January 2007
IMF Country Report No. 07/26

Greece: 2006 Article IV Consultation—Staff Report; Public Information Notice on the Executive Board Discussion; and Statement by the Executive Director for Greece

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2006 Article IV consultation with Greece, the following documents have been released and are included in this package:

- the staff report for the 2006 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on October 20, 2006, with the officials of Greece on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on December 18, 2006. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF;

- a Public Information Notice (PIN) summarizing the views of the Executive Board as expressed during its January 22, 2007 discussion of the staff report that concluded the Article IV consultation; and

- a statement by the Executive Director for Greece.

The document listed below has been separately released.

Selected Issues Paper

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International Monetary Fund
Washington, D.C.

INTERNATIONAL MONETARY FUND

GREECE

Staff Report for the 2006 Article IV Consultation

Prepared by the Staff Representatives for the 2006 Consultation with Greece

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December 18, 2006

EXECUTIVE SUMMARY

Real GDP grew an estimated 4.1 percent in 2006 and is projected to slow only slightly in 2007. The fiscal deficit has fallen sharply, to under 3 percent of GDP in 2006. However, vulnerabilities have developed in the form of very high credit growth, persistent inflationary pressures, eroding competitiveness, and an unsustainably large current account deficit.

Significant fiscal consolidation was put in place in 2005–06, but further deficit cuts are needed, notably to prepare for the costs of population aging. Staff recommends achieving budget balance in 2010 and a surplus after that (balance or better by 2012 on the authorities' plans), focusing on current primary spending restraint. The 2007 budget targets only a small further deficit cut, as the authorities favor easing the pace following the front-loaded cuts of 2005–06. Reforms to expenditure management and tax administration, needed to bolster consolidation, are underway.

Pension reform will be needed to safeguard the long-term public finances. While no reform will be undertaken in this parliament, work is underway to better estimate the long-term costs and formulate possible policy options. While the authorities viewed the process as on schedule, staff sees a need to step up preparations for early action in the next parliament.

The banking sector appears to be sound, but continued very high credit growth and high NPLs warrant close prudential supervision. The Bank of Greece has taken an appropriately proactive stance, but continued vigilance is needed.

Recent product market reforms include further privatization and implementation of reforms to state-owned enterprises. The corporate income tax is being cut further and the government has announced personal income tax reform. Further cuts to red tape, improved performance of state-owned enterprises, and further liberalization of network industries are priorities looking ahead. **Labor market reform** has been more modest; employment protection legislation should be eased and centralized bargaining agreements made more flexible.

Data are adequate for surveillance, but improvements are needed. In particular, the authorities concur that national accounts revisions should be more timely, and, to bolster its reputation, that the statistical service should be made independent.

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I. BACKGROUND

1. **Economic growth has been strong for several years, but vulnerabilities emerged**. Real GDP grew by 3¾ percent a year on average during 1995–2005 (Table 1, Figure 1).[1] Financial-sector liberalization and the sharp drop in interest rates with euro adoption resulted in very large increases in private sector credit, which has underpinned strong domestic demand growth. Fiscal policy was expansionary in the first part of this decade, including to fund the 2004 Olympic games. On the supply side, capital formation and productivity growth have been strong, and substantial immigration, mainly from the Balkans, has swelled the workforce. This period of strong growth narrowed the gap in real incomes between Greece and the EU15 but, notwithstanding significant reforms in recent years (see the text table on Fund Policy Recommendations), vulnerabilities also developed:

- **The fiscal deficit widened**. In 2004, the general government deficit peaked at 6.2 percent of GDP (Table 2), due principally to rapid growth in primary spending, which averaged 8.3 percent a year in 2001–04. As a result, little progress was made in cutting the debt-GDP ratio, which stood at 85.3 percent in 2005 (107.5 percent on the old national accounts estimates). In the wake of large upward revisions to historical deficit estimates, the EC launched an excessive deficit procedure (EDP) in 2004, requiring a deficit below 3 percent of GDP by 2006. In response, the authorities cut the deficit sharply in 2005 and again in the 2006 budget.

Greece: General Government Expenditures, 2001–05
(Percentage change)

	2001	2002	2003	2004	2005	Average growth (2001–04)		2005
						Nominal	Real	Percentage of total
Expenditures	4.3	5.9	7.8	9.5	1.0	6.9	3.4	100.0
of which: wage bill	6.4	14.0	6.5	14.4	4.0	10.3	6.7	25.6
Consumption	4.8	11.9	2.3	7.4	2.5	6.6	3.1	37.9
Social transfers, excl. those in kind	11.6	7.5	13.0	5.6	9.2	9.4	5.9	36.8
Interest	-5.0	-9.1	-1.8	8.6	-4.0	-1.8	-5.0	10.3
Subsidies	1.6	5.1	16.1	0.8	7.1	5.9	2.5	0.3
Other current expenditure	3.9	8.4	31.7	28.9	5.8	18.2	14.4	3.3
Investment expenditure	-3.6	-0.4	17.2	23.9	-19.8	9.3	5.7	11.4
Primary expenditures	5.9	8.3	9.1	9.6	1.6	8.3	4.8	89.7
Primary expenditures (excluding Olympics expenditure)	5.6	6.7	8.5	8.5	4.5	7.3	3.8	89.0
Current primary expenditures	7.7	9.8	7.9	7.3	5.7	8.2	4.7	78.3

Sources: National Statistical Service; Ministry of National Economy; Bank of Greece.

[1]The national accounts were recently revised significantly, raising the level of output in 2000-05 by about 26 percent, although real GDP growth rates were little affected; see Section II.E and Box 4. The authorities explained that the new estimates are now official and national accounts will no longer be prepared under the old methodology. Eurostat has yet to verify the revised estimates and, in the meantime, the authorities have chosen to present the 2007 budget using the old estimates to emphasize that the 2006 fiscal deficit fell below 3 percent of GDP regardless of the revisions. This report uses the revised estimates throughout, unless otherwise indicated.

- **Private-sector borrowing expanded rapidly**. Although the FSAP, conducted in 2005, found no systemic threats to the banking sector, it highlighted risks arising from lending to new and untested client classes, expