 2012 budget in January-October 2012 points for a much better outcome for the 2012 budget, than that envisaged in the 2013 budget. In fact, based on budget implementation developments in January – October 2012, it is now projected that the GG primary balance will actually register a surplus of at least 0.2% of GDP in 2012 from a deficit of -1.2% of GDP projected in the budget 2013 and from a deficit of -10.4% of GDP in 2009. Also, the overall GG deficit is now projected to fall to the very low -5.2% of GDP in 2012, compared with the fall to the deficit of -6.6% of GDP projected in the 2013 budget and its fiscal derailment level of -15.7% of GDP in 2009. This constitutes a fiscal adjustment of more than 10 percentage points of GDP within three years, an outcome that was considered as impossible by international analysts in early 2010.

Table 5. The 2012 Budget has been implemented much better than Troika's implementation estimate in the Budget 2013

	2011 Budget	Troika's implementation estimate of the 2012 Budget included in the 2013 Budget		Real Implementation of the 2012 budget in Jan-October 2012	EAD Alpha Bank estimate of the implementation of the 2012 budget	
	Million €	Million €	%Δ	%Δ	%Δ	Million €
Net current budget revenues	50.159	47.706	-4,9%	-0,5%	-0,2%	50.058,7
Current budget primary expenditure	53.798	49.555	-7,9%	-9,2%	-7,9%	49.548,0
Interest payments & EFSF expences	16.348	12.300	-24,8%	-24,5%	-24,8%	12.293,7
Public investment budget: Revenues	3.773	4.687	24,2%	40,1%	24,2%	4.686,1
Public invest. budget: Expenditure	6.559	6.850	4,4%	-13,4%	-3,0%	6.362,2
Central Budget Surplus	-22.773	-16.312	-28,4%	-41,7%	-40,9%	-13.459,1
Central Budget Primary Surplus	-6.425	-4.012	-37,6%	-86,3%	-81,9%	-1.165
National Accounts adjustments	2.318	2.925				2.925
CG Budget Susrplus ESA - 95	-20.455	-13.387				-10.534
Balance of GG state controlled entities	1.621	2.171				2.171
Local Govern. Oraganizations Balance	521	556				556
Social Security Organ. Balance	-1.373	-2.223				-2.223
GG Budget Susrplus ESA-95	-19.686	-12.883				-10.030
GG intereat payments	14.901	10.486				10.486
GG Budget Primary Surplus ESA-95	-4.785	-2.397				456
GG Budget Susrplus ESA-95 (% of GDP)	-9,4%	-6,6%				-5,2%
GGB Primary Surplus ESA-95 (% of GDP)	-2,3%	-1,2%				0,2%

Source: Report on the 2013 Budget. Ministry of Economy

In particular, our projections for 2012 are based on data regarding the implementation of the updated 2012 budget (B2012) in Jan.–October 2012. In this period the Central Government (CG) primary deficit reached the € 0.8 bn and was lower from the CG primary deficit in Jan. - October 2011 by € 5.05 bn, registering a fall of -86.3% yoy. As shown in Table 5, taking into account developments in the main budget items in Jan. – October 2012, we project a CG primary deficit for the year 2012 as a whole of € 1.17 bn, which is compared with the CG primary deficit of € 4.01 bn projected in the 2013 budget. Moreover, assuming that all other budget 2012 magnitudes included in the 2013 budget towards the calculation of the General Government (GG) overall deficit and the GG primary balance remain as in the 2013 budget, implies that the GG overall deficit will fall to as low as -5.2% of GDP and the GG primary balance will reach a surplus of 0.2% of GDP.

The same outcome regarding the 2012 budget GG primary balance can be projected from the implementation data of the GG budget in Jan.-October 2012 (Table 6).

As shown in this Table, the GG primary balance in January-October 2012 turned into a surplus of € 0.2 bn, compared with a substantial deficit of € 6.5 bn in Jan.-October 2011. Indeed, this result for the GG primary deficit was achieved through an increase of the GG revenues by 1.0%, compared with a fall by -4.2% projected by the Troika in November 2012 (European Commission, 27 November 2012) and a substantial fall of the adjusted for the increase of arrears and for intergovernmental interest payments GG primary expenditure by -8.4% in January – October 2012, compared by a fall by -6.0% projected by the Troika in November 2012. From this outcome it ii easy to project that even with a 0.0% increase of the GG revenue (from their increase by 1.0% in Jan.-Oct. 2012) and a -6.0% fall of GG primary expenditure in 2012 as a whole (as projected by the Troika and compared with their substantial fall by -8.4% in Jan.-Oct. 2012), the GG primary balance in 2012 will be in surplus, possibly exceeding the 0.4% of GDP as shown in Table 6.

Table 6. Implementation of updated B2012

	January - October (€ million)		%Δ		European Commission (November 2012)		Expected B2012, EAD Alpha Bank	
	2011	2012	10μήνου	2011	€ Million	%Δ	€ Million	%Δ
GG Revenues	65.953,0	66.581,0	1,0%	88.200	84.500	-4,2%	88.200	0,0%
GG Primary Expenditure	72.446,2	66.375,0	-8,4%	93.000	87.400	-6,0%	87.420	-6,0%
GG Primary Balance	**-6.493,2**	**206,0**		**-4.800**	**-2.900**		**780**	
GDP (market prices)				208.532	194.003	-7,0%	194.003	-7,0%
GG primary balance % of GDP				**-2,30%**	**-1,5%**		**0,4%**	

It should be pointed out here, that the recorded GG revenues in January – October 2012 indicated above have been negatively affected in May and June 2012, under the influence of two very critical electoral contests. In fact, in November – December 2012 the GG revenues are expected to be boosted (compared to November – December 2011): (i) from income tax on Individuals (ITI) of the order of € 3.0 bn, given the much higher personal tax assessment in 2012 on incomes earned in 2011, (ii) from the substantial increase of the excise tax on heating oil from November 2012, with expected additional revenue of the order of € 150 million from this source in 2012 and more than € 600 million annually from 2013 onwards and (iii) from the collection of revenues from the 2012 property taxes of the order of € 0.5 bn in Nov.-December 2012 and an additional € 1.0 bn in 2013. In fact, revenues from property taxes have already reached € 2.34 bn in Jan.-October 2012, arising from the collection of the 2011 and the 2012 special tax on real estate, and it is expected to exceed € 3.0 bn in 2012 as a whole, even if a big part of revenues from the 2012 special tax on real estate will be collected in 2013.

More importantly, with additional fiscal adjustment measures amounting to a net € 9.6 bn in 2013, the stage is now set for a GG primary surplus exceeding the 2.0% of GDP next year, despite the depressing projection in the 2013 budget for a meagre surplus of 0.4% of GDP in 2013. Moreover, with the already established fiscal adjustment measures and with a more determined effort to an early recovery of the Greek economy and with accelerating positive growth from 2014 onwards, the GG primary surplus is expected to reach the

3.5% of GDP in 2014 and the 4.8% of GDP from 2015 onwards and until the end of the decade.

More analytically, regarding the implementation of the 2013 and 2014 budgets, the following consideration are of great importance: First, having established that the 2012 budget will finally register a GG primary surplus of the order of € 500 million, implies that the implementation of the 2013 budget will start from a position which will be already better by about € 3.4 bn than that projected by the Troika in Table 4 above. In fact, the € 2.8 bn improvement required by the Troika to be achieved in 2013, will have already been realized in 2012. Therefore, the additional fiscal adjustment measures amounting to € 10.6 bn demanded by the Troika and dully applied by the Greek government in 2013 will be employed towards a further improvement of GG primary balance, which is now expected to exceed the 2.0% of GDP in the next year. To this end will also contribute the fact that at the end of March 2013, Greece will have received the three remaining trances of the financial aid from the Eurozone and the IMF, amounting to € 43.6 bn and in addition € 10.2 bn for the financing of its debt buy back deal. Finally, an additional trance amounting to € 14 bn will be due to be received within 2013. These financial resources were greatly missing from the Greek economy in 2012 implying an unprecedented liquidity constrain, which led to the further excessive fall of GDP by -6.0% in the current year. In fact, the fall GDP in 2012 would have been much lower, even less than -3.0%, had the financial aid trances been received according to plan (June 2012: € 31.5 bn, September 2012: € 5.0 bn and December 2012 € 8.3 bn)[1], contributing also to a substantial abatement of uncertainty and the consequent improvement of the economic climate in the country. Now, these favourable developments are expected to apply in 2013. Therefore, the wide spread talks-projections-publications about Greece's "imminent" exodus from the Euro should eventually be permanently set aside, to the judgment of history. With the financial aid of € 43.6 bn in place, the recapitalization of the Greek banking system is expected to proceed smoothly in Q1 2013, following the drastic reorganization of this system in Q4 2012. This will imply an acceleration of the pace of return of bank deposits to this system. It should be noted that the gradual return of deposits to the Greek banking system has started since 17 June 2012, with the conclusive resolution of the political uncertainty in Greece, following the outcome of the parliamentary elections that took place in that date, and continues unabated until today.

These favourable developments will counteract a great part of the negative effects expected to be exerted on GDP growth due to the new powerful fiscal adjustment measures, which are set to be applied in 2013. Therefore, the fall of nominal GDP in 2013 may be much lower than the dramatic -5.3% assumed again by Troika, with a much stronger recovery of the economy from 2014 as well. A more relevant projection for nominal GDP developments in 2013 and in 2014 is for a -3.0% fall of nominal GDP in 2013 and a 1.8% increase in 2014. With these projections for GDP developments and with the application of already existing fiscal adjustment measures, it could easily projected that the GG primary balance will register a surplus exceeding the 3.6% of GDP in 2014 and 4.0% of GDP in 2015 (Table 7).

Therefore, with the apparent much better than expected implementation of the 2012 budget, the new measures of € 9.6 bn legislated for the 2013 Budget and additional measures of € 3.0 bn legislated for the 2014 budget, in combination with much better developments concerning GDP growth, will mostly by employed towards a much better outcome in the field of fiscal adjustment with substantial consequences for Greece's 2013-2016 financial needs and the overall Greek sovereign debt sustainability question, as will be analyzed in the following chapters of this Report.

Table 7. Greece's fiscal adjustment in 2012-2016: EAD Alpha Bank Projections

% of GDP	2008	2009	2010	2011	2012	2013	2014	2015	2016
GG Total Revenue	40,7	38,3	40,6	42,3	***45,4***	***44,9***	***44,2***	***43,9***	***43,7***
GG Total Expenditure	50,5	54,0	51,3	51,7	50,6	48,3	46,4	46,0	45,2
GG Primary Expenditure	45,4	48,8	45,6	44,6	***45,2***	***43,0***	***40,6***	***39,9***	***39,0***
GG Deficit	9,8	15,7	10,7	9,4	5,2	3,3	2,2	2,1	1,5
GG Primary Deficit	-4,7	-10,5	-5,0	-2,3	***0,1***	***2,0***	***3,6***	***4,0***	***4,7***
Billion Euros									
	2008	2009	2010	2011	2012	2013	2014	2015	2016
GG Total Revenue	94,9	88,5	90,2	88,2	***88,3***	***84,8***	***84,9***	***87,0***	***90,5***
GG Total Expenditure	117,8	124,8	114,0	107,9	98,5	91,1	89,1	91,2	93,7
GG Primary Expenditure	105,8	112,9	101,4	93,0	***88,0***	***81,1***	***78,0***	***79,0***	***80,8***
Interest Payments	12,0	11,9	12,6	14,9	10,5	10,0	11,1	12,2	12,9
GG Deficit	22,9	36,3	23,8	19,7	10,2	6,3	4,2	4,2	3,2
GG Primary Deficit	-10,9	-24,4	-11,2	-4,8	***0,3***	***3,7***	***6,9***	***8,0***	***9,7***
Nominal GDP	233,2	231,1	222,2	208,5	***194,6***	***188,7***	***192,1***	***198,1***	***207,3***
Annual % Δ									
	2008	2009	2010	2011	2012	2013	2014	2015	2016
GG Total Revenue	94,9	-6,8%	1,9%	-2,2%	0,1%	-4,0%	0,1%	2,5%	4,0%
GG Total Expenditure	117,8	5,9%	-8,6%	-5,4%	-8,7%	-7,5%	-2,2%	2,4%	2,7%
GG Primary Expenditure	105,8	6,7%	-10,2%	-8,3%	-5,4%	-7,9%	-3,8%	1,3%	2,3%
Interest Payments	12,0	-0,7%	5,7%	18,3%	-29,6%	-4,6%	11,0%	9,9%	5,7%
% Δ Nominal GDP	4,7%	-0,9%	-3,9%	-6,1%	***-6,7%***	***-3,0%***	***1,8%***	***3,1%***	***4,6%***

Overall, Greece is now well positioned for the successful completion of its fiscal adjustment program in 2013-2016, with GG primary surpluses of about 2.0% of GDP in 2013, 3.6% in 2014, 4.0% in 2015 and 4.7% of GDP in 2016 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 (with nominal GDP falling by only -3.0% in 2013) 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, which was estimated by the Troika in March 2012, even without the measures of 26 November 2012.

Employment, Productivity and GDP growth

Troika's projections for GDP, Productivity and employment growth: Despite the assumptions pointing to further substantially negative nominal GDP growth in the period 2013-2014 (Table 3), the Troika seems to project only a small fall in employment (-2.1%) in 2013 (with a fall in GDP by -4.2%) and an increase in employment by 1.4% in 2014 (with a meagre 0.6% real GDP growth). Also, according to Troika employment will surge upwards by 2.0% in 2015 and by 3.0% in 2016. Moreover, assuming also a substantial (unexplained) fall in the labour force by -1.6% in 2013 and by -0.9% in 2014, the Troika is able to project a small only increase of the unemployment rate to 22.8% in 2013, from 22.4% in 2012, and then a fall of this rate to 21.0% in 2014, to 19.4% in 2015 and to a surprising low level of 16.7% in 2016. This means that in 2016 employment in Greece will

[1]. See, European Commission (March 2012), "The Second Economic Adjustment Programme for Greece", Page 46.

have already increased by 270 thousand people compared with 2013, despite the fact that real GDP growth will have barely become positive. Moreover, assuming the same pattern of developments in 2017-2020, with an average GDP growth of 3.0%, comprising an average annual increase in employment by 2.2% and an average annual increase in productivity by 0.8%, unemployment may be projected to fall to 8.1% of the labour force in 2020 (see Table 8a bellow).

This is an outcome which would be a jubilant development for Greece, except of the fact that its sovereign debt would again be calculated by the Troika to be unsustainable, as already pointed out, a result which exerts considerable annoyance on Greece's lenders and to many international analysts and commentators[2].

Table 8a. Troika's assumptions about GDP and employment growth, with productivity growth culculated as a residual.

	2009	2010	2011	2012	2013	2014	2015	2016	2017-2020
Labour Productivity	-2,5	-2,4	-0,5	1,9	-2,1	-0,8	0,9	0,7	**0,8**
Employment growth	-0,6	-2,6	-6,6	-7,9	-2,1	1,4	2,0	3,0	**2,2**
Real GDP Growth	-3,1	-4,9	-7,1	-6,0	-4,2	0,6	2,9	3,7	**3,0**
Labour forse growth			-0,3	-0,8	-1,6	-0,9	-0,1	-0,3	**-0,3**
Unemployment rate		10,8	16,5	22,4	22,8	21,0	19,4	16,7	**8,1**

Table 8b. Expected employment growth assuming that Troika's assumption about GDP growth will materialize. Productivity growth is expected to accelerate due to the fall of employment and the rationalization of functioning of the labour market

	2009	2010	2011	2012	2013	2014	2015	2016	2017-2020
Labour Productivity	-2,5	-2,4	-0,5	1,9	2,2	2,2	2,3	2,3	**2,3**
Employment growth	-0,6	-2,6	-6,6	-7,9	-6,4	-1,6	0,2	1,4	**1,2**
Real GDP Growth	-3,1	-4,9	-7,1	-6,0	-4,2	0,6	2,5	3,7	**3,5**
Labour forse growth			-0,3	-0,8	-1,0	-0,5	-0,1	-0,3	**-0,3**
Unemployment rate		10,8	16,5	22,4	26,7	27,5	27,1	25,9	**21,3**

Table 8c. Expected GDP and employment growth in a balanced scenario with healthy prodictivity growth contributing to higher GDP growth, also with the help of aggressive recovery and growth promoting policies from Q4 2012

	2009	2010	2011	2012	2013	2014	2015	2016	2017-2020
Labour Productivity	-2,5	-2,4	-0,5	1,9	2,2	2,2	2,3	2,3	**2,3**
Employment growth	-0,6	-2,6	-6,6	-7,9	-4,2	-0,1	0,7	1,4	**1,5**
Real GDP Growth	-3,1	-4,9	-7,1	-6,0	-2,0	2,1	3,0	3,7	**3,8**
Labour forse growth			-0,3	-0,8	-1,0	-0,5	-0,1	-0,3	**-0,3**
Unemployment rate		10,8	16,5	22,4	24,9	24,6	23,9	22,6	**16,9**

Πηγή: European Commission, European Economic Forcasts, Autumn 2012, ΜΠΔΣ 2013-2016, Πίνακας 3γ: Εκτιμήσεις Alpha Bank

On the other hand, considering Troika's projections of surprisingly dynamic employment growth in Greece in the following years, the question arises of how this can be reconciled with Troika's insistence in putting out depressing assumptions for a new dramatic fall of Greece's nominal GDP in 2013 and 2014. In fact, underlying these depressing assumptions for the further deepening of recession in Greece, are Troika's even more depressing assumptions about Greece's labour productivity growth. Evidently, Troika assumes a particular path of precipitous fall of nominal GDP in 2013-2014, implying the much discussed un-sustainability of Greece's sovereign debt. This is done in combination with relatively buoyant assumptions concerning employment growth even in the middle of the assumed deepening recession. Hence, productivity growth comes out simply as a residual. More specifically, the assumed dramatic fall of nominal GDP in 2013-2014, in combination with the also assumed small fall in employment in 2013 and the robust increase in employment in 2014, imply the fall of labour productivity (GDP per person employed) by -2.1% in 2013 and its additional fall by -0.8% in 2014, despite the robust increase in productivity by 1.9% in 2012. Troika does not consider worth explaining this peculiar assumption for the fall of productivity in the years in which the drastic fall in employment and the institutionalized rationalization of the labour market would entail a healthy increase in productivity.

Nevertheless, this outcome is handy for Troika if its main purpose is to show that the main problem for Greece in the following years is just its sovereign debt. And if this debt is considered to be unsustainable, Greece has to apply the needed new fiscal adjustment measures to make it sustainable.

However, labour productivity growth in Greece in the following years, far from being a residual, will be the main competitiveness and growth driver for the Greek economy, while, unfortunately, unemployment will be reduced more gradually and this will happen when robust GDP growth settles in the Greek economy. Therefore, as shown in Table 8b, with the expected healthy productivity growth in the following years, if Troikas assumptions for GDP growth in 2013 and in 2014 materialize then unemployment with surge upwards to 27.5% of the labour force in 2014, and, even with favourable GDP growth assumptions in 2015-2020, it will still be above 21.0% in 2020, with more than 1.08 million people still unemployed after 8-years from now. Therefore, the alleged Greece's debt un-sustainability under full implementation of Greece's Second Economic Adjustment program, with debt/GDP ratio reaching 144.0% of GDP in 2020, is solely due to the Troika's depressing assumptions both for the dramatic additional fall of Greece's nominal GDP in 2013-2014, as well for the extraordinary ineffectiveness of Greece's fiscal adjustment measures in reducing the remaining fiscal deficit and in forming up the required GG primary surpluses in the next two years.

However, if these assumptions do materialize, then the main problem for Greece will be not the un-sustainability of its sovereign debt, but the surge of its unemployment to unsustainable levels and, more importantly, the further fundamental destruction of its production and growth potential. Therefore, Troika's assumptions for the extraordinary deepening of recession in Greece in 2013-2014 are unattainable, not because they lead to a non-sustainable Greek sovereign debt level over the period 2013-2030, but because they are assuming a completely dysfunctional and unsustainable economic and social model for Greece. In fact, Greece is a country which has undergone and applied successfully perhaps the biggest fiscal adjustment and structural reform program in the history of the world. A program designed and imposed by Troika itself. Troika assumes now that this program will depress dramatically Greek productivity growth and economic activity in 2013-2014, with economic policy prescribed by Troika itself completely ineffective as concern the need to prevent the foreseen depression.

Fortunately for Greece, Troika's projections, although detrimental to the economic climate in the country and to its GDP growth, are rather unfounded, as they do not take into account the new favourable conditions that the country is facing from December 2012 onwards. The

[2]. The European ministers of finance, spend three overnight Eurogroup sessions, with the participation of the IMF, in order to be able to find new handouts to Greece that will (arguably) make Greek GG debt sustainable, while at the same time insisting to their projection of (or, rather, target for) a new Greek GDP fall of -5.3% in 2013, which is one of the real causes of possible un-sustainability.

most fundamental change in comparison with 2011 and 2012 is the fact that Greece's financing from the 2nd A&FSP from the Eurozone and the IMF will become again operative, following its virtual freezing, with substantial negative repercussions on deepening the recession and obstructing fiscal adjustment, since May 2012. The second, strongly related to the above, change is the fact that any conjecture, policy suggestion or market positioning pointing to Greece's exit from the Euro will now be subsided or terminated, with favourable effects on the gradual return of deposits to the newly recapitalized Greek banking system. These fundamental changes will substantially improve economic sentiment in the country and are able to counteract the negative effects on economic growth in 2013 arising from the application of substantial fiscal adjustment measures. More specifically:

The important trance, of € 31.5 bn, scheduled for June 2012, plus an additional trance of € 2.9 bn, scheduled for Q3 2012 (a total € 34.4 bn), will indeed be released now for Greece by the middle of December 2012. Moreover, an additional trance of € 9.3 bn, scheduled for December 2012, has now been rescheduled for Q1 2013. This was the long waited decision of the Eurogroup of the 26th of November 2012. It was a much favourable decision for Greece, following the eventual completion of the current June-November 2012 1st Troika's Review of Greece's Second Adjustment Program and the legislation by the Greek government of all prior actions, including the specific fiscal adjustment measures of € 13.6 bn, to be applied in 2013 (€ 10.6 bn) and in 2014 (€ 3.0 bn). This substantial for Greece Eurogroup decision was also taken in the wake of the much better than expected implementation of the Budget 2012 in the 10-month period of January-October.'2012, as analyzed in previous chapters of this Report.

This development, the disbursement of € 44.5 bn for Greece in the following 4-months, will imply a substantial improvement of economic sentiment and bank liquidity in Greece, which in combination with the mobilization of the Public Investment Program, the implementation of remaining projects in the Community Support Framework 2007-2013 and the fast track implementation of the privatization program will help the Greek economy to stabilize in H2 2013 and then to recover and register healthy positive GDP growth from 2014 onwards, boosted also by the expected substantial growth in productivity. More specifically:

Labour productivity in Greece in the period 2013-2020, is expected to be growing at an average annual rate of about 2.3%, which is the trend rate of labour productivity growth in the period 1995-2008. This is a little higher than Greece's annual rate of growth of labour productivity, which exceeded 2.0% in the 50-year period 1960-2011. Labour productivity already increased by 1.9% in 2012 and is expected to continue increasing at high rates in the following years boosted by the substantial structural reforms that took place in Greece in the period 2010-2012 and their consolidation is being secured with the additional measures and finalizing actions included in the 3rd MOP which was voted into law by Greek Parliament in early November 2012. These reforms include: the labour and product markets reforms, the pension system multiple reform reducing drastically the rate of exit from the labour force from 2013 onwards, the public sector reforms including central and local government as well as the education and health sectors and the state controlled entities, the privatizations and the overall improved functioning of the economy. Moreover, productivity will be boosted by the substantial fall in employment in the economy, which would intensify labour effort form those that remain in the labour market. Maturing structural reforms and the commencement of a new round of increasing productive investment in the country, especially from 2015 onwards, may also contribute to a labour productivity growth at rates substantially above the 1.7% in the period 2021-2030, compared with Troika's projections for productivity growth of less than 1.4% annually in the same period.

New GDP growth projections with high productivity growth: Taking into account the above expected trends in productivity and following the already recorded fall of real GDP by -7.1% in 2011 and also by -6.7% in January-September 2012, we now expect a -6.0% fall of GDP in 2012 and a -2.0% fall in 2013. Moreover, the expected gradual improvement of economic sentiment and investment recovery (from the exorbitantly low level of 2013) will help the gradual recovery of the economy from 2014 onwards securing an average annual GDP growth of 2.72% in the period 2013-2020. Finally, average annual real GDP growth in the period 2021-2030 is projected again to reach 2.62%, against Troika's baseless assumption for annual growth of 1.4% (Table 7).

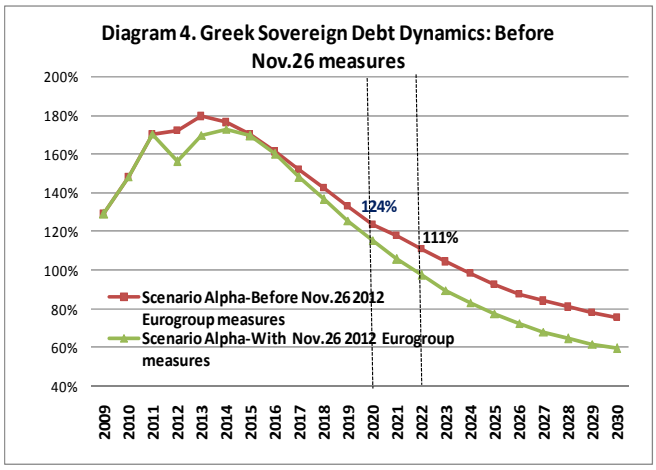
These projections may reflect a return of the economy to trend labor productivity growth and to unemployment-reducing employment growth from 2014 onwards. Trend labour productivity growth (derived in the period 1995-2008) is expected to average at 2.26% annually in the period 2013-2020 and 1.76% annually in the period 2021-2030. Plausible, unemployment-reducing employment growth is set at an average annual 0.50% increase in the period 2013-2020 and at 0.50% average annual growth in the period 2021-2030. Under these assumptions, it is estimated that unemployment (national accounts basis) will peak at 1.3 million (24.9% of the labour force) in 2013 (from 22.4% in 2012) and it is expected to fall to 880 thousand (17.2% of the labour force) in 2020 and to 400 thousand (7.9% of the labour force) in 2030. In fact, the economy will need even higher growth in order to absorb unemployment faster both in the period 2013-2020 and 2021-2030. Finally, annual GDP deflator growth is projected to 0.95% (Troika: 0.79%) in the period 2013-2020 and 2.0% (Troika: 1.8%) in the period 2021-2030. These assumptions imply an annual nominal GDP growth of 3.7% (Troika: 2.7%) in the period 2013-2020 and 4.7% (Troika: 3.2%) in the period 2021-2030.

This is a plausible scenario if one takes into consideration that the big recession of 2011-2012 was mainly due to an extreme liquidity constraint imposed on the Greek economy both by Troika and the proponents and predictors of Greece's exit from the Euro. On the contrary, the post 2012 Greek economy will operate under a newly shaped market-friendly institutional, organizational and entrepreneurial environment and with a much improved liquidity situation as a result of the of considerable official financing scheduled for the following four months and until 2014. Improved liquidity and

consumer and business confidence nay also contribute to stabilizing and then increasing domestic demand and to the return of deposits to the official banking system. The new deficit and debt relieving measures offered to Greece with 26 November 2012 Eurogroup's decisions, are essentially positive for economic recovery and growth, as well for fiscal adjustment and debt sustainability.

Accurate financing and debt sustainability are now secured by the expected faster economic recovery-growth and fiscal adjustment, which in turn will also be boosted by the new Eurogroup's deficit and debt reducing measures of 26 November 2012.

With these latter assumptions about economic recovery, growth and fiscal adjustment, it can be shown that the general government debt to GDP ratio of Greece would stand at 123.8% in 2020 and to 118.0% in 2021, even without the additional Eurogroup's deficit and debt relieving measures of 20 November 2012. This outcome is achieved, with the GG primary surplus reaching 0.2% of GDP in 2012, 2.0% of GDP in 2013, 3.6% of GDP in 2014, 4.0% of GDP in 2015 and 4.6% of GDP in 2016 and 4.1% if GDP in the period 2017-2020. ***Moreover, the debt/GDP ratio will fall below 76% of GDP in 2030, with a GG primary balance hovering bellow the 3.7% of GDP at the beginning of the decade and falling gradually to 1.2% of GDP in 2030.***



Overall, the above exercise serves as an analytical explanation of the following facts: a) In the wake of the already established drastic policies aiming at fiscal adjustment and structural reform in Greece in the period 2013-2014, early recovery of the economy from H2 2013 and healthy employment - increasing growth from 2014 onwards is the key to the establishment of conclusive debt sustainability and availability of financing for Greece in the following years. b) No debt-relieve measures (e.g., debt buy back with borrowed money) can be effective for establishing debt sustainability, if these measures fail to contribute to the effort for the early recovery and growth of the Greek economy. On the other hand, taking into account the deficit and debt reducing Eurogroup's measures of 26 November 2012, the financing needs of the economy in the period 2013-2016 are fully covered with money to spare and debt sustainability improves even further (Diagram 4).

Financing needs are also secured.

The evolution of Greece's financing needs before the new Eurogroup's measures of 26 November 2012 under the above nominal GDP assumptions, with trend productivity growth and unemployment reducing employment growth, is shown in Table 9 bellow. Fiscal performance is that envisaged in Table 7.

The progress already achieved in fiscal consolidation, as analyzed in the previous chapter and the progress achieved in the field of structural reforms and the fundamental improvement of Greece's international competitiveness, which will be analyzed in the following chapters of this Report, in combination with the successful completion of PSI plus in April 2012, had to a large extend, removed the risks for a Greek default in the following years, even without the additional financial resources awarded to Greece with the decisions of the Eurogroup of 26 November 2012. More specifically:

Table 9. Greek deficits and financing needs: Before the new deficit and debt reducing measures of the Eurogroup decisions of 26 November 2012.

	2012	2013	2014	2015	2016	2017	2018	2019	2020
Bonds Maturities (31.6.2012)	3,70	12,90	25,20	16,10	6,70	7,50	3,10	7,10	5,40
Treasury bills maturities	14,90	5,35	2,35	7,85	16,15	21,05	23,95	21,25	21,35
Interest payments	2,95	10,00	11,10	12,20	12,90	12,00	11,80	11,00	11,00
Government arrears	4,00	3,00	1,00	0,00	0,00	0,00	0,00	0,00	0,00
Total payments	25,55	31,25	39,65	36,15	35,75	40,55	38,85	39,35	37,75
Primary Balance GG	0,30	3,70	6,90	8,00	9,70	10,10	10,60	11,00	11,10
Privatization Revenues	0,50	2,50	3,50	4,00	5,00	6,50	7,00	7,00	7,00
Financing from the 1st and 2nd FSP	19,40	22,70	21,40	8,00	0,00	0,00	0,00	0,00	0,00
Total Revenues	20,20	28,90	31,80	20,00	14,70	16,60	17,60	18,00	18,10
Treasury bills issuing (Financing needs)	-5,35	-2,35	-7,85	-16,15	-21,05	-23,95	-21,25	-21,35	-19,65
Nominal GDP (Billion €)	194,60	188,76	192,73	199,47	209,44	220,34	232,45	245,47	259,46
% Δ of Nominal GDP	-6,70%	-3,0%	2,1%	3,5%	5,0%	5,2%	5,5%	5,6%	5,7%

Source: Ministry of Finance, Medium Term Fiscal Strategy 2012-2014 and EAD Alpha Bank estimates

Table 9a. Greek deficits and financing needs: Before the new deficit and debt reducing measures of the Eurogroup decisions of 26 November 2012.

	2012	2013	2014	2015	2016	2017	2018	2019	2020
Bonds Maturities (31.6.2012)	3,70	12,90	25,20	16,10	6,70	7,50	3,10	7,10	5,40
Treasury bills maturities	14,90	5,35	-0,55	1,45	5,85	6,41	3,65	-4,68	-9,47
Interest payments	2,95	7,10	7,60	8,30	8,70	6,60	6,50	6,40	6,30
Government arrears	4,00	3,00	1,00	0,00	0,00	0,00	0,00	0,00	0,00
Total payments	25,55	28,35	33,25	25,85	21,25	20,51	13,25	8,82	2,23
Primary Balance GG	0,30	3,70	6,90	8,00	9,84	10,36	10,93	11,29	11,68
Privatization Revenues	0,50	2,50	3,50	4,00	5,00	6,50	7,00	7,00	7,00
Financing from the 1st and 2nd FSP	19,40	22,70	21,40	8,00	0,00	0,00	0,00	0,00	0,00
Total Revenues	20,20	28,90	31,80	20,00	14,84	16,86	17,93	18,29	18,68
Treasury bills issuing (Financing needs)	-5,35	0,55	-1,45	-5,85	-6,41	-3,65	4,68	9,47	16,44
Nominal GDP (Billion €)	194,60	188,76	192,73	199,47	209,44	220,34	232,45	245,47	259,46
% Δ of Nominal GDP	-6,70%	-3,0%	2,1%	3,5%	5,0%	5,2%	5,5%	5,6%	5,7%

Source: Ministry of Finance, Medium Term Fiscal Strategy 2012-2014 and EAD Alpha Bank estimates

Assuming that the disbursement of the trances of the 2nd A&FSP, amounting to € 44.4 billion until the end of December 2012, would be implemented by the end of December 2012, then the remaining financial needs of Greece would reach € 5.35 bn in 2012, € 2.35 bn in 2013, € 8.0 bn in 2014, € 16.2 bn in 2015 and € 21.1 bn in 2016. These needs could continue been financed through short term financing, provided that this process would continue been facilitated by Greek banks with the consent of the ECB. Longer term financing could also become available from 2016, taking into account that this would be the 4th year in which Greece would have been running GG primary surpluses and Greek GDP would have been growing at rates above 3.0% annually for 2-years. Overall, the financing gap of Greece in the period 2013-2020, without any additional assistance awarded by its official lenders is shown in Table 9.

However, Greece's Official Lenders, considering the risks that still existed at the end of 2012 concerning the successful implementation of the MTFS 2013-2016, for which they themselves were presenting the depressing projections analyzed above, have now decided in the Eurogroup of 26 November 2012 to offer Greece the additional deficit and debt reducing measures presented in the previous chapters of this report. These measures include the substantial reduction and postponement of interest payments by Greece and also the return to

Greece of any profits which the Euro Central Banks may have from buying Greek debt in the secondary market and redeeming this debt at its face value. These, new measures are included in Table 9a in the form of additional substantial reduction of interest payments in the period until 2020, as well as in the form of higher primary surpluses by the amount of Euro Central Banks' profits which are expected to be returned to Greece.

It is shown in Table 9a that with the additional saving of interest payments in the period 2013-2020 implies that the Greek financing gap stays below the € 6.5 bn until 2017 and then it becomes an increasing surplus in the period 2018-2022.

Overall, following: a) the successful implementation of the PSI Plus in March 2012, b) the successful implementation of the 2012 budget with a possible GG primary surplus of 0.2% of GDP, c) the already specified measures of € 13.4 bn securing the planned implementation of 2013 and 2014 budgets and d) the improvement in the international competitiveness of the Greek economy and maturing structural reforms implying fast increasing productivity, Greece is no longer threatened by the risk of default and from Euro exit, for the following reasons:

a) The financial resources needed to refinance the banks and the official debt maturities after PSI Plus, as well as the main part of the significantly reduced interest payments on the remaining debt, are largely covered by the 1st and the 2nd A&FSP from the EFSF (or the ESM) and the IMF, up to 2015.

b) From 2015 onwards, the Greek economy, as previously analyzed, will register significant primary surpluses (exceeding 4.0% of GDP), healthy economic growth and substantial revenues from privatizations and from the development of public real estate property, as well as from the return to the HFSF of capital arising from selling bank recapitalization stock in its possession. Moreover, after 2015 debt maturities, mainly to official lenders, do not exceed € 8.0 bn annually until 2020.

c) The first phase of banks recapitalization has already been completed, while the process of consolidation and privatization of the Greek banking system has also started with the disposal of ATEbank, the acquisition of Emporiki Bank by Alpha Bank and the merger of the National bank of Greece with Eurobank. Capital increases, underwritten by the HFSF to the extend necessary, as well as mergers and acquisitions between banks are expected to have been completed by the end of H1 2013. The completion of this huge project will create an entirely new situation for the Greek economy and may also contribute to the return of a significant part of deposits which have fled from Greek banks due to prevailing uncertainty. This will substantially reduce the needs of the Greek banks for ECB financing.

Overall, the above exercise serves as an analytical explanation of the following facts: a) In the wake of the already established drastic policies aiming at fiscal adjustment and structural reform in Greece in the period 2013-2014, early recovery of the economy from H2 2013 and healthy employment - increasing growth from 2014 onwards is the key to the establishment of conclusive debt sustainability and availability of financing for Greece in the following years. b) No debt-relieve measures (e.g., debt buy back with borrowed money from the EFSF) can be effective for establishing debt sustainability, if these measures fail to contribute to the effort for the early recovery and growth of the economy. In fact, these measures may indeed have a positive effect on growth only if are allowed to contribute to the material improvement of business and consumer confidence.

Internal real devaluation within the Eurozone.

Based on data from the European Commission (Price & Cost Competitiveness and European Economic Forecast, Autumn 2012), the relative (against 36 trading partner countries) Unit Labour Cost (ULC) based real effective exchange rate (REER) of the Euro for Greece had appreciated by 23.7% in Q4 2009, versus 2000 (See Diagram 1 and Table 2 in the 1st Chapter of this Report).

Internal devaluation, implemented through the application of Greece's adjustment program reached -9.8% in Q4 2011, compared with Q4 2009 and led to a decline of Greece's REER appreciation to 11.7% in Q4 2011, compared with 2000. Moreover, for 2012 the European Commission projects a further devaluation of the Euro REER for Greece by -11.8%.

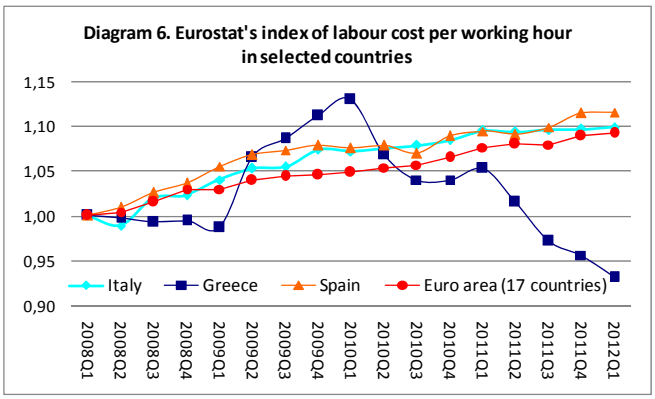
This projection was based on the following assumptions: a) An increase in labour productivity in 2012 by 2.0% (due to the projected fall of real GDP by -6.0% with a fall in employment by -7.9%). b) A fall of compensation of employees per head by -6.8% for the economy as a whole. This fall of wages and salaries in the economy, imply a fall of ULC of -8.6%. ULC increase for the 35 competitor countries in 2012 is estimated by the European commission at +2.0%. Therefore, relative ULC for Greece is now estimated to fall by -10.6% in 2012. Then, with the estimated depreciation of the nominal effective exchange rate of the Euro for Greece by -1.4% in 2012, we obtain a depreciation of the ULC based Euro REER for Greece in 2012 exceeding -11.8%.

This implies that in Q4 2012 the Euro REER for Greece will have depreciated (Greece's competitive position will have improved) by -22.7% versus Q4 2009 and also by a substantial -4.3% versus 2000. Moreover, the projection of the European Commission for an additional depreciation by -6.3% of REER ULC for Greece in 2013, implies an additional improvement of Greece's international competitiveness in the following year. Overall, internal ULC based real devaluation in Greece will exceed -22.7% by the end of 2012 and 27.5% by the end of 2013, compared with Q4 2009. With this Greece's ULC competitiveness will have improved by -10.3% in the end of 2013, compared with the year 2000.

This significant improvement of Greece's international competitiveness in 2010-2012 has taken place in a period in which Greek labour productivity is substantially underestimated by official GDP data, which have been depressed by the wide underestimation of the real GDP of the country and by the surge of economic activity in the unofficial economy in the last 2-years. Moreover, the GDP have fallen due to the destructive impact of the unprecedented loss in confidence affecting the economy for reasons unrelated to the functioning of the labour market. Therefore, productivity

appears to register negative or very low positive increase, despite the substantial structural reforms and the precipitous fall in employment.

On the other hand, ***the improvement of competitiveness in Greece has already contributed substantially to the impressive increase of exports of goods*** by 11.5% in 2010 and by 18.5% in 2011, as well as by 6.9% yoy in January-September 2012 after increasing by 23.5% yoy in January – September 2011. ***Exports of goods amounted to € 16.1 bn in*** January-September 2012***,*** compared to € 15.05 bn in January-September 2011 and € 12.2 bn in January-September 2011. Moreover, these are expected to exceed € 22.0 bn (10.4% of GDP) in 2012, compared to € 20.2 bn (9.4% of GDP) in 2011 and € 17.1 bn (7.5% of GDP) in 2010. Also, the sharp fall in imports of goods and services is now partly attributable to a gradual process of import substitution. It is of particular importance the fact that exports of goods excluding ships and fuels will be higher by € 2.3 bn in 2012, compared with 2010, at the same period in which imports of goods excluding ships and fuels will be € 4.4 bn lower. The import content of Greek exports is obviously falling rapidly, with a corresponding substantial increase in domestic value added. In fact the import content of Greek tourism is falling fast. This process will take a much faster pace as soon as the dramatic liquidity constraint plugging domestic production in the second half of 2011 and in the whole year 2012 will be alleviated as expected from 2013.



Remarkable was also the decrease of the current account deficit of the Balance of Payments, by -86.2% yoy in Jan.-September 2012, following its fall by -11.2% in Jan.-September 2011. This deficit is now projected to fall to 3.0% of GDP in 2012, from 8.8% in 2011, 9.4% in 2010 and 10.3% in 2009. Moreover, the current account is expected to reach near balance by 2014 and turn into a surplus subsequently, assuming that the capital account will turn into deficit. In fact, the capital account will turn into deficit and it will remain in deficit due to the repayment of Greece's official debt after 2015, to the extent that these capital outflows will not be compensated by FDI and other portfolio capital inflows. However, we expect that both FDI and portfolio capital inflows in Greece will indeed be strong from 2015 onwards.

Finally, the external sector of Greece is expected to continue its positive contribution on GDP growth, which started in 2008 and continues unabated until today. Therefore, the positive impact of net exports on GDP growth is projected to reach the 3.5 percentage points in 2012 (4.1 pps in H1 2012) and to 2.5 pps in 2013 and 2014, compared with 2.3 pps in 2011, 2.94 pps in 2010 and 2.89 pps in 2009.

Greece has proved 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 odd 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 has 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). 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, implying that harmonized CPI inflation in Greece (0.9%) is now the lowest than in any other Eurozone country and also the lowest from all EU-27 countries except Sweden (0.7%).

On the other hand, it has to be noted that ***CPI based REER is an inappropriate and misleading indicator of competitiveness in very small open economies like Greece, which are price takers in the international markets.*** It becomes a completely misleading indicator when used: a) in periods in which administered prices in a country are forced upwards through extensive increases in excise tax rates in order to reduce deficits and to clear up existing imbalances in the public and the private sector created mainly by very low (disequilibrium) prices in previous periods, b) in periods in which exportable goods prices in a country are increasing fast indicating a terms of trade gain for this country, instead of a competitiveness loss. Overall, Greece is a small country completely open to the international flows of goods, services and capital and price taker in all these markets. Therefore, the only relevant competitiveness indicator for such a country is the relative price between traded and non-traded goods and the most suitable proxy for this indicator is the index of the relative unit labour cost between the domestic country and its main trading partners.

Remarkable progress in structural reforms

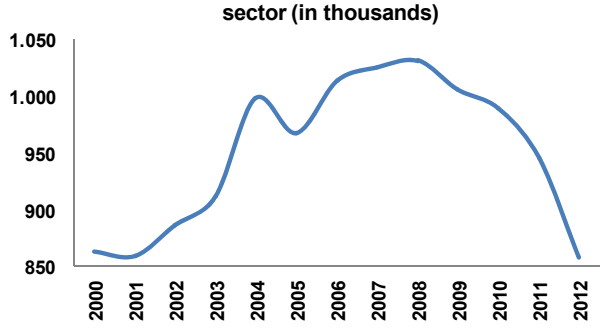
Greece has made significant progress in structural reforms, which have contributed greatly to the fiscal adjustment effort and the aforementioned improvement of its international competitiveness. In fact, important reforms in many sectors are still in the process of consolidation and institutionalization, a process which is expected to be substantially boosted with the multitude of supplementary and more aggressive reform measures included in the November 2012 3rd MOU agreed between Greece and the Troika and ratified by the Greek Parliament (Law 4093/7.11.2012).

However, even after this accelerating reform process imposed by Troika at the end of 2012, the results of these drastic reforms on the efficiency of operation and growth of the Greek economy are expected to be felt gradually in the following years, implying a much faster growth of labour productivity than in the past.

In particular, substantial progress has been achieved in drastically reforming, inter alia, the following sectors:

a) The public administration and especially labour market relations in the public sector, so that the necessary drastic decrease of expenditure on wages and pensions and other operational costs in this sector may be facilitated. It should be noted that compensation of employees in the general government is expected to fall to € 23.5 bn (11.52% 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 € 6.5 bn in 3-years is not a minor development in the Greek public sector. Of course, the government has undertaken to reduce further the GG wage bill by 1.5 pps of GDP in 2013-2015. This is set to be achieved by further reform of public sector employee compensation (including the reform of special wage regimes, which has already been legislated and is in application since August 2012) and with the implementation of the target for reducing general government employment by at least 150.000 in the period 2010-2015. It should be noted that employment in the wider public sector has 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 (Diagram 7).

Diagram 7. Number of employees in the wider public sector (in thousands)



Source: ELSTAT, Labour Force Survey.

The Troika has advanced a multitude of drastic measures to reduce the size of the Greek public sector, targeting an additional reduction in GG employment count of 150 thousand people. Every prescription appears to be directed to expenditure and personnel reduction both in central and local government and in public entities, without due consideration to the need for efficient management and performance in terms of services offered by these organizations. The implied loss of valuable specialized personnel in 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). Demands for closing down, downsizing and outsourcing in a multitude of GG operating units should not be forced upon underpowered management to be implemented as self-contained objectives.

Overall, Central Government primary expenditure has already registered a € 10.0 bn fall to € 50.6 bn in 2011 from € 60.67 bn in 2009, while it has also registered an additional -9.2% fall in Jan.-October 2012, compared with a targeted fall by -5.1% in 2012 as a whole. This indicates that the Government is on target to achieve much higher than the required GG expenditure cuts. Therefore, there is no need for forced-arbitrary personnel cuts, which may contribute slightly to reduce expenditure on the one side, while destroying any chance to increase net current revenues of the other side of the budget.

b) The social security system and 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 cuts on pensions, due: (1) to the substantial fall of revenues of the state controlled pension funds from social insurance contributions, which was mainly to the prolonged deepening of the recession and the increasing unemployment and much lower wages and salaries, but also due to a surge of social insurance contribution evasion and (2) to the observed increasing pension expenditure due to a rush to early retirements. These developments implied that current budget contributions to the financing of social security funds remained high, despite plans to curtail them drastically. Thus, mainly due to the drastic fall of current pensions and the substantial health sector expenditure savings achieved in 2010-2012, GG social GG transfers are now estimated to fall to € 45.3 bn in 2012, from € 47.2 bn in 2011 and € 49.0 bn in 2009.

However, this GG expenditure on social transfers increased, instead of falling, as a percent of GDP, to 23.2% of GDP in 2012 (public health expenditure: 6.0% of GDP), from 21.8% of GDP in 2010 and 21.2% of GDP in 2009. Therefore, in order to contain this expenditure to levels comparable with the current GDP of the country, the 2013 budget contains new cuts of social transfers payments, amounting to € 5.33 bn (pensions cuts: € 4.68 bn), aiming to reduce GG social transfers payments to 21.4% of GDP in 2013. Moreover, further reforms to the parameters of the social security system comprise an immediate increase (from 2013) of the retirement age to 67 years of age (from 65 years of age provided by the 2010 pension law), and to 62 years of age with 40 years

of working life (from 60 years of age). These new drastic changes in the parameters of the social security system, in combination with the expected recovery of social security contributions with the recovery of the economy, are expected to further reduce GG social transfers expenditure to 20,7% of GDP in 2015 and to 20.2% of GDP in 2016. The aim is for these savings to be achieved while at the same time improving social protection programs for those who are most in need.

c) The Greek labour market underwent a fundamental reform program which has essentially already been completed. The newly reformed legal and institutional environment in this market already contributes to a more efficient functioning of market (both in the private and the public sectors). However, this new environment has also contributed to the dramatic fall of employment in Greece by 316 thousand persons in 2012, following its fall by 297.3 thousand persons in 2011 and by 134 thousand persons in 2010 and in the consequent surge of unemployment to 25.7% of the labour force in September 2012 from 12.5% of the labour force in 2010. It should be noted that this dramatic fall in employment in 2011 and in 2012 took place despite ***the "unprecedented downward wage flexibility that has been observed in the Greek labour market throughout 2012"[3].*** Employment has been falling precipitously as a result of 2010-2011 reforms which have reduced drastically the degree of employment protection in Greece from its pre-existing high levels. It took place, despite the also substantial fall of the Unit Labour Cost both in the private and the public sector in Greece as shown in the previous chapter. Therefore, the fall in employment and the excessive deepening of the recession in the country was the result, not of insufficient reforms, as Troika tend to argue, but most importantly of the economic sentiment destroying activities (of the Troika itself, of the Greek Government, of Political parties, of fame seeking domestic and international analysts and commentators, etc.) and of the unprecedented and widely unjustified liquidity constraint imposed (mainly by Troika) on the Greek economy since September 2011.

Nevertheless, the fundamental reform of the Greek labour market is a reality and it was completed (or overdone) through the new measures agreed be the Greek Government and legislated in November 2012, including: a) The fundamental reform of the minimum wage framework, with a relatively low minimum wage to be now set by the Government (taking into account the existing economic conditions in the country) and not by agreement of the social partners. b) The further reduction of the already substantially curtailed degree of employment protection aiming to further facilitate firing and hiring of employees, increasing mobility in the labour market. However, in practice, in the heat of deepening recession and of explosive growth of unemployment, employment protection in Greece has already been almost completely irrelevant. c) The further easing of regulations for the adjustment of working hours in each business firm, which enhances substantially the efficient use of labour services by the firm. Overall, businesses established in Greece are facing now almost zero constraint in their endeavour to efficiently manage their labour force for higher productivity growth and international competitiveness. Despite the short term adverse and painful consequences, mainly in terms of increasing unemployment, these reforms in the labour market will also contribute to the rapid improvement of Greece's business environment and international competitiveness. This will happen, 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 the Greek labour market, leading to gradually accelerating increases in labour productivity, starting with its increase by 2.0% in 2012 under extremely unfavourable economic conditions.

d) The tax system: Greece's fiscal adjustment effort was extensively compromised, especially in H1 2011, from some specific provisions of the Tax Law 3842/23.4.2010 and especially those providing: (i) For a sizable reduction of tax rates in the personal income tax (PIT) for taxable income bellow € 30.000 and (ii) For the substantial increase of the tax-free threshold in the PIT to the very high (by international standards) € 12.000. In fact, this threshold could become even higher through the bonus provided to tax payers submitting a surplus amount of retail purchases receipts, collected for the purpose of combating tax evasion in VAT and the PIT of earners of income by professionals, self-employed and in general non-wage incomes earners. (iii) For the substantial increase of the tax - free threshold for the property tax to € 400.000, from € 200.000. All these misplaced provisions were reversed aggressively, and to a great extent arbitrarily, in H2 2011 with, the substantial reduction of tax free threshold in the PIT to € 5.000, the introduction of an additional surcharge on PIT taxable incomes above € 12.000 of 1%-4% depending on the income level of taxpayers and, finally, with the introduction of a new specific property tax on all electrified real estate through the electricity bill of the Public Power Corporation. These new measures helped to improve tax revenues in H2 2011 and in 2012, but the need was still present for their concrete incorporation into a new consolidated and rationalized tax system. From October 2012 the new system of increasing the tax of heating oil to the level of the slightly reduced tax on diesel is applied.

This new tax system will still be conducive to the much needed further fiscal adjustment, aiming to an net revenue increase of the order of € 1.0 bn from 2013 onwards. Therefore, it must be revenue positive, mainly through the abolition of the existing extensive array of tax allowances and tax credits to various income groups, which were extended mainly for social policy purposes. This will result to the needed effective broadening the tax base, which is supposed to be extended also through combating tax and social security contributions avoidance and evasion. The efficiency of the system will be improved by a thorough simplification of the PIT, while maintaining the progressivity of the system. The aim is, however, to avoid increases in effective taxation of low and middle income households. Moreover, the new system must also contribute to a more effective taxation of non-wage income earners and to a fairer distribution of tax burdens - with the long sought alleviation of the excessive burden on compliant tax payers. Corporate

[3]. See European Commission (27/11/2012), "The Second Economic Adjustment Programme for Greece-First Review". Page 44.

income tax system is also overhauled in order to increase compliance and become more business and investment friendly. In this case the reform is accompanied by the simplification of the tax accounting system, centered on the repealing of the Code of Books and Records. The MTFS 2013-2016 also includes important measures aimed at harmonizing the regulations of social security contributions across all categories of workers.

On revenue administration, tax collection and auditing activities are strengthened, with tax administration authorities acquiring the much needed autonomy from political interference. The Secretary General of Public Revenues will be a well qualified person for the job and of high ethical standards and will be appointed on a basis independed from the political process.

It should be noted here that tax reform efforts are well under way in Greece since 2010 with concrete efforts to improve the tools for combating the still increasing tax evasion, as overdue tax liabilities continue an a growing path having already surpassed € 40 bn. Moreover, unaudited tax cases constitute an additional factor for the excessive delay of tax payment by households and businesses, a huge backlog of disputed tax cases have build up at the courts. Substantial efforts have already been undertaken in order to deal effectively with these issues, increase tax compliance in a much wider spectrum of taxpayers and increase tax revenues: First, the use of tax declaration audits has changed and its main thrust is now redirected towards the identification of tax cases or classes of tax payers most at risk of evasion. The conduct of tax fraud investigations has been speeded up with the creation of the position of the "Attorney General for Economic Crime", with nationwide powers. The Financial and Economic Crimes Unit (SDOE) has been re-powered so that to be able to act much more efficiently having also the power to issue tax fines on the spot. Penalties for tax fraud have been increased and appeals filed in the courts against the initial decision of the tax authorities no longer have the effect of suspending payment of the tax liability including penalties. Second, the Minister of Finance has now the right to waive tax secrecy and to disclose the identity of persons who use false documents in their tax declarations and of persons who have a tax debt exceeding € 150 000 for which they are more than a year in arrears. Also, substantial capital flight cases are now systematically investigated for the possibility tax fraud, while arrangements and concrete negotiations are under way for administrative cooperation and the exchange of information with other countries in the area of foreign national's bank deposits and related direct taxation issues. Third, efforts are under way to address the big problem in Greece of the large backlog of tax cases in courts. It is estimated that such cases outstanding exceed 186 thousand in autumn 2012 and the Troika demands that this number must be reduced substantially until the end of 2013. The Ministry of Justice is ready to put forward legislation according to which the tax cases involving amounts exceeding € 150,000 should be cleared up within a few months. Moreover, an independent arbitration board has been created to speed the settlement of tax disputes involving amounts of more than € 150 000. Finally, a transparent procedure has been instituted in order to be able to segregate tax arrears that are reasonably expected to be operational in terms of generating revenues for the state from those that are not. It is estimated that from more than € 40 bn of arrears outstanding only about € 8 - € 10 bn are actually recoverable. On the other hand, the practice of Greek governments on issuing successive amnesties in order to reduce the backlog of unaudited or disputed tax cases is not supported by Troika and is actually exerting negative effects on tax compliance.

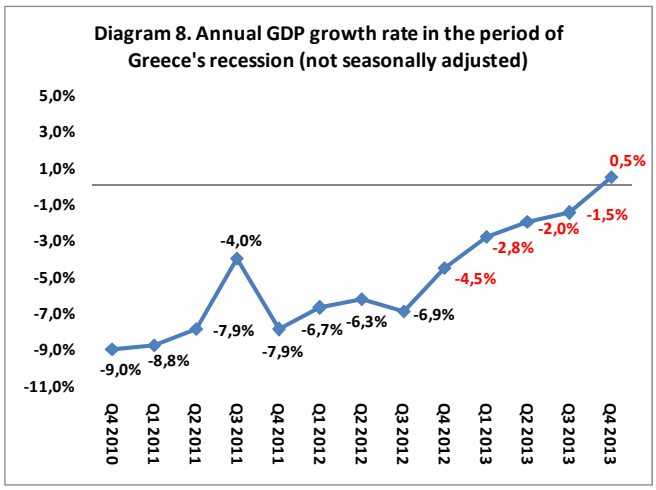
Overall, the drastic and far reaching fundamental reforms that took place in the Greek labour market, the pension and the health care systems and on other sectors of structural reform in Greece in 2011 and in 2012 are extensively and accurately analyzed in the successive reports of the IMF and the European Commission reviewing Greece's progress in applying the economic adjustment programs agreed with the Troika. From these reports one can easily conclude that, following these reforms, the Greek labour market, comprising now highly valued and qualified personnel with high degree of availability, has become today one of the most flexible, adjustment friendly and growth conducive labour markets in Europe and the world as a whole.

Moreover, extensive reforms have been implemented, or are in progress, in many other areas which gradually change the whole institutional and organizational structure of the country. Diagram 2 in Chapter 1 of this Report, gives a first estimation from OECD (December 2011) of the responsiveness of its member countries to going for growth reform recommendations, with Greece leading the pack. In fact, Greece's comparative position must have further improved by the end of 2012, taking into account the aggressive reform efforts undertaken in the current year, especially in the labour market.

There are certainly delays in implementing and institutionalizing reforms in many sectors in Greece and in particular in the implementation of Greece's privatizations' program and the program for the development of its public real estate property. However, these delays cannot be regarded as unaffected by the sinking of the economic climate created in the economy under the stifling influence of the extremely negative factors accompanying the implementation of the reforms. For example, when an investor is informed by the most authoritative parties (e.g., by the Troika in October 2011 and then again in October 2012) that the public debt in Greece will reach 198% of GDP in 2012 (after the July 2011 PSI) and that essentially the Greek economy is not to recover and grow over the next 20 years, it follows that he will not come to invest in Greece, whether in companies that are privatized or in Greenfield businesses. This problem, unfortunately, will persist, and affect the Greek economy until domestic and foreign investors will become well-informed and convinced that in fact Greece does have substantial comparative advantages and growth prospects. This will happen when the country's fiscal adjustment will progress further, as mentioned above, and when international and domestic investors' decisions whether to operate in Greece become well entrenched given favourable prospects. The Troika at times affects negatively the prospects for a timely recovery of the Greek economy by not recognizing the magnitude of the adjustment that has already taken

place in Greece and also by its depressing predictions concerning the development prospects of the Greek economy. In any case, substantial preparatory actions have already been completed by the Hellenic Republic Assets Development Fund (TAIPED). Many privatization projects are ready for hitting the market, attracting already widespread foreign investor interest. With economic climate improving, privatizations can move rapidly contributing to the timely recovery of the Greek economy and the consolidation of its fiscal finances.

Recent Economic Developments and prospects: Real GDP fell by -6.6% in January – September 2012 (Q1 2012: -6.7%, Q2 2012: -6.3%, Q3 2012: -6.9%), following its fall by -7.1% in 2011, -4.9% in 2010 and by -3.1% in 2009. The performance of the economy deteriorated dramatically in Q4 2011, where GDP fell by -7.9%. This constituted an outright derailment of the recovery process in which the economy had entered in Q3 2011, when the recorded fall of GDP had decelerated to -4.0%, from a fall of -7.9% and -8.8% in Q2 and Q1 2011 respectively and also from a -9.0% fall in Q4 2010. In January-September 2012 there was again a slight deceleration of the falling trend of GDP, which is expected to be more pronounced in Q4 2012 with a yoy fall of GDP of less than -4.5% and a drop of -6.0% for 2012 as a whole.



Negative developments in the Greek economy in Q4 2011 and in January-September 2012 were the direct result of the overall turmoil that prevailed in Greece in that period. Negotiations for the approval of the 2nd A&FSP from the Eurozone and the IMF drugged along for a long time, an almost unending process. Instead of being successfully terminated with the decisions of the heads of state of the EU in 20 July 2011, the 2nd A&FSP went through another two substantial revisions before its final conclusion in 20 February 2012. From then on, a period of great uncertainty continued with the PSI Plus ending in April 2012 and then the Greek general elections first on 6 May 2012 and then again in 17 June 2012.

The decline of production in most of the main sectors of the Greek economy accelerated in the period September 2011 – June 2012, despite the satisfactory performance of exports of goods and of external tourism (especially in 2011). Developments in these sectors improved in Q3 2012 and are expected to get into a stabilization path from Q4 2012. The main aspects and prospects of these developments are as follows:

Tourism: The performance of the tourist sector was much better than expected in 2011 and especially in the period June-September 2011, before plummeting in Q4 2011 and in H1 2012. Greek tourism has suffered materially in the period of great uncertainty and extremely bad publicity plaguing Greece from September of 2011 and until September 2012.

According to ELSTAT, arrivals of foreign tourists in 2011 registered a 9.5% increase, reaching 16.43 million, from 15.0 million 2010. Arrivals from the EU-27 countries (excluding Cyprus) registered a 6.6% increase. In particular, arrivals from the UK fell by -2.4%, while arrivals from Germany registered an increase by 9.9% and from Sweden an increase by 18.8%. One should notice the substantial fall of arrivals from Finland by -18.3%. Outside the EU arrivals from the USA fell by -2.7%, while arrivals from Australia increased by 7.2%. Of particular importance is the surge in 2011 of arrivals from Russia (+63.8%), Switzerland (31.7%) and Norway (21%). Finally arrivals from Serbia – Montenegro fell by -2.1% yoy in 2011 but remained high at 692.1 thousand, while arrivals from Albania surged in 2011 by 69,9% reaching 411.2 thousand and arrivals from Bulgaria also increased by 3.3% to the high of 686.2 million.

Also, in January – November 2012 arrivals of foreign residents to the main Greek airports were down by -3.4% yoy, compared with their substantial increase by 11.1% in January – November 2011. Also, revenue from foreign tourism was also down by -2.7% in January – September 2012, reflecting mainly the particularly negative performance of the tourist sector in H1 2012 (where the fall of revenues reached -10.0%). However, the performance of the tourist sector has improved notably in July – September 2012, following the election of the new pro-reform Parliament and the formation of the 3-party coalition government. It is now expected that revenues from foreign tourism will reach € 10.4 bn in 2012, slightly only lower, by -1.1%, from the tourist revenues in 2011.

On the other hand, expenditure of Greek citizens for tourism abroad fell substantially by -17.3% in Jan.-September 2012, implying an increase by 1.0% in the external surplus of the tourist sector in Jan.-Sept.'2012. This surplus is now € 9.3 bn in 2012 and to increase further in 2013 and in the following years.

Shipping: Greece's merchant shipping receipts fell slightly, by -3.4% yoy, in January-September 2012. This was a substantial improvement as compared with the sizable fall of these receipts by -10.3% yoy in Jan.-September 2011 and also by -8.6% in 2011 as a whole. Moreover, outflows from the shipping firms in Greece declined by -14.5% in Jan.-September 2012, on the back of a drop of -10.0% in Jan.-September 2011. These developments implied a strengthening of the Greek net surplus revenue from shipping by 8.9% in January - September 2012, following its fall by -10.5% in January – September 2011 and by -5.5% in 2011 as a whole. Therefore, in January - September 2012 net shipping revenues had a high positive effect on GDP growth, reversing the negative effect on growth of these revenues in 2011. Therefore, the effect of the shipping sector on

Greece's GDP growth in Jan.-September 2012 must have turned positive, from substantially negative in 2011.

Industrial Production and turnover: In the manufacturing industry (accounting for about 8% of value added in the Greek economy), the falling trend of production decelerated markedly to -4.4% and -4.0% in Q3 and Q2 2012 respectively, from -9.5% in Q1 2012 and from -13.4% in Q4 2011. Moreover, manufacturing production registered a positive 1.1% increase in October 2012 and is expected to register a positive 1.0% increase in Q4 2012 as a whole and an even higher increase in Q1 2013. This is the second attempt of the Greek manufacturing industry to get out of the recession, with the first attempt aborted, following the overturn of the strong recovery prospects of the Greek economy, in September 2011. In fact, the falling trend of manufacturing production had again decelerated markedly to a fall of -1.3% in September 2011 and -4.6% in Q3, from falls by -11.8% in Q2 2011 and -7.1% in Q1 2011. This unambiguous trend towards a recovery in Q3 2011 was abruptly reversed by the economic and political turmoil in Q4 2011, with the drop in manufacturing output taking again crisis proportions (reaching -13.4% in Q4 2011 and -9.5% in Q1 2012).

Overall, industrial production continues mainly to be negatively affected by the substantial fall in production of the following industries: a) The traditional industries, such as textiles, clothing and footwear, facing intensifying competition from low cost countries, for which production indices have fallen to 26.7, 33.1 and 29.0 respectively from 2005=100. b) The industries related to the depressed domestic construction activity, with the index of the important for Greece sector of non metallic minerals (including in particular the cement industries), reaching 32.4 in Jan.-October 2012, from 2005=100, despite growing export activities of these industries. c) The state-controlled industries in the transportation equipment sector, like shipyards and defense equipment and support industries, which until recently relied mainly on public procurement-defense contracts which are no longer forthcoming. In recent months production in such industries has virtually stopped, despite their undisputed potential for growth in the future under new entrepreneurial management, in the new flexible labour market environment in Greece, especially if it could operate completely independent from government interference. The production index of the other transportation equipment sector has fallen to 24.3 in Jan.-October 2012, from 2005=100.

Of particular importance are developments in the index of business expectations in Greek industry in 2011 and in January – November 2012. This index shadows the movements in industrial production. In 2011, the index improved substantially to 80.6 in February 2011, from 71.3 in December 2010, but it fell again to 76.2 in June 2011. The Eurozone Heads of State 21 July 2011 decision for a 2nd FSP for Greece contributed to a sizable recovery of the index of business expectations in industry to 77.5 in July and to 81.0 in August (the highest level since 2008). This recovery was followed by the aforementioned substantial improvement of manufacturing production in Q3 2011. However, in tandem with the collapse of confidence, the index of business expectations in manufacturing industry fell to 76.2 in September 2011 and to 74 in October 2011, preceding the consequent drop of manufacturing production. The Heads of State decision of 26 October 2011 for a substantially revised 2nd FSP brought an improvement of the index of business confidence in manufacturing once more in November, but the implementation of this decision did not materialize before March 2012, with detrimental effects for Greek manufacturing production and for the economy as a whole until March 2012. In April, following the successful implementation of the PSI Plus by the Greek Government, the index surged again to the level of 81.6 in April 2012, in order to fall again to the level of 77.1 in May 2012 and to 74.1 in June 2012 following the results of the inconclusive 6 May 2012 parliamentary elections. Following the formation of the new pro-reform government in June 2012, the index increased again to 75.8 in August 2012 and to 81 in October 2012 and then to 80.4 in November 2012.

Table 10. Basic sectors of the Greek Manufacturing industry

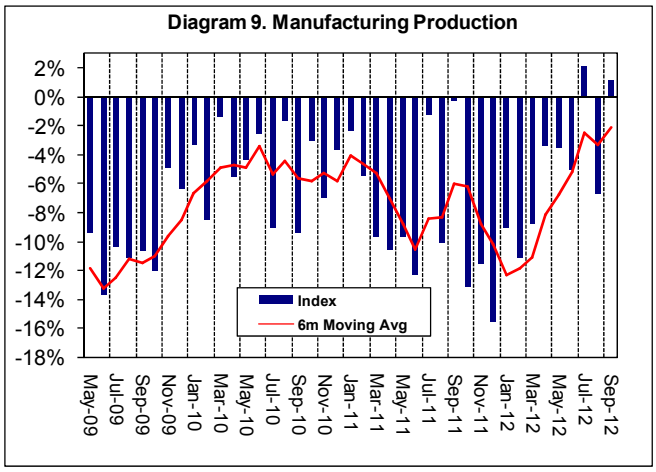
	Weights	2012 Jan-Oct	2011	2010	2009	Level 2012 Jan-Oct (2005=100)
Food	18,2	-4,2	-4,3%	-4,1%	-2,7%	94,4
Beverages	6,0	-10,6	-9,3%	-7,6%	-4,8%	83,4
Tobacco	1,9	-5,4	10,5%	-17,5%	-2,7%	77,4
Oil (refineary) products	11,3	20,8	-14,5%	5,7%	-0,1%	114,0
Chemicals	5,3	-12,8	-4,7%	1,9%	-14,6%	73,8
Pharmaceuticals	2,5	-5,3	-0,6%	2,4%	18,3%	142,8
Basic metalls	8,0	-5,7	6,5%	12,0%	-17,9%	92,9
Manuf. Of metall products	5,1	-11,0	-5,4%	0,2%	-17,7%	68,8
Machinery and equipment	2,1	-21,8	-6,3%	-21,0%	-27,0%	47,1
Wood and cork products	1,2	-12,0	2,8%	9,4%	-27,3%	68,1
Plastic products	4,2	-11,0	-7,3%	-7,0%	-13,7%	72,1
Non-Metallic minerals	10,3	-18,9	-35,9%	-14,2%	-24,2%	32,4
Electrical equipment	3,0	-7,8	-13,6%	-4,1%	-20,1%	65,9
Textiles	3,1	-19,0	-22,0%	-20,6%	-27,8%	26,7
Clothing	3,4	-9,6	-25,4%	-23,1%	-23,6%	33,1
Other transport equipment	1,6	-31,5	-37,1%	-35,1%	-18,6%	24,3
Vechicles, trailers and others	0,8	-10,4	-28,8%	-1,6%	-13,3%	43,4
Repair and machinery instalation	4,1	-14,5	-2,6%	-22,8%	-15,2%	46,0
Manufacturing Industry	**100,0**	**-5,3**	**-9,5%**	**-5,1%**	**-11,2%**	**73,7**

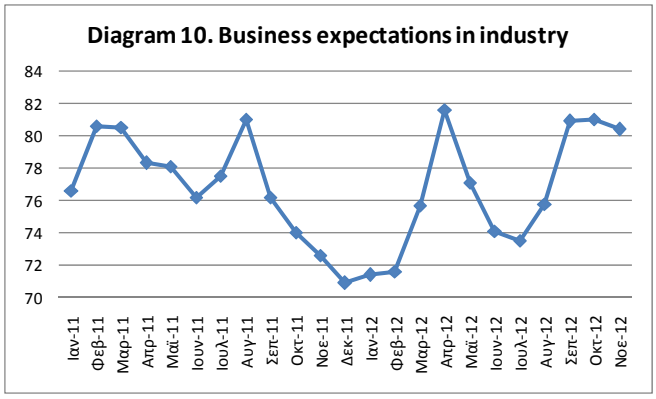
Source: ELL.STAT.

The relevant PMI index had been fluctuating around 43 until February 2011, but it improved to 45.4 in March 2011, 46.8 in April 2011, 45.5 in June, 45.2 in July, 43.3 in August –September 2011 and then fell to around 40 in Q4 2011 and to 37 in February 2012, showing the failure to build on the Q3 2011 improvement and the falling back on a higher falling trend of the manufacturing production until March 2012. 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. Then, the successful implementation of the PSI Plus led to a new improvement of business confidence and a new deceleration of the falling trend of manufacturing production in April – October 2012, with the PMI index still fluctuating at around 42 in September – November 2012.

Some important sectors of the Greek manufacturing, especially those with substantial export activity, registered positive growth in production in 2010 and in 2011, or minor fall of production, as shown in Table 7. In particular, the food industry, which is the most important sector of Greek manufacturing, registered positive growth of 3.0% in September 2011 but a new fall of production in Q4 2011 and in January-September 2012, contributing to an overall -4.3% fall in 2011 and to a -4.2% yoy fall in Jan.-October 2012, on the back of a -4.1% fall in 2010. Production in this sector is affected negatively by a sizable rationalization-fall of domestic demand and positively by increasing exports. The same applies for

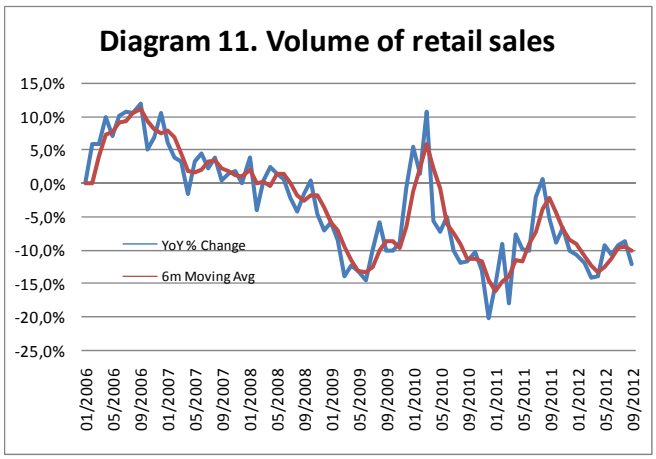
other exporting sectors, as the basic metals and metal products in which production is also positively affected by strong exports but negatively affected by the substantial reduction of domestic construction activity, especially of housing investment. Thus, the basic metals sector registered a -5.7% fall in Jan.-September 2012, from an increase by 6.8% in 2011 as a whole. Its index stands at 92.9 in Jan.-September 2012 from 98.5 in 2011. Higher growth in the last few years has been recorded in the pharmaceutical industry, which registered a -5.3% fall in Jan.-September 2012, from a -0.4% fall in 2011, with its index standing at 142.8 in Jan.-Sept. 2012, from 2005=100. On the other hand, chemical industry has been affected by the crisis, registering a fall of production by -12.8% in Jan.-September 2011, from a fall of -2.5% in 2011. Petroleum products registered a 20.8% increase in production in Jan.-Sept. 2012, from a fall by -14.8% in 2011. Its index stands at 114.0 in Jan.-Oct. 2012.



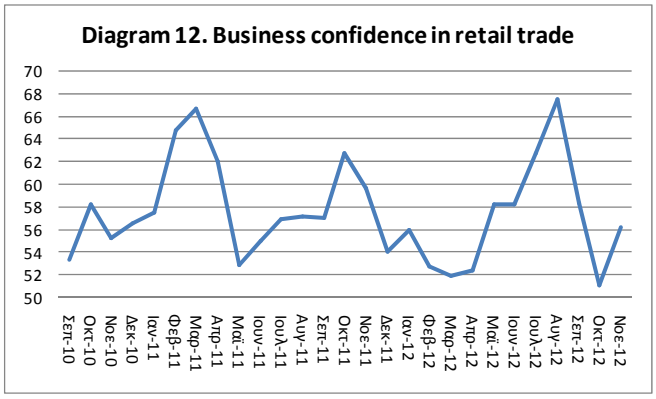


Moreover, ***the index of turnover*** in the manufacturing industry registered a 2.5% increase in Jan-September 2012, on top of a 10.7% increase in Jan.-September 2011, a 7.3% increase in 2011 and a 4.2% increase in 2010. More importantly, a small fall by -2.9% in Jan.-September 2012 was registered in the index of manufacturing turnover in the domestic market, following a -1.2% fall in Jan.-September 2011. ***Finally, the dynamic export drive in Greek manufacturing industry can also be shown with the spectacular increase of industrial turnover in foreign markets*** (exports) by 12.4% in January-September 2012, on top of a 31.7% increase in Jan.-September 2011 and a 23.0% increase in Jan.-September 2010. Also, industrial export turnover registered a 27.1% increase in September 2012, on top of a 48.2% increase in September 2011 and a 7.2% increase in September 2010. Therefore, despite the existence of manufacturing sectors which have been dramatically negatively affected by the economic crisis in the country, exporting sectors are registering a spectacular performance in redirecting their activities to foreign markets.

PRIVATE CONSUMPTION*:* In 2011, the fall of the volume of retail sales has decelerated notably to -2.0% in Q3 2011, compared with the substantial fall by -9.1% in Q2 2011 and by -14.7% in Q1 2011. Due to substantial favourable base effects, it was expected that the falling trend of this index would continue in Q4 2011, where it could even turn positive. Instead, the falling trend of retail sales accelerated again in Q4 2011, due to the demoralization of the Greek consumers who was brought face to face with prospects of Greece's default and exit from the Euro, with rapidly rising unemployment and uncertainties about losing its savings. Greek households turned their whole attention on how to cover for these risks, further postponing their consumption, opting at the same time for unrecorded transactions without the payment of VAT.

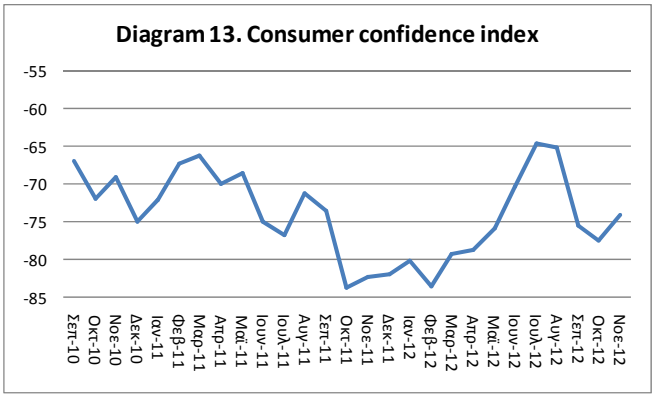


Therefore, the substantial yoy fall of retail sales by -8.6% in Q4 2011 took place, from the increase of +1.2% in August 2011 and -2.0% in Q3 2011. Thus, for the year as a whole the fall of the volume of retail sales reached an unprecedented -8.6%, from -6.9% in 2010.



In 2012, there was a substantial improvement of the Index of business expectations in retail trade in April-August 2012, from its very low level in March-April 2012. Then the unending discussions with the Troika foe the imposition of ne fiscal adjustment measures amounting to € 13.5 bn (on top of measures exceeding € 18.5 bn applied in 2012), in combination with the intensification of

the liquidity constraint imposed on Greece by its lenders, implied a substantial increase in uncertainty and a fall in business confidence in the retail trade as shown in Diagram 12. Recovery of business confidence in this sector occurred only in November following the adoption of the new MOU by the Greek parliament. The same pattern of developments has taken place in the field of consumer confidence as shown in Diagram 13.



Therefore, the volume of retail sales remained depressed, registering continuous big falls until September 2012 as shown in Diagram 11. Its fall was -9.9% in Q3 2012 (from a small fall by -2.2% in Q3 2012), -11.4% in 2012 (from a relatively big fall of -9.1% in Q2 2011) and -12.2% in Q1 2012 (from the very big fall of -14.0% in Q1 2011).

Of particular importance was also the fact that the fall of the volume of retail sales was relatively contained in the big department stores and the big supermarkets both in 2011 and in January-September 2012, as shown in Tables 11 and 12.

Table 11. Index of the Volume of Retail Sales

2005=100	January - December				
Specialized store categories	Index 2009	Index 2010	Index 2011	*2010%*	*2011%*
Supermarkets	106,9	101,4	97,8	-5,1%	*-3,6%*
Department stores	109,2	96,6	99,0	-11,5%	*2,5%*
Food-beverages-tobacco	93,2	88,9	75,7	-4,6%	*-14,8%*
Pharmaceutical products, cosmetics	109,2	107,7	98,0	-1,4%	*-9,0%*
Clothing and footwear	97,6	86,5	70,2	-11,4%	*-18,8%*
Furniture, electrical equipment	101,8	88,8	74,9	-12,8%	*-15,7%*
Books, stationery, other goods	83,0	79,4	75,4	-4,3%	*-5,0%*
Overall Index	**100,0**	**93,7**	**84,2**	-6,3%	*-10,1%*
Index (except automotive fuel)	**98,8**	**92,0**	**84,0**	-6,9%	*-8,7%*

Source: Hellenic Statistical Authority

Table 12. Index of the Volume of Retail Sales

Specialized store categories	Jan-Sep'12	Jan-Sep'11
Supermarkets	-6,7	-3,8
Departments stores	-5,3	3,5
Food-beverages-tobacco	-14,9	-13,5
Pharmaceutical products, cosmetics	-10,6	-10,7
Clothing and footwear	-20,8	-17,7
Furniture, electrical equipment, household equipment	-17,1	-16,2
Books, stationery, other goods	-12,6	-4,6
Automotive fuels	-14,3	-15,3
Overall Index	**-11,6**	**-9,9**
Overall Index (except automotive fuel)	**-11,2**	**-8,7**

Source: ELL.STAT.

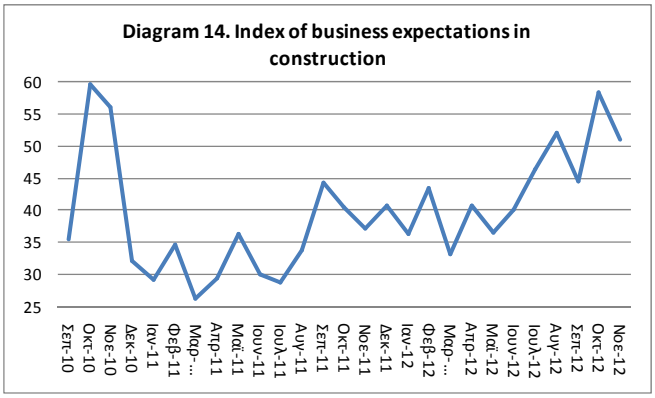
In 2011 the volume of retail sales in the big department stores actually increased by 2.5%, wile it fell slightly, only by -3.6%, in the big supermarkets. Also, in January – September 2012 the fall of the volume of retail sales in these two categories of retail outlets was relatively small, compared with the huge fall in sales in small and medium size retail shops (of food-beverages and tobacco, or clothing ant footwear, furniture and electrical equipment appliances, etc). This development may be partly due to the apparent inability of small shops to compete with the big department stores and supermarkets. However, the depressing numbers may also reflect the fact that in the big supermarkets and department stores all sales are recorded. On the contrary, small shops can avoid recording a sizable part of their transactions to evade paying taxes, an act which evidently took explosive proportions in the period following September 2011.

On the other hand, the new fall of sales of durable goods in 2010 and in 2011 is related to the substantial fall of disposable incomes in 2011 but also to the depressed consumer and business confidence in the Greek economy, which persisted until September 2012.

Pervasive uncertainty and abnormally low consumer confidence have greatly affected the new passenger cars market and the housing market. New passenger cars registrations dropped by -29.8% in 2011, following their fall by -37.2% in 2010. However, even in this sector the falling trend of yoy sales decelerated in Q3 2011 to -4.0% yoy, from -21.3% in Q2 2011 and the big fall by -55.9% in Q1 2011. Registrations fell to 107 thousand in 2011, from 152.3 thousand in 2010 and from 315.8 thousand in 2007. Moreover, the fall of new passenger cars registrations continues in 2012 reaching -40.7% yoy in January-November 2012, on top of the -31.9% yoy fall in January-November 2011. Overall new private passenger car registrations are expected to fall to about 75 thousand in 2012, less than ¼ of their level in 2007. Finally, expenditure on imported cars is expected to fall to about € 0.8 bn in 2012, from € 1.25 bn in 2011, € 2.18 bn in 2010, € 3.3 bn in 2009 and € 5.26 bn in 2007. These developments in the passenger cars and other imported durable goods markets indicate that the real looser from the current unprecedented recession plugging the Greek and other European economies is not the taxpayer in creditor countries which provide financial support to the overindebted countries of southern Europe. The real losers are the exporting producers and the employees of exporting businesses in these countries.

Concerning investment in housing, the falling trend of residential construction activity – as measured by the volume (m^3) of building permits – continues unabated. After registering a fall -37.7% yoy in 2011, following its fall by -23.3% in 2010, by -26.5% in 2009, by -17.1% in 2008 and by -5.0% in 2007, the falling trend took new dimensions in 2012 as well. Its fall in Jan.-September 2012 reached – 26.3%, on top of its fall by -35.5% in Jan.-September 2011. In fact, the volume of residential construction is now expected to fall to 17.2 million m^3 in 2012, down from 22.6 million m^3 in 2011, 36.29 million m^3 in 2010 and 102.24 million m^3 in 2005. These developments led to residential investment falling in real terms by -31% in 2012, from -23.6% in 2011, -18.0% in 2010, -23.5% in 2009, -28.2% in 2008 and -9.0% in 2007. In fact, residential investment is expected to fall to about € 5.35 bn in 2012, from € 7.45 bn in 2011 (in 2005 prices) and from € 23.81 bn in 2006. This level is extraordinarily low for Greece and a gradual recovery of residential investment due also to demographic reasons and to the

need for renewal, renovation and extension of the existing housing stock, may be expected from H1 2013.



In the current period, the aforementioned adverse developments in consumer and business confidence until October 2012 have delayed 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 44.3 in September 2011, from 28.8 in July 2011. However, this was still a very low level of business confidence and it deteriorated again to 40.6 in October and to 37.1 November 2011. A new improvement to 43.4 has registered in February 2012, in order to fall again dramatically to 33.2 in March 2012. One explanation for these unfavourable developments may be provided by the new substantial fall of expenditure of the Public Investment Budget by -17.1% in 2011 from the already very low level of 2010 (-11.3%). The precipitous fall of construction activity in the private sector is not in any way compensated by a positive increase in investment activity in the public sector. In fact, other construction activity, excluding investment in housing, fell by -7.3% in Q1 2012 and by -0.7% in Q2 2012 following a substantial fall of this activity by -25.0% in 2011. In fact, the index of business expectations in construction has improved substantially to 46.3 in July, to 52.0 in August 2012 and even to 58.3 in October 2012 (the highest level since 2010). Despite the fall of the index to 51.1 in November 2012, further improvement is expected in the following months, especially after the approval of the continuation of the financial support provided to Greece by the Eurozone and the IMF. It should be noted that a more determined effort is now under way to reactivate activity in public investment projects, while the substantial fall in housing prices and the ongoing improvement in consumer confidence is expected to boost demand for housing as well from its low level in end-2012.

INFLATION: CPI Inflation in Greece fell to 1.0% in November 2012, from 1.6% in October 2012, 1.7% in August 2012 and 2.4% in December 2011, dropping from 5.2% in December 2010. Average CPI inflation is now expected to fall to 1.5% in 2012, from 3.4% in 2011 and 4.7% in 2010. This evolution of inflation 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. Additional increases in VAT rates and other taxes from early 2011, in combination with substantial increases in the international price of oil and other commodities, implied that inflation remained high in 2011 and, to some extent, even in H1 2012, despite decelerating fast from May 2011 onwards. Overall, inflation is expected to drop again to 0.9% in January 2013, and then to fall further to 0.7% in June 2013 and to -0,3% in October 2013 and finally to -0.2% in December 2013. Due to the extraordinary low level of domestic demand and the appreciation of the Euro, average inflation is expected to fall bellow 0.6% in 2013 as a whole.

IMPLEMENTATION OF 2012 BUDGET: The Central Government Budget deficit fell to € 12.92 bn in Jan.-November 2012, from a deficit of € 21.5 bn in Jan.-November 2011 and it was significantly lower from the target set by the Government and the Troika for a € 15.5 bn deficit in January-November 2012. In addition, the Central Government Primary Balance fell drastically to € 1.49 bn in Jan.-November 2012, from € 5.96 bn in the same period of 2011 and it was much lower from the targeted deficit of € 3.6 bn for January-November 2012.

This result was achieved despite the persistent fall of net current budget revenues by -2.3% yoy in January – November 2012, on top of their fall by -3.0% in January – November 2011 as well. This fall of net current revenues occurred despite the substantial additional revenue increasing measures undertaken in 2011 and 2012, which increased drastically the tax burden imposed on compliant taxpayers in the last two years. In fact, net current budget revenues have been negatively affected in May, June and July 2012 from the two very critical parliamentary elections in the country. Moreover, the substantial fall of current budget primary expenditure and the deep recession in the country imply a corresponding fall of tax revenues. However, all these parameters were taken into account in February 2012, when the supplementary 2012 budget was formulated. It was then estimated that with the substantial revenue increasing measures imposed for 2012, net current budget revenues would reach € 51.41 bn. This estimation was also already assuming a huge increase in tax evasion in 2012, on top of the explosive increase of tax evasion in 2007-2011. Therefore, the additional loss of € 4.0 bn during the year 2012, in which compliant tax payers have seen their tax burden increasing to the very limit of their economic abilities, constitutes the most dangerous and extremely painful for the country failure of the over all economic adjustment program.

It should be noted that the above depressing outcome was achieved despite the fact that tax rebates were lower by € 1.74 bn in Jan.-November 2011, while for 2012 as a whole are expected to be lower by € 1.59 bn from 2011. The main problems in the implementation of the 2012 budget on the revenue side appear to be the following:

a) The substantial fall of the VAT revenues by -11.1% yoy in Jan-October 2012, to € 12.86 bn, from € 14.46 bn in Jan-October 2011. This abnormal fall occurred in a period in which VAT rates on restaurants was increased from 13% to 23% from the 1st of September 2011. In fact this measure implied a huge fall of recorded turnover in restaurants and hotels of -18.2% in Q4 2011, -24% in Q1 2012 and -20.8% in Q2 2012.

b) The substantial fall of revenue from corporate income taxes, by -38.8% yoy to € 1.35 bn in Jan.-October 2012, compared with € 3.8 bn in 2009. This development is

again to a great extent due to corporate income tax evasion by businesses and self employed (professional) workers, who are involved in the practice of the increasing in number unrecorded transactions on which they first don't pay their VAT liabilities and secondly they don't pay any income tax either.

c) Concerning personal income tax (PIT), a substantial increase was expected in 2012 due: (i) to the imposition of the special tax of 1%-4.0% on all taxable incomes above € 12.000 both for 2012 and for 2011, with expected additional revenues from this source exceeding the € 2.8 bn in 2012, (ii) to the substantial reduction of tax free threshold to € 5.000 from € 12.000, with expected additional revenues in 2012 exceeding the € 1.5 bn. iii) to the substantial increase taxable incomes of non-wage earners through the use of much stricter criteria for the objective estimation of this income, with expected additional tax revenues of more than € 500 million. Therefore, revenues from PIT should increase in 2012 by about € 5.0 bn. Instead, the recorded increase is projected not to exceed the € 1.65 bn.

d) Concerning revenues from the equalization of heating oil excise tax with the much higher tax on diesel, additional revenues were expected, amounting to € 250 mln in October – December 2012 and about € 600 million from 2013 onwards. However, revenues from the special excise tax on fuels were down by -3.7% in January – October 2012 and are also expected to be down by -2.0% in 2012 as a whole.

On the expenditure side, ordinary budget primary expenditure dropped significantly by -9.5% yoy in Jan.-November 2012 and they were lower by € 4.43 bn from Jan.-November 2011 and by € 461 million from the target set in the 2013 budget. In particular, overall salaries and pensions in the public sector were lower by -6.9% yoy in Jan.-October 2012, following their fall by -6.3% in 2011 and by -9,4% in 2010. Also, grants to social security funds including subsidies to the Single Health Services Organization (EOPYY) and the Manpower Employment Agency (OAED) were lower by -7.0% yoy in Jan.-October 2012. However in 2012 as a whole, total subsidies to these organizations are expected to increase by more than 12.4% yoy and, most possibly, to exceed the budgeted amount of € 13.2 bn and to reach € 13.78 bn. This overspending is mainly due to the substantial fall in the revenues of the social security funds (due to the substantial increase 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 fall by -2.4% in Jan.-October 2012, while it is now budgeted to register a -1.0% fall for 2012 as a whole. Overall, current budget primary expenditure is expected, in the budget 2013, to reach € 47.58 bn in 2012, registering a fall of -6.0%, compared to its fall by -9.5% in January – October 2012. It is now very doubtful whether a current budget primary spending of the order of € 9.6 bn can happen in only one month.

Finally, the decrease in the Central Government budget deficit was also due to the substantial fall of public investment budget (PIB) expenditure by -13.7% yoy in Jan.-November 2012, from an increase of 2.6% in the same period of 2011. On the other hand, PIB revenues reached € 2.96 bn in Jan.-October 2012, when the targeted PIB revenues for this period were € 3.44 bn. In any case PIB expenditure is now expected to reach only € 6.3 bn in 2012, compared with the initial budgeted level of € 7.3 bn and the November 2012 budgeted level of € 6.85 bn. The continuous fall of the PIB expenditure is a main contributor to the big fall of GDP in 2010-2012. On the other hand PIB revenues are now expected to reach the budgeted € 4.75 bn.

Regarding the implementation of the general government (GG) budget, there was a significant improvement in the GG primary balance in cash basis, ***which in fact recorded a primary surplus of € 2.31 bn in Jan.-October 2012,*** from a deficit of € 4.24 bn in Jan.-October 2011. This impressive result was due to the following developments: (i) To the increase of the GG revenues by 1.0% yoy, in Jan-October.'2012, compared with a projected fall of these revenues by -2.4% in the year 2012 as a whole. (ii) To the substantial fall of the GG primary expenditure by -8.4% in Jan.-October 2012, compared with a projected fall by -6.0% in 2012 as a whole. This fall of GG primary expenditure was achieved mainly due to the Central Government primary expenditure fall by -8.7%, while, primary expenditure of GG state controlled entities increased BY 5.1%, local government primary expenditure increased by 3.2% and primary expenditure of social security funds fell substantially by -9.9%.

Overall, a more determined effort is needed in order: a) to collect the assessed additional revenues from the personal Income Tax (exceeding € 6.5 bn) and the property taxes to be collected in H2 2012 and also b) to combat VAT and social security contributions evasion, which took unprecedented proportions in 2012 and c) to receive the budgeted revenues from the EU structural funds. If these happen, then the implementation of the 2012 Budget is expected to continue to be better than planned, with a possible general government primary surplus of at least 2.0% of GDP in 2013, compared with the budgeted small surplus of about 0.4% of GDP.

Balance of Payments: The Current Account Balance recorded a surplus of € 766.5 mln in Sept.'12 versus a deficit of € 1.06 bn in Sept.'11. Also, a surplus of € 1.97 bn was recorded in Aug. '12, against a surplus of € 477.2 mln in Aug. '11. Overall, the Current Account Deficit (CAD) including net capital transfers decreased to € 1.88 bn (1.0% of GDP) in Jan.-Sept.'12, from € 13.59 bn (6.5% of GDP) in January-September 2011 (a -86.2% yoy fall) and € 15.3 bn (6.9% of GDP) in Jan.-September 2010 (a -11.2% yoy fall).

The reduction of the trade deficit excluding oil and ships was also significant to € 3.11 bn or by -31.8% yoy in Jan.-Sept.'12, on top of its reduction by -21.9% in Jan.-Sept.'11. This substantial fall in the deficit is due to the precipitous fall in imports of goods excluding oil and ships by -15.0% yoy in Jan.-Sept.'12, on top of their -5.0% fall in Jan.-Sept.'11, but also due the increase of exports of goods excluding oil and ships by 1.8% in Jan.-September 2012, on top of their 20.9% surge in Jan.-Sept.'11.

Nevertheless, the payments for import of fuels increased again by 4.9% yoy in Jan.-Sept.'12, on top of their

unexpected (in the period of shock fiscal adjustment) surge by 24.8% in Jan.-Sept.'11. On the other hand, revenues from fuel exports grew by 19.4% in Jan.-Sept.'12, after their increase by 36.3% in Jan.-Sept.'11, explaining to some extent the substantial increase in fuel imports. Overall, in Jan.-Sept.'12 was recorded a slight decrease in the fuel deficit at € 8.17 bn compared to € 8.42 bn in Jan.-Sept.'11, but this deficit is still significantly higher than the deficit of € 7.06 bn in Jan.-Sept.'10. The increase in total exports of goods (including fuel and ships) was 6.9% in Jan.-Sept.'12, versus 23.5% in Jan.-Sept.'11, an important support for the economy during current recession. Exports of goods amounted € 16.09 bn in Jan.-Sept.'12, versus € 15.05 bn in the same period 2011 and are expected to exceed € 21.6 bn (10.4% of GDP) in 2012, compared to € 20.23 bn (9.4% of GDP) in 2011 and € 17.08 bn (7.5% of GDP) in 2010.

Balance of Services: The surplus increased by 4.9% yoy in Jan.-Sept.'12, on top of a 6.7% increase in Jan.-Sept.'11. The increase in this surplus is mainly due to the substantial fall in payments for imports of services to € 9.38 bn in Jan.-Sept.'12, from € 10.72 bn in Jan.-Sept.'11. Revenues from exports of services amounted to € 22.0 bn in Jan.-Sept.'12 from € 22.75 bn in Jan.-Sept.'11, as both revenues from international tourism and from international transportation registered a fall in Jan.-September 2012. More specifically:

Tourism: A decrease in receipts from foreign tourism was recorded amounting to € 248.5 mln (-2.7% yoy) in Jan.-Sept.'12, compared to their 9.8% yoy increase in Jan-Sept.'11. On the other hand, payments for tourism by the domestic residents abroad declined by -17.63% in Jan.-Sept.'12, against their increase by 8.45% in Jan.-Sept.'11. Therefore, the surplus of tourism balance stood at € 7.61 bn in January-September 2012, up by 0.9% yoy, following its sizable increase by 10.1% in Jan.-Sept.'11.

Shipping: The receipts from Greek international shipping fell by -3.4% yoy in Jan.-Sept.'12, following their bigger-crisis driven - reduction by -10.3% in Jan.-Sept.'11. On the other hand, payments for international transportation (shipping) abroad fell by -14.5% in Jan.-Sept.'12, resulting in a significant increase in the surplus of Greece's international transport balance (mainly shipping) by 8.9%, to € 5.44 bn.

Exports of other services: A decline in receipts from exports of other services by -4.6%, to € 2.74 bn, in Jan.-Sept.'12 was recorded, following their increase of 17.3% in Jan.-Sept.'11. Also, the payments for other services registered a substantial fall by -6.2%, to € 3.16 bn, in Jan.-Sept.'12, on top of their fall by -6.5% in Jan.-Sept.'11, resulting in a decrease in the deficit for these services by -15.5%.

Incomes Balance: A drastic fall of -68.6% in the deficit to € 2.01 bn, was recorded in Jan.-Sept.'12, versus its rise by 11.6%, to € 6.43 bn, in Jan.-Sept.'11. This development was mainly due to much lower interest payments on public debt, with interest - dividends and profits falling by -51.7% yoy following their fall by -0.2% in Jan.-Sept.'11. The sizable fall in interest payments abroad is due to a great extent on Greece's PSI Plus, implemented in March 2012, which implied a substantial reduction of the nominal value of the Greek Government Debt held by foreign banks and institutional investors. Moreover, it also reflects the substantial capital flight of portfolio capital from Greece in the last two years. On the other hand, the receipts of domestic residents of interest, dividends and profits from abroad increased marginally by 0.4% yoy in Jan.-September 2012, following their fall by -21.1% in January – September 2011.

Current transfers balance: Its surplus increased to € 1.57 bn in Jan.-September 2012, from € 0.65 bn in Jan.-September 2011 and € 0.69 bn in Jan.-Sept.'2010. More specifically, current transfers from the European Union increased by 31.4% yoy, to € 3.7 bn in Jan.-Sept.'12, while emigrant remittances fell again by -9.4% in Jan.-Sept.'12, on top of their fall by -19.5% in Jan.-Sept11. Also significantly decreased were the payments for remittances abroad by -26.6% to € 820.3 million in Jan.-Sept.'12 from € 1.1 bn in Jan.-Sept.'11.

Capital transfers balance: Its surplus was also higher to € 1.58 bn in Jan.-Sept. 2012 from € 1.15 bn in Jan.-Sept. 2011. This was due to higher receipts from the Structural Funds of EU-27, which reached to € 1.7 bn in Jan.-Sept.'12, compared to € 1.2 bn Jan.-Sept.'11. However, despite this increase, the receipts from the EU structural funds are still at much lower levels than expected, as for 2012 as a whole these receipts have been projected to be significantly higher, compared to their level in 2011 and 2010.

The above developments lead us to the following observations: First, it is now evident that the fall of the current account balance in 2011 was mainly due to the sizeable reduction of the country's trade deficit- excluding fuels and ships and also to the important improvement of its balance of services and its capital transfers. However, this balance in 2011 was again burdened by € 2.5 bn from the abnormally high increase of the deficit of the fuels balance as a consequence of the new surge of imports of fuels in 2011, in an environment of deep recession in the domestic economy.

Second, the pace of improvement of Greece's CAD accelerated in 2012, again as a result of the huge fall of its trade deficit – excluding fuels and ships but also as a result of the substantial fall this time of the deficits of the sips and fuel balances. Moreover, in 2012 there is the substantial of payments of interest, profits and dividends to foreign investors. Therefore, the reduction of the current account deficit is turning out to be drastic in 2012, where we expect now that this deficit will fall to levels bellow the 3.0% of GDP. This will be the result of an even higher fall of the fuels deficit until the end of the year and also of an even higher fall of the trade deficit excluding fuels and ships. Moreover, the incomes balance deficit will improve further in Q4 2012 and especially from 2013 onwards due to the additional substantial fall of interest payments on public debt following the Eurogroup's decisions for a further alleviation of the debt burden for Greece with an additional substantial fall of interest payments. Overall, provided that the fiscal targets of the Medium-Term Fiscal Strategy 2013-2015 will be implemented, implying a general government deficit below 3.0% of GDP after 2014, the deficit of current account will fall fast in the next years and it can turn into surplus from 2014 onwards. Greek economic

development from 2013 will be based on Greece's comparative advantage, international competitiveness and current account surpluses, overturning its development pattern until 2009, which was based on huge capital account surpluses and on a continuous boost of domestic demand through foreign borrowing.

The Capital Account of Greece's BoP: The surplus of this account fell significantly and amounted to € 3.4 bn in Jan.-Sept.'12, versus € 14.9 bn in Jan.-Sept.'11, indicating the huge liquidity deficit under which the Greek economy operated in 2012. These developments in the capital account of Greece's BoP in January-September 2012 are analyzed as follows:

In the field of Foreign Direct Investment (FDI), the pattern is already set for the significant surpluses which are expected in the following years. A net inflow of FDI of € 2.02 bn was recorded in Jan.-Sept.'12, compared to a net outflow of € 1.96 bn in Jan.-Sept.'11. In particular, there was a net inflow of capital from foreign firms operating in Greece amounting to € 1.83 bn compared to a net outflow of € 727.3 mln in Jan.-Sept.'11. Also, inflows were recorded by local businesses due to the liquidation of their FDI abroad of € 185.3 mln in Jan.-September 2012, compared to a € 1.23 bn outflow in Jan.-Sept.'11.

The flow of capital for portfolio investment indicates the magnitude of crisis plaguing the Greek economy and the level of PSI Plus transactions which took place in 2012. Thus, a net outflow of capital took place in Jan.-Sept.'2012 amounting to € 75.98 bn compared to net outflows of € 16.94 bn in Jan.-Sept.'11. Specifically, there was an outflow of capital due to an increase in residents' holdings of 'bonds and treasury bills issued by non-residents (including bonds EFSF) by € 38.8 bn and also due to a decline in non-residents' bonds and Treasury bills issued by domestic residents (and the Greek state) by € 36.2 bn. Moreover, a capital outflow of € 719 mln was recorded for investments in financial derivatives abroad. Finally, an outflow of € 102 mln was for the purchase of foreign shares by residents and an outflow of € 149 mln was due to de reduction of holding of domestic shares by non-residents.

Other investment capital flow indicates mainly in recent months the level of financing of the Greek government by its official lenders. Thus, a net capital inflow of € 77.33 bn was recorded in Jan-Sept.'2012, compared to a net inflow of € 33.78 bn in Jan.-Sept.'11. This was mainly attributed to the inflow of € 75.12 bn of official lending to Greece by the EFSF and the IMF in March – June 2012. Official lending stopped in June 2012 and there was not any additional inflow from this source until the middle of December 2012. Moreover, domestic banks and institutional investors contributed to an inflow of € 13.2 bn, through the reduction of their holdings of deposits and repos abroad. On the other hand, foreign banks and institutional investors contributed to an outflow of € 10.98 bn through the reduction of their holdings of deposits and repos in domestic financial institutions.

MONEY & FINANCIAL MARKETS: Credit expansion to businesses and households fell by -4.8% at end-October 2012, from -4.5% at end-September 2012, from its fall by -1.3% at end-December 2011 and -2.2% at end-October 2011. In particular, the annual rate of change of mortgage and consumer lending fell by -3.6% and -5.2% respectively at end-October 2012, from -2.9% and -6.4% respectively at end- December 2011 and from -2.4% and -6.7% respectively at end-October 2011. Moreover, lending growth to businesses decreased by -5.6% at end-October 2012, from -4.9% at end-September 2012, -2.0% at end-December 2011 and -0.9% at end-October 2011. Overall, the annual rate of change of credit to the private sector is expected to decelerate further to around -3.0% by year-end 2012, from -3.1% at year-end 2011.

Diagram 8. Credit Expansion

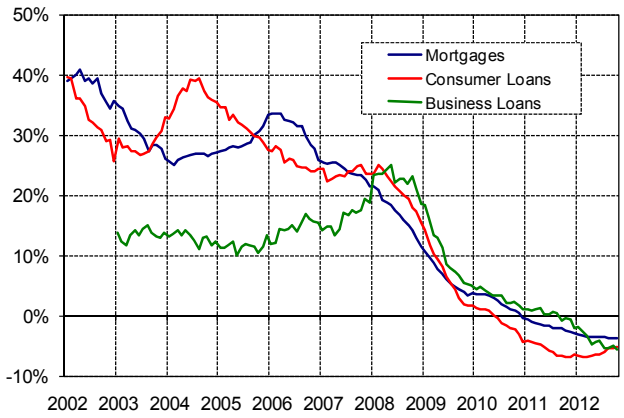
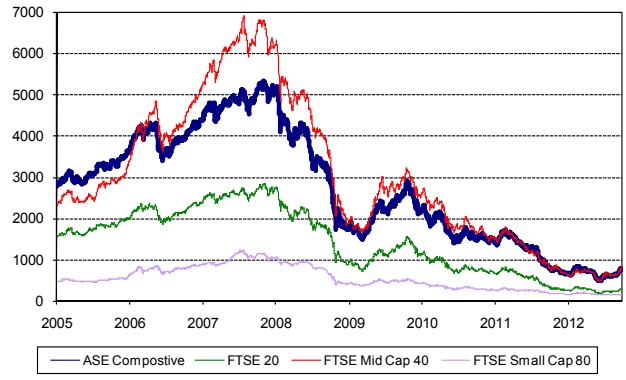


Diagram 9. Athnes Stock Exchange Indices



By the end of November 2012, the main ASE composite index was up by 18.9% on a yoy basis (FTSE-20 stocks: +5.4%, FTSE-40 mid-cap: +52.6%), from -51.9% at end-2011 (FTSE-20 stocks: -60.0%, FTSE-40 mid-cap: -57.3%). Following these developments, at end-October 2012 51.4% of the total stock exchange value of listed firms was in the hands of foreign investors, up from 50.9% at end-2011 and 50.2% at end of August 2011.

2. ROMANIA

ECONOMIC OVERVIEW: Romania's economy contracted by a real -0.5 q/q in Q3 2012 according to preliminary data released by the National Statistical Office (INS). On an annual basis, GDP fell 0.8% on a seasonally adjusted basis in Q3 2012. On an unadjusted basis, GDP decreased 0.6% y/y in Q3 2012, while in the first 9 months of the year increased by 0.2% y/y. The Romanian economy expanded by a real 1.1% in annual terms in Q2 2012. The GDP grew also in Q2 2012 by 0.5% q/q based

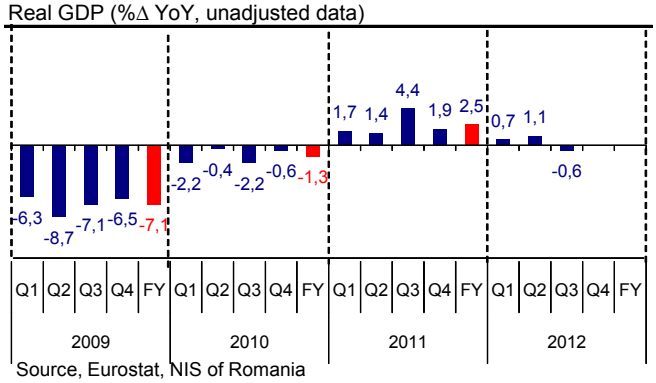
on seasonally adjusted data. The GDP totalled an estimated RON 138.3 billion (€ 30.8 billion) at current prices in Q2 2012. The main drivers of the economy in the second quarter were the construction sector, which expanded by 3.6% y/y, and information & communications sector which recorded an annual increase of 1.5%. The agriculture sector output registered a -1.6% y/y fall and the public administration, defence & social services sector a fall by -2.1% y/y in Q2 2012. Private consumption rose by 1.8% y/y from 0.6% in Q1 2012, while government expenditure fell by -4.0% in Q2 2012, compared to a -1.4 y/y fall in Q1 2012. On the other hand, gross fixed investment remained strong, expanding 15.5% y/y in Q2 2012 from an equally strong increase by 12.2% y/y in Q1 2012. The external sector made a negative contribution to economic growth, as exports of goods and services fell by -0.5% y/y in Q2 2012 from -2.2% y/y in Q1 2012, while imports increased marginally by 0.2% y/y in Q1 2012 from -0.3% y/y in Q1 2012 supported by domestic demand. The negative manufacturing climate in the Eurozone (the main trading partner of Romania), is not encouraging for Romanian industry and exports in H2 2012, while the investment sentiment is likely to remain sour amid fears over Spanish banking sector. Economic recovery in Romania remains fragile and we expect a modest advance in H2 2012.

Romania's economy registered a robust growth by 2.5% in 2011, supported by the buoyant agriculture sector and industry. The International Monetary Fund (IMF) and the European Commission project a GDP growth at 0.9% and 0.8% respectively, in 2012. Improvement in employment and lower inflation support incomes and are expected to give a boost to private consumption in H2 2012. The continued fiscal consolidation is likely to affect public consumption although with parliamentary elections in late November, pressures to relax fiscal policies and structural reforms will likely be strong. Economic growth could be supported by the European Structural Funds where a strong absorption rate is necessary. This year the Romanian authorities have set the target to increase the absorption rate to a minimum of 20% from 8.8% in May 2012. According to IMF and EU projections growth should accelerate to around 2.5% and 2.9% in 2013.

On March 25, 2011, the Romanian authorities signed up to a new 24-month IMF stand-by agreement (SBA) of about € 3.4 billion, which also included additional precautionary support from the EU of € 1.4 billion and a loan of € 0.4 billion from the World Bank. The agreement was supportive of the economic recovery by focusing on enhancing potential growth via targeted structural reform policies in conjunction with fiscal consolidation measures. The fall of the government under Prime Minister Ungureanu in a no confidence vote on April 2012, raised concerns about Romania's commitment to SBA agreement. However, the new government, a coalition of three parties (Social Democratic-PSD, National Liberal-PNL, Conservative -PC) pledged its commitment to EU-IMF agreement. The government of Romania and the IMF in June 2012 reached a staff-level agreement to release an additional SDR 430 million (€ 509 million), the sixth tranche of the EUR 3.4 billion agreed in March 2011.

According to IMF, the ongoing Eurozone crisis poses threats to country's banking system and the pace of economic growth. Fiscal discipline is important to contain spending pressures and remain within the cash deficit target. Although, the deficit target in Q1 2012 was met, underlying spending pressures have increased. IMF warned that structural reforms crucial for future growth have been delayed. Although, the authorities have made big steps for electricity and gas price liberalisation the calendar for privatization of State Owned Entities (SOEs) continues to stay back and the search for private independent managers in SOEs has not progressed sufficiently. Meanwhile, the need to strengthen the resilience of the banking sector, as well as, the reforms on health and tax systems is deemed urgent by the IMF.

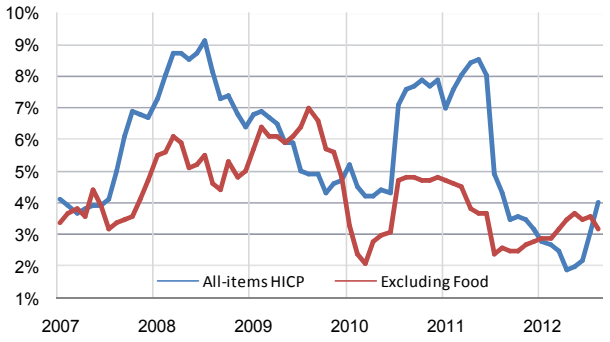
Real GDP (%Δ YoY, unadjusted data)



Source, Eurostat, NIS of Romania

FISCAL POLICY: The implementation of the fiscal consolidation program in the context of the precautionary SBA with the IMF remains on track. The general government cash deficit target in Q1 2012, which was adjusted for higher capital spending, has been met. The deficit amounted to RON 3.5 billion (-0.6 % of GDP) including expenditures of the National Development and Infrastructure Program (PNDI). Consolidated public budget deficit in January-June 2012 reached the -1.12% of GDP, compared to a deficit of -1.94% of GDP in Jan.-June 2011. In 2012, the target is for a general government deficit of -2.2% of GDP or 2.1% of GDP including IMF approved off-budget expenditures (PNDI). In fact, the government proposed relaxing the program's cash deficit target slightly, while keeping the accrual deficit below the 3% of GDP target. The authorities intend to use the additional fiscal room to compensate workers and pensioners with an 8% wage increase for social contribution payments ruled illegal by the constitutional court. Despite the wage increase, personnel spending should remain at 6.7% of GDP in 2012, unchanged from last year. Total revenue in Jan.-June 2012 increased by 8.9% y/y to RON 93 billion or 15.3% GDP. On the income side significant increase was recorded on core revenues (corporate tax +7.7% y/y, personal income tax +15.5%y/y, VAT +9.5% y/y, excises +6.6% y/y), which rose by 11.5% y/y. Non financial revenues were up by 19.4%. On the spending side, total expenditures rose to RON 99.8 billion in January-June 2012 posted an increase of 3.3% y/y. Personnel expenses were up by 1.2% y/y. A strong commitment is required by the government in order to meet budget deficit target this year, as spending control might ease as we approach parliamentary elections.

Consumer Price Inflation - (%Δ yoy)



Source: Eurostat, National Statistical Office

INFLATION: Harmonized consumer price (HCPI) inflation decreased to 5.0% y/y in October 2012 from 5.4% y/y in September 2012 and 3.2% y/y in December 2011. Poor harvest caused by this year's drought combined with the hike in international commodity prices, and the depreciation of RON put pressure on producers to hike prices. Food prices slowed to 6.1% in October 2012 from a year earlier, compared with 6.9% in September 2012. Inflation for non-food items decelerated to 4.0%, compared with 4.3% in September 2012, as fuel prices dropped. Romania's inflation outlook, which points to a moderate upward trend during the remainder of the year held back the National Bank of Romania (NBR) from cutting its basic rate needed to support the vulnerable economy. The inflation could jump up to 5.5% due to volatile prices in vegetables and fruits and to exceed the central bank's target band of 3 ±1%. The BNR recently revised upwards the inflation target to 5.1% for the year. Although BNR expects the inflation to ease further to 3.5% in 2013, key risk factors are new administrative price adjustments, a weaker RON and possible higher international food price inflation.

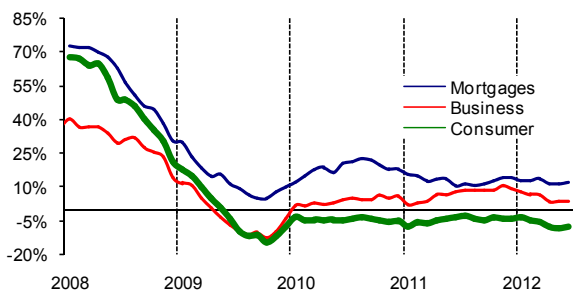
BALANCE OF PAYMENTS: The current account deficit narrowed by 23.2% in January- September 2012 from the corresponding period a year ago, mainly due to a surplus in current transfers & services, and to the shrinkage of the income deficit. The current account deficit decreased to -2.8% of projected GDP for 2012 in the first nine months of the year from -4.0% of GDP in January-September 2011 and -4.3% for the whole 2011. Romania's exports decreased by -0.5% y/y and imports increased by 0.1% y/y in the first nine months of this year to €33.5 billion, and to €38.9 billion correspondingly, according to the National Bank of Romania The same period, the trade deficit increased by 4.1 % y/y to € 5.4 billion. The current transfers balance kept on improving (+17.4% y/y). FDI inflow amounted to € 1.109 million in January-September 2012, as compared with € 861 million in January – September 2011 and covered only 30.2% of the current account deficit. According to IMF, the current account deficit is expected to narrow to below -4% of GDP in 2012.

Current Account: January - September 2012 (€ million)			
	Jan- Sep 2012	Jan-Sep 2011	%Δ
Exports (fob)	33.506	33.677	-0,5%
Imports (fob)	38.947	38.902	0,1%
Trade Balance	-5.441	-5.225	4,1%
Services Balance	371	52	613,5%
-Tourism-travel	-233	-305	-23,6%
Income Balance	-1.178	-1.802	-34,6%
Current Transfers Balance	2.578	2.196	17,4%
Current Account Balance	-3.670	-4.779	-23,2%
Source: National Bank of Romania			

EXTERNAL DEBT: Total external debt rose marginally at the end of September 2012 and it was standing at €99.1 billion from €98.4 billion by the end-2011. In terms of GDP the total external debt in July 2012 declined to 70.4% from 74.4% at end-2011. Medium & long- term external debt service ratio was at 29.3% in January-September 2012 versus 28.9% in 2011. Borrowing from the IMF decreased to € 9.6 billion at end-September 2012 from € 10.2 billion at end-2011. Finally, at end September 2012, the National Bank of Romania's foreign exchange reserves stood at € 32.43 billion, down from € 33.19 billion at end-December 2011.

MONEY & FINANCIAL MARKETS: The domestic currency (RON) continued its downward path against euro during January-September 2012. The depreciation of the RON lies within the NBR's comfort zone of 2-3% which means NBR should not act to limit currency pressure. Recent developments on the political front, as well as the coming parliamentary elections remain an upside risk for the exchange rate. The FX reserves are stabilized around €32 billion in September 2012 and make NBR's potential currency action job painless. The National Bank of Romania (NBR) on the back of recent developments (local political environment, Eurozone debt crisis, currency volatility) decided to keep its key rate unchanged at 5.25%. Liquidity in the money market remains a major issue. Outstanding average monthly volume of repo operations climbed to RON 10.5 billion in July 2012 from RON 4.9 billion in December 2011.

Credit Growth (%Δ YoY)

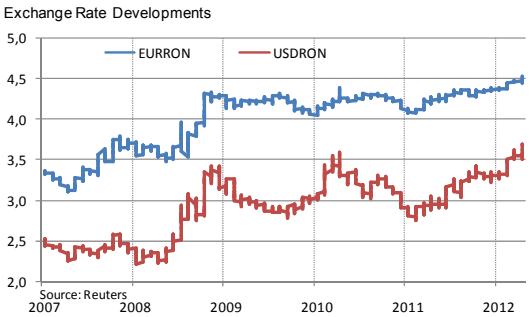


Source: National Bank of Romania, ALPHA BANK Reasearch

The NBR might be enforced to cut the minimum reserve requirements ratio for RON liabilities from its current 15% in order to enhance liquidity but a cautious action is needed as to avoid currency weakness. ***Credit expansion (in euro terms) to the private sector has grown moderately since the beginning of the current year. In particular, credit expansion stood at 0.1% y/y in September (businesses: 2.3%, households: -2.3%) from 5.5% y/y in December 2011.*** Households continued to prefer foreign currency loans. The non performing loans

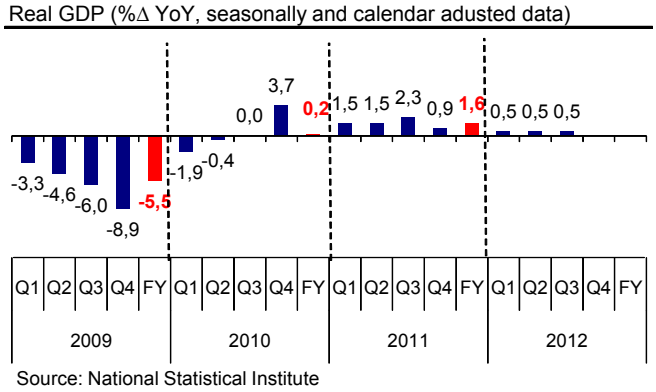
stood at 15.88% in March 2012 from 14.33% at end-2011. The commercial banks remain well capitalized and liquid, with the capital adequacy and loans to deposits at 14.6% and 119.6% respectively at end-March 2012.

The domestic currency (RON) depreciated against the US Dollar and depreciated against the Euro in 2011 by 3.4% and 0.9% respectively (average levels). Until the end of October 2012 the RON had depreciated against the US Dollar and the Euro by 15.4% and 5.5% correspondingly.

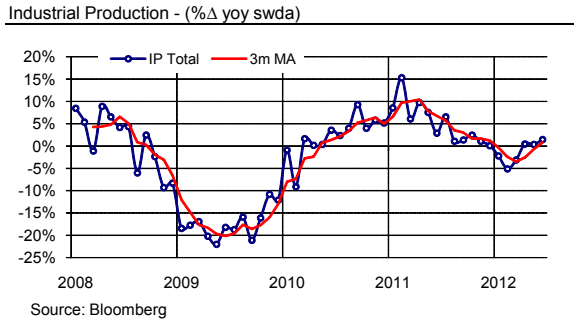


3. Bulgaria

Economic Overview: The Gross Domestic Product (GDP) of Bulgaria expanded 0.5% in Q3 2012, compared with the same quarter of the previous year and 0.1% compared with the second quarter of 2012. More specifically, the GDP at current prices (preliminary data) in Q3 2012 amounted to BGN 21,735 million or € 11,114 million. Bulgaria's GDP according to the seasonally and working-day adjusted data, expanded by real 0.1% q/q in Q3 2012 from 0.3% rise q/q in Q2 2012.



On the supply side, growth rate was determined mainly by the increase registered in the agricultural sector 6.3% y/y, industry 3.5% y/y. The services sector has a negative contribution with a decline of 1.0% y/y over the period. General government, education, human health care and other services had a negative contribution. As compared with Q2 2012 the agricultural sector increased its share in the economy by 6.1 percentage points to 11.5% in Q3 2012; the services sector reduced its share at 57.3%, while the industrial sector decreased its share by 2.2 percentage points to 31.2%. On the positive side, favourable domestic demand was reflected in 2.9% y/y growth of individual consumption. Exports continued for 2nd consecutive quarter its positive performance and increased by 3.5% y/y and imports by 3.0% y/y. ***As exports are affected by the Eurozone debt crisis the domestic demand remains the major driving force of the economic recovery.*** However, the rising unemployment rate (12.3% Q2 2012) implies that domestic demand will remain subdued for the remaining of the year. Bulgaria's GDP growth is expected to slow down to 0.6% in 2012 from 1.7% in 2011 due to the continued Eurozone sovereign debt crisis and inadequate domestic demand. The IMF expects growth to reach 1.0% in 2012 and to rise at 1.5% in 2013.

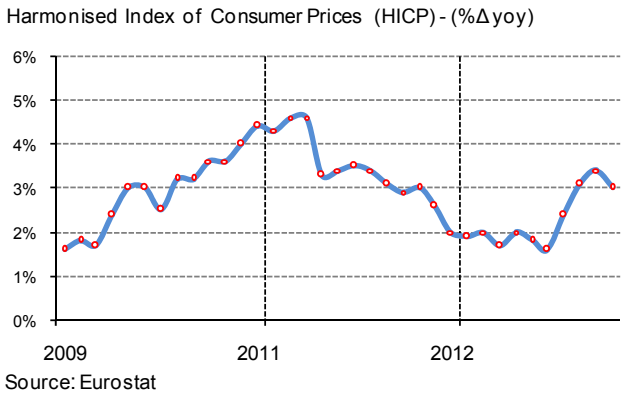


Fiscal policy: The government's budget balance turned into a minor surplus in Jan.-September 2012. More specifically, the budget balance accumulated since the beginning of the year, under Consolidated Fiscal Program (CFP) amounted to a BGN 248.1 million surplus. For the first nine months of 2012 the consolidated budget revenues amounted to BGN 19.98 billion (+BGN 1.6 billion, or +8.9% y/y). This is mostly due to higher indirect tax, non-tax and grant revenue. The general government expenditures, including the contribution of Bulgaria to the EU budget, reached BGN 19.74 billion. In particular, capital expenditures rose by BGN 262 million on an annual basis reaching BGN 2.13 billion, contributing to the healthy increase of total investment in the economy. The balance on the fiscal reserve account (FRA) stood at BGN 7.2 billion at the end of September 2012 (minimum targeted balance BGN 4.5 billion) from BGN 5.0 billion at end-2011. Fiscal reserve levels received a boost following the issuance in July of € 950 million 5-year Eurobonds These reserves are needed to support the currency board regime. Fiscal policy is on track to meet the fiscal deficit target for 2012. The general government deficit was reduced to -2.0% of GDP in 2011 and it is expected to fall to -1.5% of GDP in 2012 and in -1.1% of GDP in 2014, supported by a continued freeze in the public sector wages and an improvement in revenues.

Meanwhile, Fitch Ratings affirmed Bulgaria's long-term foreign currency Issuer Default Rating (IDR) at BBB- and its long-term local currency IDR at BBB with stable outlook. The affirmation reflects Bulgaria's successful fiscal consolidation and stable monetary policy.

Inflation: Inflation declined to 4.4% in October 2012, from 4.9% in September 2012. Prices for food and beverages went up by 0.3% m/m, transportation prices decreased by 1.7% m/m and housing-water-electricity-gas & other fuels by 0.4% m/m. Cumulative inflation for the first ten months of the year was 4.0%, due to electricity prices hike in July and the higher fuel prices in the summer. Harmonised index of consumer prices

(HICP) inflation was at 3.0% in October 2012, from 3.4% in September 2012. The HICP rate since the beginning of the year had been 2.7%. The group of 'transport' had the biggest downward impact on the total HICP. Inflation pressures will remain relatively contained for the rest of the year due to weak labour market. The European Commission's autumn forecast predicted HICP inflation to be at 3.5% on average in 2012 and to rise at 4.9% in 2013.

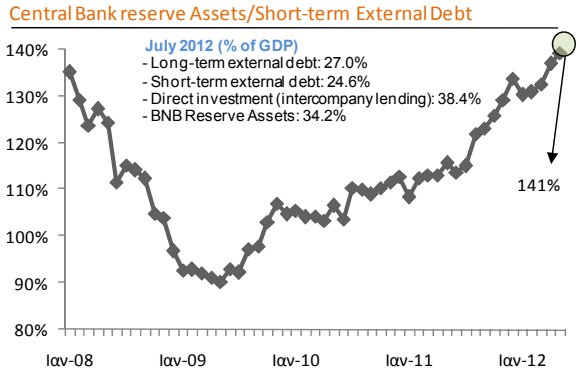


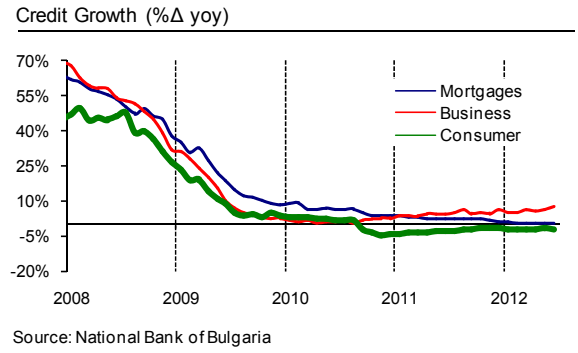
BALANCE OF PAYMENTS: The current account showed a surplus of € 392 million in September 2012, versus a surplus of € 21 million in September 2011. In Jan.- Sept. 2012 the current account posted a surplus of € 206 million (0.5% of projected GDP 2012) against a surplus of € 895 million in Jan.- Sept. 2011. In particular, the trade balance registered a deficit in Jan.-Sept.2012 amounted to €2,717 million (-7.0% of GDP), compared with a deficit of € 1,266 million in Jan.- Sept. 2011. In the period Jan.-Sept.2012 exports reached €15,434 million (+2.0% y/y), while imports reached € 18,150 million (+11.0% y/y). Moreover, the services surplus increased to € 2,246 million (5.8% of GDP) in Jan-Sept.2012, compared with a surplus of € 2,153 million a year ago. In the capital account, the foreign direct investment (FDI) account for the first nine months of 2012 increased to € 860 million (2.2% of GDP), from € 572 million in the same period of 2011.

Current Account: January - September 2012 (€ million)			
	Jan-Sep 2012	Jan-Sep 2011	%Δ
Exports	15.434	15.100	2%
Imports	18.150	16.366	11%
Trade Balance	-2.717	-1.266	115%
Services Balance	2.246	2.153	4%
Income Balance	-909	-1.334	-32%
Current Transfers Balance	1.586	1.343	18%
Current Account Balance	206	895	-77%
Source: Bulgarian National Bank			

EXTERNAL DEBT & INT. RESERVES: Total gross external debt stood at € 36.4 billion at the end of August 2012 from € 35.4 billion at the end 2011. The ratio of foreign reserves with the Central Bank to short-term debt was 133% at end of August 2012, virtually the same level as at year-end 2011.

MONEY & FINANCIAL MARKETS: Bulgaria continues the currency board regime, pegging the Bulgarian Lev (BGN) to the Euro at a fixed exchange rate of 1.95583 BGN to 1 Euro. Although, country fulfils the criteria for joining ERM II, the Eurozone waiting room, Bulgaria is not intending to make any move toward the euro adoption within the next years. Domestic demand for credit remained subdued amid rising unemployment. In September 2012 credit expansion stood at 3.9% y/y, from 3.8% y/y in December 2011. Business financing grew by 6.9% y/y in September 2012 and credit to households declined by -1.6% y/y. Consumer credit declined by -3.4% while mortgages grew by 0.5%.





4. CYPRUS

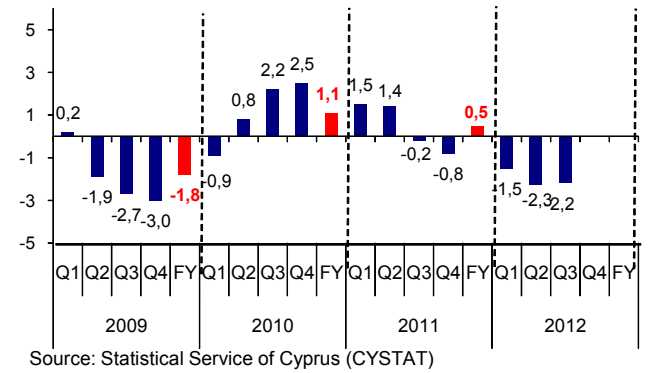
ECONOMIC OVERVIEW: Cyprus economy continued to be in recession in Q3 2012, as the country's Gross Domestic Product (GDP) contracted for the fifth successive quarter. GDP decreased a seasonally adjusted 0.5% (preliminary data) in Q3 2012, after falling 0.9% in Q2 2012. The sectors of construction, manufacturing, trade, transport and services recorded negative growths during the quarter, driving the overall slump in activity. According to the Statistical Service, on an annual basis, the unadjusted GDP dropped by 2.2% y/y in Q3 2012, following the second quarter's 2.3% y/y contraction. On a seasonally and working day adjusted basis, GDP decreased by 2.3% y/y. On positive track were only the sectors of tourism and banking. The Cypriot economy expanded by a moderate 0.5% y/y in 2011 as the economic activity was badly affected by the explosion at Mari naval base in July 2011, which destroyed the Vassilikos plant, the island's main power station. Domestic demand, the main pillar of the economic growth in recent years, receded remarkably in 2011 due to tightening credit conditions and increasing unemployment. Positive contributor to growth was the tourism sector. Following recent developments concerning Cyprus's request for financial help from the Eurozone and the IMF, GDP is now projected to shrink in 2012 by -2.3%, as the domestic demand will continue to suffer and the external environment remains uncertain. High unemployment (September 2012: 12.2%) and

squeezed incomes notably for public sector's employees due to government's efforts to curb budget deficit, as well as falling investment will contain domestic demand.

The government plans to bring the budget deficit down to -5.0% of GDP in 2012, from -6.3% of GDP in 2011. In the first nine months of the year the budget deficit was -3.3% of GDP and it is forecasted to reach around -5.2% of GDP by year end. The construction sector is expected to remain sluggish as housing demand is low, although various infrastructure projects will support sector's growth. The Cypriot government has predicted that the economy will contract -0.5% in 2012 but this was before the application for financial assistance from the European Financial Stability Facility (EFSF) on June 29. According to the latest forecast by the Cypriot government, economy will shrink -2.2% in 2012 mainly due to the fiscal consolidation program.

The financial assistance is needed mainly to increase the capital of Cyprus's two largest banks, which were hit by their voluntary participation in the haircut on the Greek sovereign debt, but also to cover about € 4.5 billion of public financing needs to the end of 2014. In order to determine the capital needs of the banking sector the Central Bank of Cyprus at the request of the Troika (EC, ECB, IMF) will proceed with an independent due diligence exercise. The exercise will include an asset quality review and a bottom-up stress test for each participating banking institution. Although negotiations with Troika are still ongoing, the economic assistance is expected to be granted. The recapitalization of the banking system is expected to increase the government debt ratio to around of 89.7% of GDP in 2012, from 71.1% in 2011. Cyprus is still in negotiation with the European Commission and the IMF over the amount required for re-igniting its economy. Estimates for the amount needed range from €11-15 billion (or around 60-80% of GDP).

Real GDP (%Δ YoY, seasonaly adjusted data)

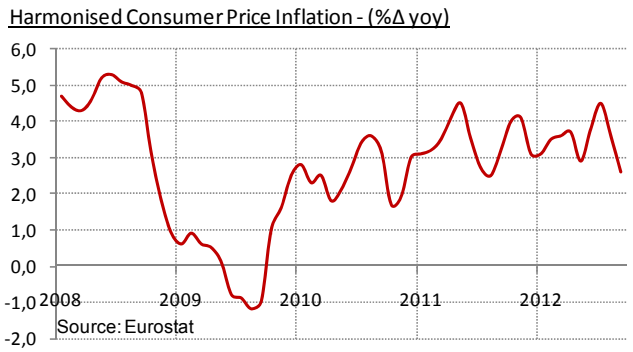


Source: Statistical Service of Cyprus (CYSTAT)

Standard & Poor's, the ratings agency on August 2, lowered its country's long-term sovereign credit rating by one notch from BB+ to BB, while it also placed Cyprus on CreditWatch with negative implications. The ratings agency believes that Cyprus' despite an international bailout, it would remain in a weak fiscal position due to its banking system, which has been unable to cope without state assistance. The agency estimates that Cyprus' financial assistance from EC-ECB-IMF will reach €11 billion (60% of GDP) in order to recapitalise the banking system, to absorb further bank losses, and to meet 2012-2014 borrowing needs. About € 6.6 billion will be absorbed by the state to cover maturing debt and underlying deficits during 2012-2014. Finally, the Ratings agency, expects Cyprus' real GDP growth to contract by 1.5% this year and, at best, to stagnate in 2013. Standard and Poor's estimates Cyprus' net general government debt will increase by nearly 12% of GDP on average in 2012 and in 2013, peaking at over 105% in 2013. Moody's, the ratings agency on October 9, lowered its country's long-term sovereign credit rating by three notches from Ba3 to B3 with negative outlook, citing the difficulties in the banking sector. According to Moody's, the three largest Cypriot banks will require more than € 8 billion in capital (equivalent to over 47% of GDP). Just five weeks after its last ratings cut, Moody's warned it would review country's rating for a possible downgrade, due to the slow pace of negotiations with the international lenders and the resulting uncertainty regarding the likelihood and timing of a support package.

FISCAL POLICY: The budget deficit was marginally increased in the first nine months of 2012 to -3.3% of GDP or € 582 million, from -3.1% of GDP or € 565 million the same period in 2011. Total revenues amounted to € 4,687 million (down by 1.0% y/y) or 26.5% of GDP for 2012, while the total expenditures reached € 5,269 million (down by 0.6% y/y). Revenue increase appears to be related to higher direct taxes (income taxes and various direct taxes). Revenue from VAT rise was less than anticipated due to weak private consumption. On the other hand, expenditure slippages emerge from the application of policy aiming at freezing of salary increases in the public sector (including cost-of-living adjustment-COLA) and the reduction of capital investments.

In November 2011, the Cypriot authorities introduced a 4th consolidation package in order to cut public spending by about 8% and to bring the budget deficit down to -3.5% of GDP in 2012 from -6.3% of GDP in 2011 and -5.3% in 2010. New corrective measures are already in place in order to incorporate government's negative growth assumption for 2012, versus the initial +1.5% growth assumption in the initial budget. Targeting to cover its financing needs for 2012, the Cypriot government agreed in October 2011 a € 2.5 billion loan from Russia with a very attractive interest rate of 4.5%, well below the current market rates and a repayment period of 4.5 years. Despite the loan from Russia which was paid in three tranches in the first quarter of the year, the funds are not enough to secure the public sector borrowing needs in the next three years. For this reason the government in June decided to ask for financial aid from the Troika (EC, ECB, IMF) in order to cover its financial gap. The fiscal performance so far indicates that the government will miss its target of budget deficit in 2012 while Troika warns that without additional fiscal adjustment measures the budget deficit could reach around -5.5% of GDP.



INFLATION: HICP inflation decelerated to 2.6% in October 2012, from 3.6% in September 2012 and 4.5% in August 2012. This is the lowest reading since October 2011 and compares with the 2.5% Euro area inflation. This inflation increase is mostly attributable to the sectors of food and non-alcoholic drinks and housing, water supply, electricity and liquid gas. The largest annual increases were registered in housing, water electricity and gas followed by transport with 6.9% and 5.7% respectively. In the first ten months of 2012, HICP inflation reached 3.4%. However, we expect inflation pressures to remain subdued for the rest of the year due to weak domestic consumption and the fading of base effect from last year's hike in electricity prices. European Commission expects a marginal drop of HICP inflation to 3.2% in 2012, from 3.5% a year ago. The national CPI inflation reached 1.7% y/y in October 2012, from 2.5% y/y in September 2012 and 3.0% y/y in October 2011, while for the first ten months of 2012 CPI inflation reached 2.6% y/y.

BALANCE OF PAYMENTS: The current account gap stood at -4.6% of GDP or € 809 million in January-June 2012, having increased by 21% y/y. Exports increased by 2% y/y and imports declined by -9%, implying a trade deficit fall to € 1,921 million from € 2,214 million in January - June 2011. The more defining factors behind the widening of the current account deficit are the relative low decrease of the service balance surplus and the notable increase of income balance deficit due to lower income from direct and portfolio investment. Net Foreign Direct Investment inflows stood at € 58 million in January-June 2012 or 0.3% of GDP, from € 829 million. We expect the current account deficit in 2012 to increase around -6.0% of GDP from -4.2% of GDP in 2011, due to deterioration in the income and services balance.

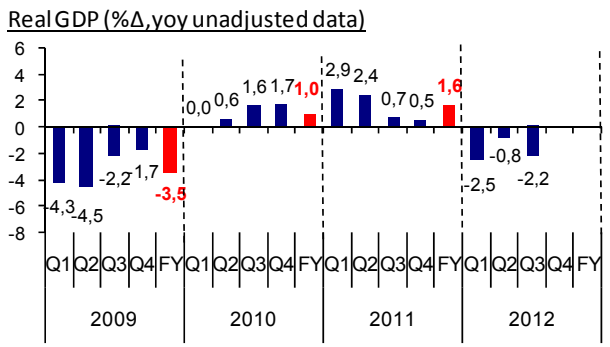
Current Account: Jan.-Jun.'12 (€ million) provisional data			
	Jan.-Jun.'12	Jan.-Jun.'11	%Δ
Exports	736	722	2%
Imports	2.657	2.936	-9%
Trade Balance	-1.921	-2.214	-13%
Services Balance	1.575	1.582	-0,4%
Income Balance	-374	43	-962%
Current Transfers Balance	-89	-81	10%
Current Account Balance	-809	-669	21%
Source: Central Bank of Cyprus			

MONEY & FINANCIAL MARKETS: Credit to the private sector grew by 9.8% y/y in September 2012, from 13.5% y/y in September 2011 and 14.0% y/y in December 2011. Business loans rose by 15.0% y/y in September 2012 and loans to households by 2.1% y/y. Mortgages were up by 1.2% y/y while consumer credit by 3.4% y/y. On the other hand, private sector deposit growth remains subdued, as it increased slightly by +1.6% in September 2012, from -1.0% in December 2011 and 20.3% in December 2010. Private sector deposits from domestic residents actually decreased marginally by -0.6% y/y in September 2012, compared with a -3.7% fall in December 2011. Private sector deposits from non-residents grew by 5.1% y/y in September 2012 from 13.7% a year earlier. The loan-to-deposit ratio stood at 101.2% in September 2012 from 97.3% in December 2011 and 86.3% in December 2010.

The ratings agencies Moody's and Fitch downgraded Cyprus's long-term foreign and local currency sovereign credit ratings by two and one notch respectively. In particular, Moody's cut Cyprus's government bond ratings by two notches to Ba3 and placed the ratings under review for further possible downgrade, while Fitch cut by one notch to BB+, with negative outlook. The country's short-term ratings were also cut by one notch to "B". Both ratings agencies for their decision cited the large exposure of the banking sector to Greece and the recapitalization costs that are likely to enlarge the public debt. As of June 30, the public debt stood at € 14.6 billion or 78.7% of GDP for 2012. By now, the three major ratings agencies (Fitch, Moody's, Standard & Poor's) evaluate Cyprus's sovereign credit rating, as non investment grade. Yields on Cyprus' 10-year bonds maturing in 2020 are priced at 12.44% on November 21, after having jumped to 16.31% (June 28), well above the borrowing rates that forced countries like Ireland and Portugal into financial aid.

5. SERBIA

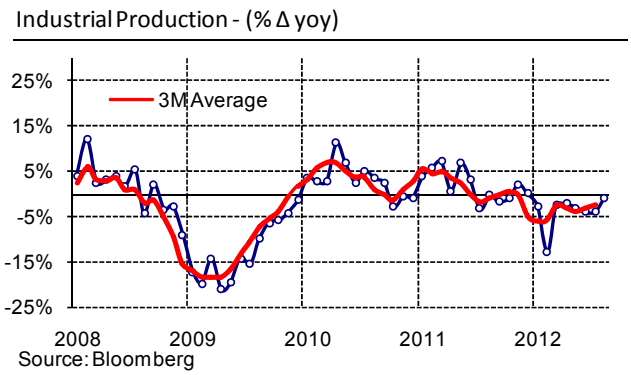
ECONOMIC OVERVIEW: Serbia's real GDP fell by -2.2% y/y (preliminary data) in Q3 2012, having already recorded negative performance in the first two quarters. In Q2 2012 the GDP shrank by -0.8% y/y in Q2 2012, compared to an increase by 2.4% y/y in Q2 2011. The Q1 2012 GDP fall was also revised to -1.3%. With seasonally adjusted data, the GDP rose by 2.1% q/q in Q2 2012. Positive growth in Q2 2012 was recorded in manufacturing (+3.2% y/y), in construction (+1.2% y/y), in wholesale & retail trade (+2.0% y/y) and in water- sewerage-waste (+1.0%y/y). On the other hand, negative growth in Q2 2012 was recorded in the agricultural sector (- 17.2% y/y), electricity & gas (-14.6% y/y) and in mining (-7.7% y/y). In February 2012, the IMF suspended a stand-by arrangement of € 1 bn to Serbia, after the country didn't keep its promises to reduce the fiscal deficit to 4.25% of GDP. Although, the presidential and parliamentary elections are over, the political environment remains fragile. The big challenges which the three-party coalition is facing are to curb fiscal deficit and probably to introduce new fiscal consolidation measures on top of those already taken.



Source: Statistical Office of the Republic of Serbia, Bloomberg

The economic slowdown has increased the budget deficit, the current account gap and the public debt. The European Commission estimates that without extra measures the fiscal deficit could reach 6.7% of GDP in 2012. Standard & Poor's on August 7 cut Serbia's sovereign debt rating, by one notch to BB-, as a reaction to government's decision to tighten control over the National Bank of Serbia. The ratings agency noted that the recently adopted relevant legislation could weaken the statutory independence of the National Bank and could affect the country's monetary policy. S&P's also put Serbia on negative outlook because of its deteriorating fiscal and external deficits. Similar action took place on August 16, by Fitch. The ratings agency lowered Serbia's outlook from stable to negative, citing the weakening fiscal position and low economic growth while blaming the new government for the recent adoption of regulations strengthening parliament's control over the central bank. An IMF team visited Serbia on September 10-14 for a fact-finding mission, after government's request for a new IMF supported programme. The IMF made clear that will watch Serbia's public finances and Central Bank's autonomy before agreeing to a new programme.

Industrial production fell by 6.8 % y/y in September 2012, compared to an annual drop of 1.6% the same month a year ago. Manufacturing plunged by 5.3% y/y while mining and quarrying by 11.4% y/y. Substantial fall of output was recorded the sector of the intermediate products (-11.9% y/y) while the biggest growth was noted for durable consumer goods (+ 11.2% y/y). In the period January- September 2012, compared to the same period in 2011, industrial production fell by -3.8%. Manufacturing is expected to register positive growth in the coming months as Fiat Group starts the production of a new car model at its factory in Kragujevac. Moreover, the government has decided to adopt the first package of anti-crisis measures worth approximately € 1 billion in the following 12 months, including soft loans for companies. Similar package was in place in 2009/10 and had a positive effect on growth.

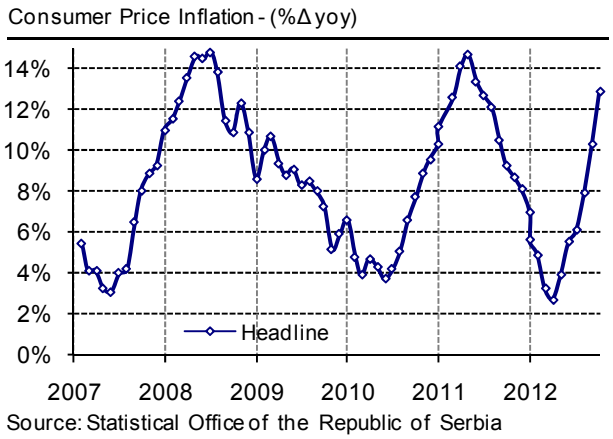


Source: Bloomberg

GDP growth is expected to drop by 1.7% yoy in H2 2012 bringing the annual rate drop at -1.7%, while a modest recovery is also expected in 2013. Meanwhile, employment will continue to drop, with the unemployment rate rising marginally in 2012 before it starts to improve in 2013.

FISCAL POLICY: In 2011, the budget deficit reached RSD 135.2 billion or -4.5% of GDP against a year-end target of RSD 133 billion or -3.6% of GDP. In the first eight months of the year the deficit reached RSD 123.1 bn (€ 1.1 bn). Revenues amounted to RSD 473.3 bn and expenditures to RSD 578.3 bn. Also, VAT revenues reached RSD 234 bn, excise duties revenue RSD 116 bn and corporate income tax revenues RSD 36 bn. On the expenditure side, transfers to social security funds reached RSD 186 bn, public employee's expenditures RSD 151 bn, and social assistance from the budget RSD 58 bn. In August 2012, a budget deficit of RSD 11 bn was achieved, since budget expenditures in that month reached RSD 71 bn, and revenues RSD 60 bn. Traditionally, August is a month with low revenues. For, example, VAT revenues reached RSD 27.6 bn against RSD 36.5 bn in July 2012, when quarterly VAT obligations were paid. The biggest items regarding expenditures are the payment of salaries and transfers to social insurance funds such as the Fund for Pension and Disability Insurance (PIO), the Serbian Health Insurance Office (RZZO), and the National Employment Service.

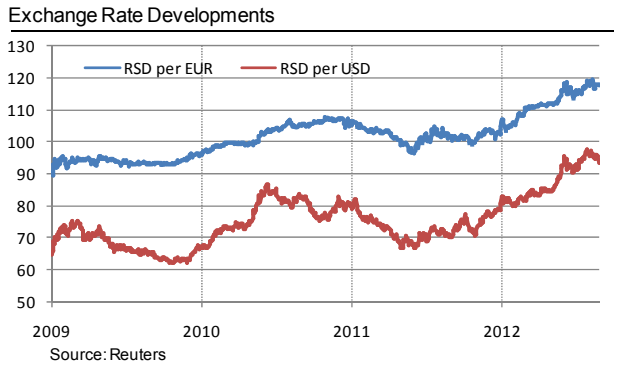
Parliament adopted a revised 2012 budget, narrowing the deficit to -6.7% of GDP or RSD 203.5 bn, from -7.1% in June 2012. According to the revised budget 2012 the adjusted revenues were raised by RSD 79.5 bn and expenditures by RSD 158.7 bn. The Serbian government plans to reduce the 2013 budget deficit to -3.5% of GDP and to -1.9% in 2014, as well as to convince the IMF of its commitment to fiscal discipline. In order to finance this year's budget deficit, the government managed successfully to sell $ 1 bn worth of Eurobonds in the international markets. The bond issue with a yield of 6.625% per year was the reopening of the 2021 bond issue, first sold in September 2011. The government may again tap international markets in 2013.



INFLATION: Serbia's annual inflation in October 2012 accelerated to 12.9% compared with 3.9% in June 2012. With October spike, inflation has overshot National Bank of Serbia's upper bound of its tolerance band (2.7%-5.7%). High monthly reading is attributable mainly to the rise in processed food prices, administered price growth at local level and the increase in the general VAT rate and excise duties. The highest price increase in October in comparison with the previous month was noted in alcoholic beverages & tobacco (+3.1%), housing, water, electricity, gas and other fuels (+2.2%), and food & non-alcoholic beverages (+11.1%). In the first 10 months of the year, the inflation grew 6.3% y/y on average, recording a sizeable decline from the 11.6% rise in the corresponding period of 2011. We expect inflation to continue moderately rise in the coming period mainly reflecting the low base effect, dinar's behaviour, the expected increase in administered prices and agricultural product's prices. Annual inflation is expected to start retreating from the second quarter of 2013 and to return within the tolerance band by the end of next year. According to European Commission's forecast average inflation is expected to be around 7.3% in 2012, from 11.2% in 2011 and to drop to 5.2% in 2014.

BALANCE OF PAYMENTS: Serbia's current-account deficit widened in the first eight months of the year by 14% y/y and reached € 3.7 bn. The trade gap grew by 14% y/y in January-August 2012 as exports increased by 1% y/y and imports by 6%. Net FDI was in red in Jan.-Aug. 2012, with a cumulative outflow of €60 million compared to a surplus of €1,105 million in Jan.- Aug. 2011. Portfolio investment increased to € 74 million in January-August 2012 from € 905 million the same period in 2011 which primarily relate to less risk appetite for dinars T-Bills by foreign investors. Banks reduced deposit flow to deposit accounts abroad, while remittances, an important source of deficit financing, dropped to € 1,335 million (-8.6% y/y) in January-August 2012 from € 1,461 million in Jan.- Aug. 2011. Serbia has pledged to keep its current-account deficit at -7.2% of GDP in 2012.

Current Account: January - August 2012 (€ million)			
	Jan - Aug 2012	Jan - Aug 2011	%Δ
Exports	5.619	5.577	1%
Imports	9.292	8.798	6%
Trade Balance	-3.673	-3.221	14%
Services Balance	40	39	-6%
Income Balance	-490	-470	5%
Current Transfers Balance	1.951	2.026	-8%
Current Account Balance	-2.171	-1.626	38%
Source: National Bank of Serbia			



Stock of External Debt as of 30.9.2012 (in million of EUR)	
Total External Debt	**24.832**
Public Sector External Debt	**10.944**
Medium and long-term debt	**10.944**
of which IMF sba	1.524
Short-term Debt	**0**
Private Sector External Debt	**13.889**
Medium and long-term debt	**13.526**
of which Banks	3.745
of which Enterprises	9.781
Short-term Debt	**363**
of which Banks	292
of which Enterprises	71
Source: National Bank of Serbia	

EXTERNAL DEBT & INT. RESERVES: In September 2012 the stock of external debt rose by 2.9% y/y to € 24.4 billion (preliminary data). The split between public and private sector debt, as a percent of the total, stands at 44% and 56% respectively. The level of National Bank of Serbia's (NBS) foreign exchange reserves stood at € 9.8 billion at end-September 2012, down by € 2.2 billion from December 2011. The decrease of the fx reserves reflects the interventions of NBS in the interbank currency market. Short term Debt/ Fx reserves stood at 3.7% in September 2012 while short term debt/total debt at 1.5%.

MONEY & FINANCIAL MARKETS: The National Bank of Serbia (NBS) raised its key policy rate (2-week repo) by 20 bps to 10.95% for 5th time (November 8, 2012) this year after its first hike by 50bps in June. The rate hike was largely induced by recent inflation increase due also to dinar's depreciation. This depreciation against euro from the beginning of the year until November 21, has reached 6.0%, while the increase in the dinar position of the FX mandatory reserve rate made in early June and early August is expected to stabilise the local currency. Dinar's depreciation since end-2011 is due to the suspension of stand by arrangement (SBA) with the IMF, the increased budget deficit, the widening of the current account deficit, and the absence of foreign investors due to the fragile political environment in the country in combination with the continued debt crisis in Eurozone.

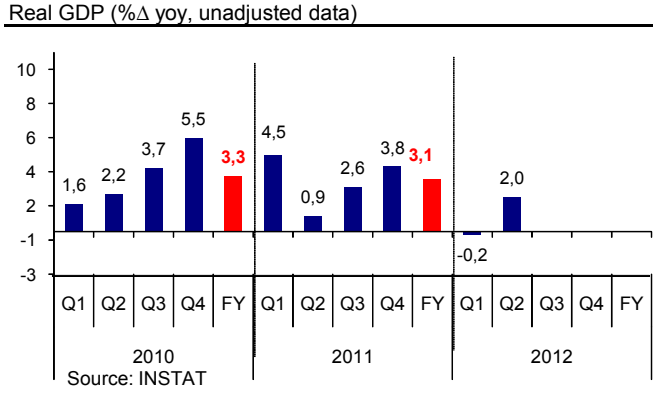
In the year to date, the NBS intervened in the interbank FX market by selling € 1.6 billion. NBS also, introduced

1w repo securities purchase as the main vehicle for open market operations, instead of 2w reverse repo transactions in order to normalise the interbank market. The continued dinar depreciation as well the fiscal consolidation developments will affect NBS's future monetary policy. ***Credit expansion to the private sector*** increased by 2.7% y/y in September 2012 from 6.7% y/y in December 2011 (in euro terms). Loans to businesses increased by 4.4% and loans to households fell by 0.4% y/y. On the other hand, private sector deposits marginally increased by 0.1% increase in September 2012 from 8.2% y/y increase in December 2011. The loan to deposit ratio stood at 134% in September 2012 from 129% in December 2011, whereas NPL ratio was at 20.4% in March 2012 (11.9% for households and 61.3% for corporate).

6. ALBANIA

ECONOMIC OVERVIEW: In a deteriorating external environment in neighbouring Europe and in particular in Greece, Albanian economy has been relatively resilient. Its GDP rose in Q2 2012 by 2.0% y/y and by 0.9% from the previous quarter, following a decrease of -0.2% y/y and -1.2% q/q in Q1 2012. Positive growth rates in Q2 2012 registered the sectors other services (+5.6% y/y), trade (5.1% y/y), agriculture (5.6% y/y) and industry (6.4% y/y). On annual basis, negative growth during Q2 2012 was registered in construction (-18.4%) and in transport (-7.0%). The agriculture sector (21% of GDP) expanded by 1.4% q/q and by 5.6% y/y in Q2 2012.

Real GDP (%Δ yoy, unadjusted data)



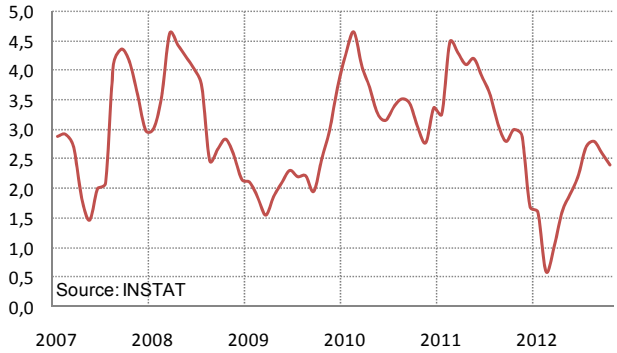
Source: INSTAT

The unemployment rate remained unchanged at 13.3% in Q2 2012 from the prior quarter. World Bank, IMF and EBRD revised downwards their forecasts predicting a deceleration of economic growth in 2012. The IMF in its projections forecasting a real GDP growth of 0.5% in 2012 and a pickup in 2013 to 1.7%, while the EBRD is predicting a real GDP growth of 0.6% in 2012 and 1.3% in 2013. On the other hand, the Albanian government is more optimistic forecasting a 3.0% growth in 2012, from 3.1% in 2011.

FISCAL POLICY: The budget deficit stood at ALL 26 billion (€ 185 million) in January-September 2012, although the Budget 2012 envisages a total deficit of around ALL 14.8 billion or -3.0% of GDP. The Albanian authorities plan to reduce the budget deficit further to -2.0% of GDP in 2013. Total revenues in the first nine months of the year reached ALL 244.9 billion (+2.3%y/y), although the pace of growth decelerated. On the other hand, cautious government spending contributed to a fall of expenditure by -0.2% y/y (ALL 270.6 billion). The narrowing of the deficit has been primarily driven by a reduction on expenditure and in particular a decline of local budgets and capital expenditure. The deficit in the period January-September 2012 accounted for -1.9% of the projected GDP for 2012. Rating agency Standard & Poor's (S&P) confirmed country's B+ (long-term foreign and local currency) credit ratings with a stable outlook. Moody's also, kept its B1 rating and the stable outlook. The fiscal discipline will boost country's credibility and will reduce funding costs to the economy.

INFLATION: According to National Statistical Office (INSTAT) CPI inflation increased to 2.4% in October 2012, from 2.6% a month earlier. A year before the annual rate was 3.0%. In monthly terms, "Food and non-alcoholic beverage" posted an increase by 0.2%, with the highest increase recorded in fruit products. The group of "Clothing and footwear' registered an increase in prices of -0.5% and the group of "Alcoholic beverage and tobacco" an increase by -0.5%. On the other hand, "Transport" registered a decrease in prices by 0.1% due to lower prices in petrol. Finally, the group of "Education service" recorded an increase in prices by +1.9%, supported by the higher tariffs of university by 4.0%. Looking ahead, we expect average inflation to settle to about 2.7% in 2012, well in line with the Bank of Albania's target (3% +/-1%) for 2012-14.

Consumer Price Inflation - (%Δ yoy)



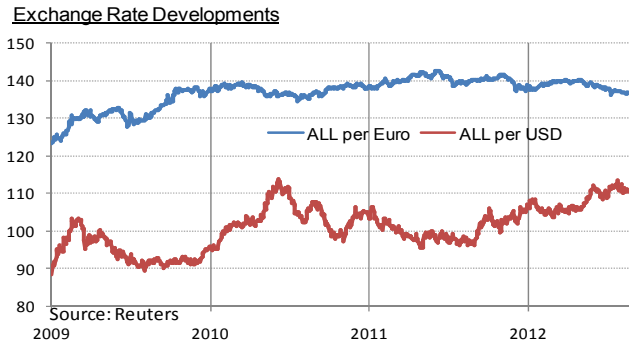
Source: INSTAT

BALANCE OF PAYMENTS: During H1 2012, the current account deficit reached $ 578 million or -4.5% of projected GDP from a deficit of $ 742 million in the corresponding period of 2011.The main factor for the narrowing of the current account was the shrinkage of the trade balance, as exports decreased by -5% y/y and imports fell by -10% y/y. At the same time, the services account posted a surplus of $ 48 million from a deficit of $ 32 million in H1 2011, as the increase in inbound tourism surpassed the rise in travel outflows. In H1 2012, current transfers balance fell by 7.0%. Net inflows of remittances, which represent 71% of current transfers, declined by -6.7% compared to the same period a year before. In particular, net remittances decrease in the first six months of the year to $ 438 million from $ 486 million in the corresponding period a year ago. FDI had a small decrease in Q2 2012 to $ 234 million from $264 million in Q1 2012. The major contributor to FDI is equity capital and reinvested earnings (Q2 2012: $ 295 million). The

current account deficit would gradually decrease further during the coming months on the back of buoyant exports and moderate increase or fall in imports. According to IMF the current account deficit is expected to stabilise around -13.2% of GDP in 2012.

Current Account: January- June 2012 ($ mln)			
	Jan-Jun 2012	Jan-Jun 2011	%Δ
Exports	934	983	-5%
Imports	2.153	2.380	-10%
Trade Balance	-1.219	-1.397	-13%
Services Balance	48	-32	-250%
Income Balance	-23	27	-185%
Current Transfers Balance	616	660	-7%
Current Account Balance	-578	-742	-22%
Source: Bank of Albania			

MONEY & FINANCIAL MARKETS: The Albanian Lek (ALL) appreciated against Euro on average basis, by around 1.2% in the period January-September 2012 compared with the same period a year ago. Bank of Albania (BoA) on July cut its key repo rate by 25 bps, to a record low level of 4% in order to stimulate domestic demand amid weak inflationary pressures. The cut was the 5th since September 2011. The Bank of Albania (BoA) intervened in the money market, during the first semester of 2012, in order to inject liquidity. The total amount of injected liquidity amounted to an average of ALL 17.2 billion in Q2 2012 from an average of ALL 22.8 billion in Q1 2012. In order to increase liquidity, the BoA used its main instrument, the 1-week reverse repurchase agreement, at an average of ALL 12.99 billion per week, as well as the 3-month reverse repo agreement at an average of ALL 1.97 billion per transaction. Credit expansion accelerated in September 2012 by 6.8% y/y (in Euro terms) from 13.4% in September 2011. In particular, loans to households declined by -3.9% y/y while loans to businesses increased by 11.1% y/y.

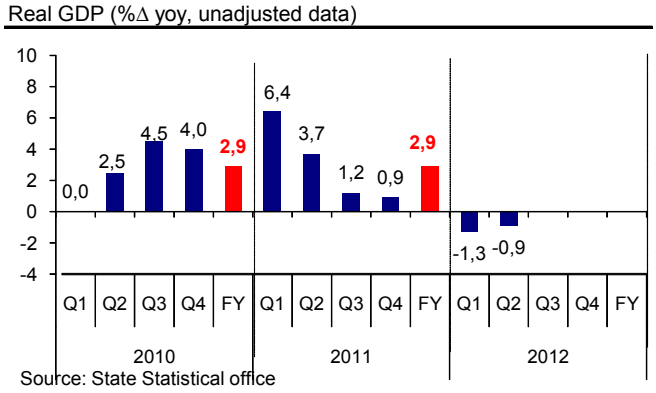


Going forward, banks do not expect the lending standards applied to businesses to tighten further in 2012. NPLs, households' financial situation and developments in the real estate market were the reasons for the tightening of lending standards applied to households. In H2 2012, the ratio of NPLs to total gross loans amounted to 21.1%, from 18.8% in H2 2011 and 17% in H1 2011. The loans to deposits ratio stood at 60.6% in September 2012 from 61.8% in June 2012 and 61.9% at the end-December 2011.

7. FYROM

ECONOMIC OVERVIEW: For 2011 the economy grew by a revised 2.9% (3.1% previously). Economic activity decelerated notably in H1 2012 due to weak external demand and public expenditures. In particular, in Q1 and Q2 2012, the economy contracted by a real -1.3% y/y and by -0.9% y/y respectively, compared to a growth of 6.4% y/y and 3.7% y/y respectively a year ago. A fall in output was recorded in the mining & quarrying-Manufacturing & electricity & gas sector by -6.9% y/y and in the construction sector by -5.1% y/y. On the other hand, the hotels & restaurants sector and agriculture sector posted positive growth of 0.2% y/y and 2.4% y/y respectively. The financial intermediation sector had a positive performance (+3.8%). Weak external demand had a negative impact on growth as export of goods & services declined by -0.7% y/y. Domestic demand remained stagnant as the personal consumption was up only 1.0% y/y in Q2 2012, whereas the same period government spending declined by -3.9% y/y.

European Commission forecasts a modest expansion of GDP in 2012 by 0.8%, while National Bank of FYROM (NBRM) forecasts a GDP growth in 2012 to 1.0% from an initial estimate of 2.0%. According to NBRM the downward revision is based on an assumption of deterioration of the economies of country's major trade partners (Germany, Greece, Serbia, Bulgaria, U.K.) and weaker economic growth in H2 2012. In our view the sluggish household consumption and the weak external demand will underpin a moderate growth at 0.6% in 2012.

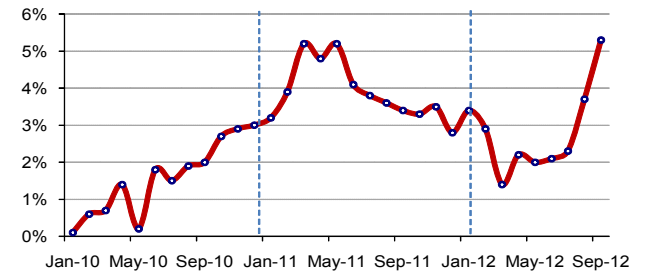


FISCAL POLICY: In the period January-July 2012, the budget deficit reached MKD 9,928 million (€ 161 million) or -2.1% of projected GDP. Total revenues slightly increased by 0.1% y/y to MKD 79,429 million (€ 1,292 million) or 17.1% of GDP and total expenditures by 1.1% to MKD 89,357 million (€ 1,453 million) or 19.3% of GDP. In order the government to achieve its goal for a budget deficit of -2½ percent of GDP, submitted to parliament in April 2012 a supplementary budget based on reduced revenues and expenditures. According to IMF the revised revenue assumptions are optimistic by about 1% of GDP. The IMF is estimating the budget deficit to exceed government's target by 0.1 pps in 2012. The financing of the deficit according to the government will be managed through a bank loan € 75 million from World Bank with interest rate 1.2% and another 5-year loan of € 75 million from Deutsche Bank with interest rate 6.8%.

INFLATION: In October 2012 CPI inflation remained at 5.3% y/y unchanged from the previous month. Average inflation in the first nine months of 2012 reached 3.1%, from 4.1% in the corresponding period in 2011. On a monthly basis, the CPI increased by 0.2% in October

2012 from a rise 1.4% a month ago. In particular, on a monthly basis, an increase has been registered in clothing & footwear by 2.6%, in services for education by 5.2%, and food by 0.6%. On the other hand, a decrease was recorded in the prices of fuel & lighting by -0.7% m/m, and transport & communication services by -1.5%. The National Bank of FYROM expects an annual average inflation of 3.4% for 2012, and 3.5% for 2013, from 3.9% in 2011. Recent data indicate that the average inflation for 2012 will be around 3.5%

Consumer Price Inflation - (Δ% yoy)



Source: State Statistical Office

BALANCE OF PAYMENTS: The current account deficit in the first 8-months of the year plummeted to € 121 million or -1.6% of projected GDP for 2012 from € 283 million or -3.8% of GDP the same period in 2011.The trade deficit rose to € -1,139 million or 15.0% of GDP in January-August 2012 from € -1,128 million the same period a year ago. In period January-August 2012 import coverage by export in euro terms, was 36.3%. The net current transfers surplus increased by 21% y/y in the first eight months of the year. In the capital account, net FDI inflows dropped by 67% y/y to € 77 million, which is 1.0 % of the projected GDP. At the end of September 2012, foreign currency reserves totalled €2.1 billion registered small increase compared to the end of 2011. Higher current transfers are the main factor for the narrowing of the negative balance in the current account, while the trade deficit widened marginally. The macroeconomic picture indicates a moderate current account deficit of -3.0% of GDP in 2012 from -2.8% in 2011.

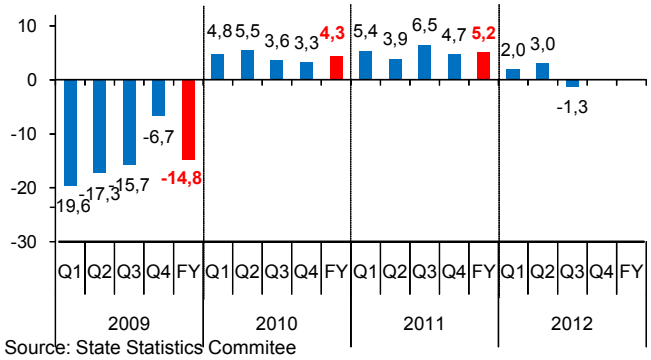
Current Account: January - August 2012			(€ mln)
	Jan-Aug 2012	Jan-Aug 2011	%Δ
Exports	2.001	2.043	-2%
Imports	3.140	3.170	-1%
Trade Balance	-1.139	-1.128	1%
Services Balance	31	71	-56%
Income Balance	-76	-104	-28%
Current Transfers Balance	1.062	878	21%
Current Account Balance	-121	-283	-57%
Source: National Bank of FYROM			

MONEY & FINANCIAL MARKETS: The deceleration of inflation in Q1 2012 helped the National Bank of FYROM to reduce its key policy rate in early May by 25 bps to 3.75%. Interest rates on the interbank money market fell moderately, following the modest declining in the weighted average interest rate on CB-Bills. In October 2012, the Central Bank 28 days-bills weighted average interest rate fell to 3.73% from 4.00% in December 2011. ***Credit expansion*** grew by 4.8% y/y in October 2012 from 10.1% y/y in December 2011 (in euro terms). In October 2012 loans to businesses increased by 4.2% y/y and to households by 5.7% y/y whereas foreign exchange lending continued to have more considerable share to the total loans. The ratio of non-performing loans to total loans accelerated to 10.0% at the end of June 2012 from 9.9% at the end of December 2011, whereas the loan to deposit ratio declined moderately to 90.3% in October 2012 from 91.3% in June 2012, which can be explained by the higher monthly growth of loans and the slower monthly growth of deposits. The solvency of the banking sector improved more during Q1 2012, with the capital adequacy ratio reaching 17.4% at the end of June 2012 from 16.8% at the end of December 2011.

8. UKRAINE

ECONOMIC OVERVIEW: Ukraine's gross domestic product (GDP) in Q3 2012 dropped by 1.3% y/y (preliminary data), the first negative reading since Q4 2009. Detailed data on the dynamics of the GDP will be released in December 2012. The fall in economic activity was primarily driven by the decline in industrial production and the negative developments in the construction and agricultural sectors. The slowdown of GDP was affected by the further weakening of the external demand. Decline in exports is recorded in three main sectors (engineering, chemistry, metallurgy). Weakening global demand for steel and iron ore weighed on the steel and mining industries. In addition, production of machinery equipment and transport vehicles was largely affected by the decline in demand in the Russian Federation. In Q2 2012, Ukraine's GDP grew by 3% y/y and by 2.0% q/q. The government in its budget for 2012 predicts a real GDP growth of 3.9%. In 2011, Ukrainian economy expanded by an annual rate of 5.2%. In H2 2012, trends of the first half of the year will persist. Exports will be weak as a result of the unfavourable international environment and growth will be supported by a fiscal stimulus at over 2% of GDP.

Real GDP (%Δ yoy, unadjusted data)



Source: State Statistics Commitee

As Ukraine, failed to implement pension reforms and to hike gas tariffs (IMF demanding hikes for households and enterprises by 30% and 60% respectively) a scheduled $ 1.5 billion tranche in March 2011 part of the $ 15.2 billion SBA, was frozen. On the other hand, the Ukrainian government considers seeking a new financial assistance from the IMF after the parliamentary elections (October 28, 2012). Ukraine repaid $ 575 million of debt to the IMF in February 2012 although it plans to pay back by year end $ 3.1 billion. Ukraine's credit spreads narrowed; indicating a declining probability of default, after the elections. Five-year CDS spreads on Ukraine tightened to

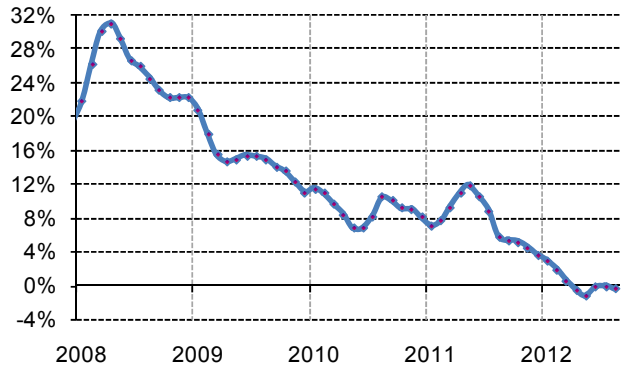
672 bps, according to Markit (November 23, 2012) from 855 bps at the end of December 2011. With a stagnated industry, due to subdued exports because of the European debt crisis, and modest expectations regarding the agriculture harvest, it is expected that the economy will expand by 0.7% y/y in 2012 and by 2.5% in 2013 from 5.2% in 2011. According to the Fitch Ratings, GDP growth in 2012 will rise only by 0.5%. The European Bank for Reconstruction and Development (EBRD) lowered its growth forecast for 2012 from 2.5% to 1.0% while Ernst & Young lowered its forecast for Ukraine's GDP growth from 3.1% to 1.7%.

FISCAL POLICY: Deficit of the state budget of Ukraine in September 2012 amounted to UAH 7.7 billion (USD 944 million), whereas in the first nine months of the year, the budget deficit reached UAH 24.4 billion (USD 3.0 billion) or -1.8% of full-year GDP, compared with UAH 8.3 billion in the same period of 2011. In particular, state's budget deficit widened in the first nine months of the year from a year earlier, as expenditure rose by 15.2% y/y. Revenue increased to UAH 246.3 billion (+8.7% y/y), while expenditures rose to UAH 267.3 billion (+15.2% y/y). Revenues to the State budget rose mainly thanks to changes in taxation so the biggest increases were registered in VAT, in corporate tax and domestic excise tax. September data indicates that government is unlikely to meet its 2012 state budget deficit target. Ukrainian parliament approved amendments to the 2012 central budget law increasing its spending and deficits targets by 0.5 pp of expected GDP for 2012 in order to provide further subsidies to local budgets to finance their debt to district heating companies. The new state budget deficit was set at -2.8% of GDP. The financing of the deficit is a major issue due to restricted access to international markets and limited potential of domestic investors. It is noted that consolidated budget includes Naftogaz and Pension Fund. Naftogaz and the Pension Fund is where imbalances are caused due to the government's resistance to hike gas tariffs and to implement pension changes.

At the same time, the Pension Fund, an important element of the consolidated budget, in January-August 2012 obtained UAH 144 billion from all sources of financing which is 10.4% up y/y. The fund's expenses in January-August 2012 reached UAH 152 billion a rise of 8% y/y, whereas its own revenues grew by 14.8%, to UAH 102.22 billion. The Pension Fund's deficit for 2012 is set at UAH 9.5 billion from a deficit of UAH 19.5 billion in 2011. According to World Bank (July 2012), Ukraine's consolidated budget deficit (excluding expenses on recapitalisation of banks) will reach -5% of GDP in 2012, -3% of GDP in 2013, and -2.3% of GDP in 2014. An IMF mission visited Ukraine to discuss country's Budget 2013, energy sector reforms and social programs. slide

INFLATION: Inflation pressures continued to ease in Ukraine with year-on-year deflation reported for May- July 2012. The main factor of negative inflation's was the base effect, as a good agricultural harvest capped prices in 2011, although it is clear that the end of low readings is approaching. In October 2012, annual inflation inched up to 0.1% from - 0.3% a month ago. On a month-on-month basis, the consumer price index was unchanged. The prices for fruit and vegetables fell further. On annualized basis the core inflation in October 2012 slowed down to 1.1% y/y from 3.7% y/y in June 2012. In the first eight months of the year, annual producers' prices (PPI) have risen by a tame 0.6% due to lower international commodity prices. Considering price developments for the first ten months of 2012, our year-end inflation forecast was adjusted downwards to 2.0% bringing the average rate for the year at 0.8%. IMF expects that inflation in Ukraine in 2012 will reach 7.4% at year-end.

Consumer Price Inflation - (%Δ yoy)



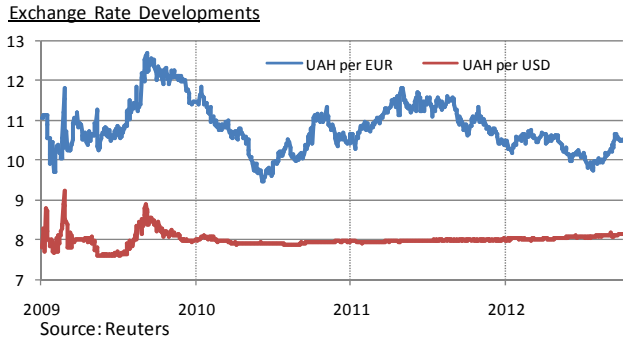
Source: State Statistics Committee

BALANCE OF PAYMENTS: Ukraine's current account deficit widened to $ 8.2 bn in the first 8-months of the year or to -5.8% of GDP, from a deficit of $ 4.8 bn in Jan.-Aug. 2011. The deterioration was due to the increase of trade deficit, which for the first 8-months this year reached $12.7 bn, compared to $ 9.5 bn in Jan.-Aug. 2011. Exports rose by 3% y/y and imports by 8% y/y. The surplus of capital and financial account, of $ 8.5 bn, offset the negative current account so the balance of payments posted a surplus of $ 304 million against a surplus of $ 2.2 bn in Jan.-Aug. 2011. Net FDI declined to $ 4.3 bn in Jan.-Aug. 2012 (-7.1% y/y) from $ 4.7 bn in the same period in 2011. Overall, external imbalances make Ukraine more vulnerable to external shocks. The current account deficit in 2012 is now expected to reach -7.0% of GDP. In 2011 the current account deficit widened to $ 9.0 bn from $ 3.02 bn in 2010.

Current Account: Jan - Aug 2012 ($ million)			
	Jan-Aug 2012	Jan-Aug 2011	%Δ
Exports	45.915	44.603	3%
Imports	58.570	54.086	8%
Trade Balance	-12.655	-9.483	33%
Services Balance	4.092	4.214	-3%
Income Balance	-1.596	-2.208	-28%
Current Transfers Balance	1.995	2.658	-25%
Current Account Balance	-8.164	-4.819	69%
Source: National Bank of Ukraine			

MONEY & FINANCIAL MARKETS: The hryvnia (UAH) after strengthening to 7.99 against USD in early January, it started to weaken gradually to 8.14 in late September, as contagion from the Eurozone debt crisis resurfaced. The advance of Ukrainian exports in the first eight months of 2012 had a minor positive effect at the national currency. The gross international reserves of National Bank of Ukraine (NBU) were reduced at the end of August 2012 to $ 30.0 bn, from $ 31.8 bn in December 2011. The NBU added $ 2.0 bn in proceeds from a 5-year Eurobond issue with a yield of 9.25% in July 2012, as well as another $ 600 million by tapping the 5-year Eurobond issue of July

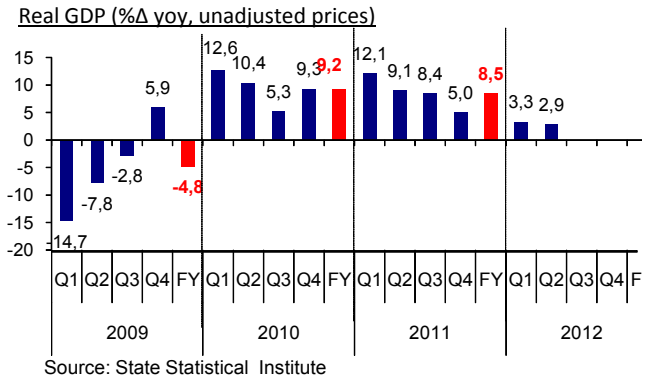
2017 with a yield of 7.46%. Ukraine last tapped the international bond markets in June 2011, when it sold a 5-year issue of $ 1.25 billion with a yield of 6.25%. In the meantime, the net demand for cash foreign exchange was reduced from $740 million in December 2011 to $ 723 million in August 2012. During July, Naftogaz purchased foreign currency from the NBU as the monopoly made a payment of $ 900 million to Gazprom for imported natural gas for July. The National Bank of Ukraine (NBU) has effectively succeeded its target of maintaining hryvnia (UAH) stable until parliamentary elections. In order to maintain this favourable environment for hryvnia the NBU during Jan-Oct 2012 used for FX interventions USD 5.4 bn from USD 3.2 bn the same period of 2011. Given strong depreciation expectations and negative external trade developments the NBU may allow a gradual hryvnia weakening. At the same time interest rates are expected to remain high, as the local authorities will attempt to determine the appropriate level for UAH. Interest rates could start declining if the IMF program continued, which is anticipated to happen after December 2012. Credit expansion (in euro terms) grew by 4.3% y/y in September 2012 from a rise of 13.3% in December 2011. Loans to corporate accelerated to 8.0% y/y in September 2012, while loans to households were down by -6.6% y/y. Private sector deposit growth grew by 15.8% y/y in September 2012 while the loan to deposit ratio was standing at 61.7% in September 2012 from 73.1% in December 2011. During the first nine months of the year the UAH was under pressure against US Dollar (-1.1% y/y avg level) while gained ground against Euro (+7.9% y/y avg level). Moody's on December 5, cut Ukraine's rating by one notch to B3, six levels below investment territory, while it retained its negative outlook. The agency cited deterioration of the country's institutional strength, a shortage of external liquidity and reduced data transparency.



9. TURKEY

ECONOMIC OVERVIEW: Following the high growth that the Turkish economy registered in 2011 and 2010, this year it is clear that economy is on a slowdown orbit. Economic activity eased substantially in H1 2012 due to weak performance of the industrial sector. GDP expanded by 2.9% y/y in Q2 2012 from 3.3% y/y in Q1 2012 and a 9.1% y/y growth in Q2 2011, signaling that the Turkish economy is experiencing a soft landing following more than eight straight quarters, of excessive growth. In Q1 2012 growth was revised to 3.3 % from an initial 3.2% reported in July 2012. According to the State Statistical Service, the GDP reached TRY 28.8 billion (€ 12.5 billion) in Q2 2012, and total GDP in H1 2012 rose to TRY 55.9 bn or by 3.1%. Net exports contributed the most to the economic growth, while domestic demand had a negative performance. In order to retain its export growth given the unfavorable economic environment in Europe, Turkey has shifted its export activities to countries in Africa, as well as, in South and North America. In particular, the external sector had a positive contribution on a net basis. Exports of goods and services accelerated by 16.0% y/y in H1 2012 whereas imports contracted by 4.8% y/y. Private consumption decreased by -0.2% y/y in H1 2012. Moreover, public investment declined by -1.5% y/y in H1 2012 from -0.5% y/y in H1 2011. Economic expansion is expected to proceed at the same pace in Q3 2012, as industrial output was 0.5% lower than the Q2 2012 average and both car and truck production in Q3 were sharply down on an annual basis.

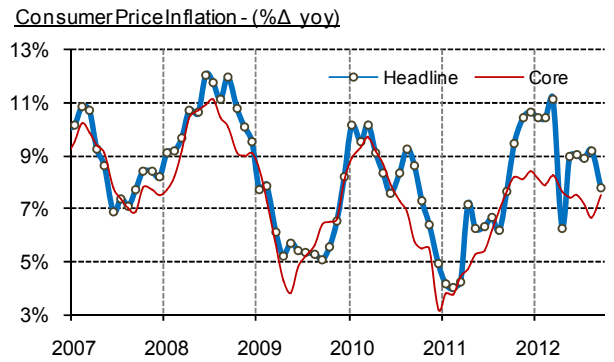
In view of the recent economic indicators and the persistence of the Euro area sovereign debt crisis, it is expected that 2012 full year GDP growth will reach 3.0%. In the government's Medium Term Economic Programme, 2012 growth is estimated at 4.0%, whereas the estimates of international organizations have been less optimistic, with the IMF and World Bank forecasting the growth to be 2.3% and 2.9% accordingly.



FISCAL POLICY: Turkey's budget deficit was standing at TRY 18.8 billion in January-October 2012 versus a deficit of TRY 1.7 billion in the same period last year. Primary surplus also, deteriorated declining by 31.5% y/y to TRY 24.5 billion from TRY 35.8 billion the same period a year ago. The deterioration comes mostly from the expenditures side; non-interest expenses growth in the first ten months of the year was 18.5% y/y above the 10.4% target. The sharp salary increases of the public sector's employees overshoot personnel expenditures by 18.9% y/y vs. the target at 12.0%. On the other hand, tax revenues were less than anticipated due to weak domestic demand. Budget revenue increased by 11.2% y/y in January-October 2012 to TRY 271.0 billion, and tax revenue was up 8.7% y/y amounting TRY 226.2 billion. Domestic VAT revenues noted an annual decrease -0.3% against a target of 10.8%. However, the coverage ratio of tax revenue to expenditure excluding interest payments stood at 91.7% in January-October 2012 against a target at 90.5%. Due to lack of measures to curb expenditures in the rest of the year, the budget deficit is expected to

reach 2.2% of GDP, although the Budget 2012 targets at a deficit of TRY 21.1 billion or 1.5% of GDP, with GDP growth of 4% (Medium Term Economic Programme).

INFLATION: After hitting a 3 year high of 11.1% in April, inflation declined to 7.8% in October. In particular, headline annual inflation rate dropped to 7.8% y/y in October 2012 from 9.2% y/y in September 2012 and from 10.5% y/y in December 2011. On a monthly basis the inflation was up by 2.0%. At the beginning of October, the Turkish government hiked natural gas prices by 9.8% and electricity prices for residential, commercial and industrial use by 9.7%, 7.9% and 4.0%, respectively. The price increases followed a rise in September in private consumption taxes (ÖTV) on fuel, automobiles and alcoholic beverages. The highest annual increase (+11.8%) was recorded in the index housing-water-electricity-gas, whereas food and non-alcoholic beverages, and transportation grew by 7.9% and 6.5% respectively. On the other hand, the core inflation in October 2012, eased to 6.1% y/y from 6.7%y/y a month ago. The average annual inflation in the first ten months of the current year was 9.5%. Inflation is expected to slow down in the last quarter of the year on both headline and core level, mainly due to base effect bringing the average rate for the whole 2012 around 9.0%. The Central Bank expects inflation will end this year at 7.4%, higher than its previous forecast of 6.2%. The Central Bank has also revised its forecast inflation for 2013 to 5.3%. Central Bank does not expect inflation to hit double figures and that will stabilise at around 5% in the medium term.

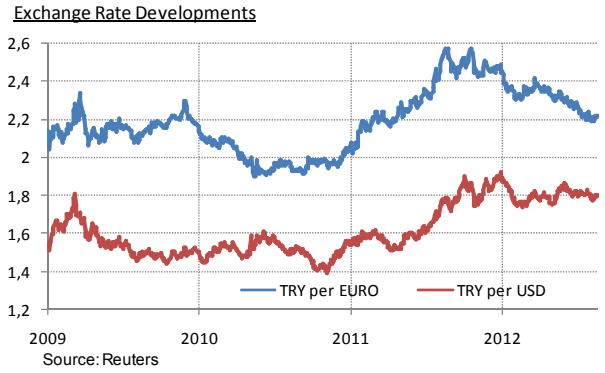


Source: Turkish Statistical Institute

BALANCE OF PAYMENTS: Current account balance recorded a deficit of $ 50.7 billion in January-September 2012, posting a substantial decline of 27.0% from a year ago. It should be noted that in 2011 the current account deficit (CAD) reached $ 77.2 billion or -10% of the GDP. Note that the 12-month rolling CAD in September 2012 reached $ 55.8 billion after its peak of $ 78.4 billion in October 2011. The considerable current account deficit is also largely related to oil as Turkey is a net energy importer. Exports of goods expanded by 14%, while imports declined by -3% in annual terms. Export/import coverage ratio increased to 66.5% in January-September 2012 from 60.3% a year ago. Services balance, improved significantly (+11%) due to the rise of net tourism revenues by 2.0% y/y. On the financing side, there was a $ 6.9 billion net FDI inflow towards mainly manufacturing and real estate. The net FDI to current account deficit ratio stood at 17.70% in January-September 2012 from 16.3% the same period a year ago. The CAD to GDP ratio we think that it will modestly reduced to -9% in 2012 as high oil prices and relatively strong economic activity in Turkey limit the chance for a sizeable reduction.

Current Account: January- September 2012 ($ mln)			
	Jan-Sep. 2012	Jan-Sep. 2011	%Δ
Exports	120.297	105.691	14%
Imports	171.033	175.433	-3%
Trade Balance	-50.736	-69.742	-27%
Services Balance	15.816	14.302	11%
Income Balance	-5.325	-6.203	-14%
Current Transfers Balance	964	1.177	-18%
Current Account Balance	-39.281	-60.466	-35,0%
Source: Central Bank of Turkey			

MONEY & FINANCIAL MARKETS: Since August 2011 the Central Bank (CBRT) has kept its key monetary 1-week repo at 5.75% and watched carefully the currency developments in order to moderate pressures on TRY, as sovereign debt crisis in Euro area continued to weigh on the global economic environment. Greek election results in June 2012 diminished the probability of Greek exit from the monetary union and led to a narrow improvement in risk appetite. In the first ten months of the year, the Turkish lira on average depreciated against US dollar by 9.4% and against Euro remained virtually unchanged. The CBRT in order to boost growth decided on November 20, to ease its monetary stance. In particular, CBRT decreased its O/N lending rate from 11.5% (February 22, 2012) to 9.0% and its late liquidity lending rate from 14.5% (February 22, 2012) to 12.0%. On June 20, Moody's upgraded country's rating by one notch to Ba1 from Ba2, placing Turkey one notch below the investment grade, while keeping the rating outlook positive. Turkey's significant improvement in public finances was noted as the rationale behind the decision. Turkey's consolidated public debt to GDP is comparable to the investment-grade countries, whereas expectations are increasing for Turkey to obtain this status over the next 18 months. Meanwhile, Fitch Ratings has upgraded Turkey's long-term foreign currency issuer default rating to BBB- (investment grade) from BB+ and the long-term local currency IDR to BBB from BB+. The outlooks on the long-term ratings are stable. The agency has also upgraded country's ceiling to BBB from BBB-.



Source: Reuters

9. ECONOMIC DATA – GREECE

(% change unless otherwise noted)

Yearly Data	2006	2007	2008	2009	2010	2011	2012f
Real GDP Growth	5.5	3.0	-0.2	-3.2	-3.5	-6.9	-5.9
Gross Fixed Total Investments	20.4	5.4	-6.7	-15.2	-15.0	-20.7	-17.5
- Equipment	15.6	37.0	1.3	-24.0	-20.0	-22.1	-18.0
- Residential	31.4	-9.0	-28.2	-23.5	-18.0	-23.6	-22.0
Unemployment (percent)	8.9	8.3	7.7	9.5	12.5	17.7	23.7
Employment	1.9	1.2	1,2	-1.0	-3,0	-6,8	-7.5
Consumer Price Index (year average)	3.2	3,0	4.2	1.3	4.7	3.3	1.4
Unit Labor Cost	2.2	5.0	8.7	6.6	-3.8	-2.6	-8.1
Credit Expansion (Private Sector)	21.1	21.5	15.9	4.1	0.0	-3.1	-3.0
Government Deficit (as % of GDP)	-5.7	-6.5	-9.8	-15.8	-10.6	-9.2	-6.5
Current Account (as % of GDP)	-9.6	-12.4	-13.3	-10.3	-9.2	-8.6	-4.8

Source: Hellenic Statisticsl Authority (ELSTAT.) and IMF, March 2012.

Quarterly Data	2010	2011	2011	2011	2011	2011	2012
		I	II	III	IV		available period
Economic Activity (avg)							
Retail Sales Volume	-6.9	-14.0	-11.7	-8.7	-8.7	-8.7	-11.2 (Jan-Sep)
Construction Activity	-23.7	-54.2	-44.6	-35.5	-36.0	-37.7	-23.0 (Jan-Aug)
Industrial Production (Manufacturing)	-5.1	-7.1	-9.6	-8.0	-9.5	-9.5	-5.3 (Jan-Oct)
PMI (manufacturing)	43.8	43.7	45.6	43.9	41.1	43.6	41.8 (Nov)
Economic Sentiment Indicator	79.3	82.2	77.5	76.5	74.2	77.6	76.1 (Jan-Nov)
Index of Business Expectations in Manufacturing	75.8	79.2	77.6	78.3	72.5	76.9	76.6 (Jan-Nov)
Consumer Sentiment Index	-63	-69	-71	-74	-83	-74	-75.0 (Jan-Nov)
Credit Expansion (eop)							
Private Sector	0.0	-0.4	-1.2	-2.2	-3.1	-3.1	-4.8 (Oct)
Consumer Credit	-4.2	-4.6	-5.8	-6.5	-6.4	-6.4	-5.2 (Oct)
Housing	-0.3	-1.3	-1.7	-2.1	-2.9	-2.9	-3.7 (Sept)
Business	1.1	1.1	0.2	-0.9	-2.0	-2.0	-5.6 (Oct)
Tourism	2.9	0.2	0.5	-0.8	-2.3	-2.3	-0.8 (Oct)
Prices (eop)							
Consumer Price Index	4.7	4.7	3.5	2.4	2.8	3.3	1.0 (Nov)
Core Inflation	3,0	2.5	1.7	0.7	1.3	1.5	-0.5 (Nov)
Interest Rates (avg)							
Savings	0.38	0.39	0.40	0.40	0.41	0.40	0.42 (Oct)
Short-term Business Loans	6.14	6.88	7.35	7.73	7.88	7.46	7.45 (Oct)
Consumer Loans (with charges)	11.64	12.25	12.51	12.68	12.04	12.37	10.64 (Oct)
Housing Loans (with charges)	3.84	4.48	4.77	4.94	4.66	4.71	3.11 (Oct)
3 month Euribor	0.81	1.01	1.42	1.56	1.50	1.39	0.69 (Oct)
10 year Bond Yield	8.95	11.92	14.76	18.23	28.95	18.69	26.01 (Oct)
National Accounts							
Real GDP	-4.9	-8.0	-7.3	-5.0	-7.5	-7.1	-6.9 (Q3)
Final Consumption	-3.6	-8.9	-8.3	-4.9	-7.9	-7.5	-8.8 (Q3)
Investment	-18.0	-24.2	-19.6	-16.4	-22.2	-20.7	-19.5 (Q3)
Exports of goods & services	3.8	-2.4	0.8	4.5	-6.1	-0.3	-4.5 (Q3)
Imports of Goods & services	-4.8	-9.8	-4.5	-3.8	-14.2	-8.1	-20.9 (Q3)
Balance of Payments (in € bn - Cumulative)							
Exports of Goods	17.1	4.3	9.5	15.1	20.2	20.2	16.1 (Jan-Sept)
Imports of Goods	45.4	11.9	23.7	36.0	47.5	47.5	31.7 (Jan-Sept)
Trade Balance	-28.3	-7.6	-14.2	-21.0	-27.2	-27.2	-15.7 (Jan-Sept)
Invisibles Balance	6.3	0.6	1.2	7.1	8.8	8.8	13.7 (Jan-Sept)
Invisibles Balance / Trade Account	22.3	7.5	8.6	34.0	32.4	32.4	88.0 (Jan-Sept)
Current Account	-22,0	-7.0	-13.0	-13.9	-18.4	-18.4	-1.9 (Jan-Sept)
Direct Investments	0.7	-0.3	-0.7	-1.6	0.03	0.03	2.0 (Jan-Sept)
Portfolio Investments	-20.9	-6.1	-9.7	-14.6	-17.3	-17.3	-76.0 (Jan-Sept)
Athens Stock Exchange (eop)							
Composite Index	1,413.9	1,535.2	1,279.1	798.4	680.4	680.4	809.14 (Nov)
% change	-35.6	-25.8	-10.8	-45.7	-51.9	-51.9	18.6
Market Capitalization ASE (% of GDP)	23.3	25.7	21.4	13.8	11.8	11.8	15.6

Source: Hellenic Statisticsl Authority (ELSTAT.), Alpha Bank - Economic Research

10. Economic Data – Southeastern Europe

Romania	2007	2008	2009	2010	2011	2012 (f)
Real Economy						
Real GDP	6.3	7.3	-6.6	-1.6	2.5	0.6
Private Consumption	11.9	9.0	-10.1	-0.4	1.3	0.5
Government Consumption	-0.1	7.2	3.1	-4.4	-3.5	0.2
Gross Fixed Investment	30.3	15.6	-28.1	-2.1	6.3	4.4
Exports (Goods & Services)	7.8	8.3	-6.4	14.0	9.9	4.1
Imports (Goods & Services)	27.9	7.9	-20.5	11.9	10.5	4.7
Prices						
HICP Inflation (Avg)	4.9	7.9	5.6	6.1	5.8	4.0
General Government (%GDP)						
Overall Balance	-3.1	-4.8	-7.3	-6.8	-5.2	-3.0
Balance of Payments (% GDP)						
Current Account Balance	-13.4	-11.6	-4.2	-3.9	-4.3	-4.2

Bulgaria	2007	2008	2009	2010	2011	2012 (f)
Real Economy						
Real GDP	6.4	6.2	-5.5	0.2	1.7	0.6
Private Consumption	9.0	3.4	-7.6	-1.2	-0.6	0.5
Government Consumption	0.3	-1.0	-6.5	-1.0	0.5	0.1
Gross Fixed Investment	11.8	21.9	-17.6	-16.5	-9.7	-2.3
Exports (Goods & Services)	6.1	3.0	-11.2	16.2	12.8	3.1
Imports (Goods & Services)	9.6	4.2	-21.0	4.5	8.5	2.8
Prices						
HICP Inflation (Avg)	7.6	12.0	2.5	3.0	3.4	2.7
General Government (%GDP)						
Overall Balance	3.5	3.0	-0.8	-4.0	-2.1	-1.7
Balance of Payments (% GDP)						
Current Account Balance	-26.8	-24.0	-9.9	-1.0	0.8	-1.0

Cyprus	2007	2008	2009	2010	2011	2012 (f)
Real Economy						
Real GDP	5.1	3.6	-1.9	1.1	0.5	-2.3
Private Consumption	9.4	7.8	-7.5	1.3	0.2	-4.1
Government Consumption	0.3	6.1	6.8	0.8	-4.4	-2.9
Gross Fixed Investment	13.4	6.0	-9.7	-1.7	-13.8	-21.0
Exports (Goods & Services)	6.1	-0.5	-10.7	3.7	3.6	-0.6
Imports (Goods & Services)	13.3	8.5	-18.6	4.9	-5.0	-8.9
Prices						
HICP Inflation (Avg)	2.2	4.4	0.2	2.6	3.5	3.3
General Government (%GDP)						
Overall Balance	3.4	0.9	-6.1	-5.3	-6.3	-5.0
Balance of Payments (% GDP)						
Current Account Balance	-11.7	-12.2	-11.0	-8.7	-11.0	-6.0

Serbia	2007	2008	2009	2010	2011	2012 (f)
Real Economy						
Real GDP	5.4	3.8	-3.5	1.0	1.6	-1.7
Private Consumption	0.3	5.4	-2.3	-3.8	-0.5	-2.0
Government Consumption	18.2	1.6	-5.1	-2.4	-0.9	3.1
Gross Fixed Investment	25.6	1.9	-9.1	2.0	9.3	-3.1
Exports (Goods & Services)	17.2	8.9	-14.9	19.1	7.1	2.6
Imports (Goods & Services)	26.0	9.3	-22.9	4.1	7.4	2.9
Prices						
Consumer Price Inflation (Avg)	6.5	12.4	8.1	6.1	11.2	6.9
General Government (%GDP)						
Overall Balance	-1.9	-2.6	-4.5	-4.6	-5.0	-6.7
Balance of Payments (% GDP)						
Current Account Balance	-15.9	-21.6	-7.2	-7.4	-10.4	-11.9

Albania	2007	2008	2009	2010	2011	2012 (f)
Real Economy						
Real GDP	5.3	8.3	3.3	3.5	2.0	0.6
Private Consumption	-	-	-			
Government Consumption	-	-	-	-	-	-
Gross Fixed Investment	-	-	-	-	-	-
Exports (Goods & Services)	-	-	-	-	-	-
Imports (Goods & Services)	-	-	-	-	-	-
Prices						
CPI Inflation (Avg)	2.9	3.4	2.3	3.6	3.4	2.7
General Government (%GDP)						
Overall Balance	-3.9	-5.5	-7.4	-4.2	-3.7	-3.5
Balance of Payments (% GDP)						
Current Account Balance	-10.3	-15.3	-13.5	-11.8	-10.9	-12.0

FYROM	2007	2008	2009	2010	2011	2012 (f)
Real Economy						
Real GDP	6.1	5.0	-0.9	1.8	3.0	0.7
Private Consumption	7.5	6.6	-5.5	0.6	3.7	0.7
Government Consumption	-0.3	10.6	0.5	-3.0	-5.5	-1.3
Gross Fixed Investment	17.1	5.4	-8.3	-2.7	15.0	5.8
Exports (Goods & Services)	11.8	-6.3	-15.8	23.6	11.3	1.4
Imports (Goods & Services)	16.1	0.8	-14.3	9.3	12.1	2.9
Prices						
HICP Inflation (Avg)	2.3	8.3	-0.8	1.6	3.9	3.5
General Government (%GDP)						
Overall Balance	0.6	-0.9	-2.7	-2.4	-2.6	-3.5
Balance of Payments (% GDP)						
Current Account Balance	-7.1	-12.9	-6.8	-2.1	-2.8	-3.0

Ukraine	2007	2008	2009	2010	2011	2012 (f)
Real Economy						
Real GDP	7.9	2.3	-14.8	4.2	5.2	1.0
Private Consumption	17.0	12.8	-14.9	7.0	14.0	3.1
Government Consumption	1.8	1.1	-2.4	3.3	1.5	2.1
Gross Fixed Investment	6.6	-1.2	-50.5	4.9	9.0	4.1
Exports (Goods & Services)	2.8	5.7	-22.0	4.5	5.8	1.0
Imports (Goods & Services)	23.9	17.0	-38.9	11.1	12.8	7.5
Prices						
CPI Inflation (Avg)	12.8	25.2	15.9	9.4	8.0	0.7
General Government (%GDP)						
Overall Balance*	-2.0	-3.2	-6.3	-5.7	-4.3	-4.4
Balance of Payments (% GDP)						
Current Account Balance	-3.7	-7.1	-1.5	-2.1	-5.6	-7.0

Turkey	2007	2008	2009	2010	2011	2012 (f)
Real Economy						
Real GDP	4.7	0.7	-4.8	8.9	8.5	3.0
Private Consumption	5.5	-0.3	-2.3	6.6	7.7	0.3
Government Consumption	6.5	1.7	7.8	2.0	4.5	3.3
Gross Fixed Investment	3.1	-6.2	-19.0	29.9	18.3	1.0
Exports (Goods & Services)	7.3	2.7	-5.0	3.4	6.5	8.9
Imports (Goods & Services)	10.7	-4.1	-14.3	20.7	10.6	4.5
Prices						
HICP Inflation (Avg)	8.8	10.4	6.3	8.6	6.5	9.0
General Government (%GDP)						
Overall Balance	-1.6	-2.2	-5.5	-3.5	-1.4	-2.2
Balance of Payments (% GDP)						
Current Account Balance	-5.9	-5.7	-2.3	-6.6	-10.0	-9.0

Source: Central Banks, National Statistical Institutes, IMF, Economist Intelligence Unit, Eurostat, World Bank, Alpha Bank Economic Research
Note: Data for a 2011 are preliminary * Excluding Naftogaz
(f): Forecast Alpha Bank Economic Research

note: budget balance on cash basis (IMF)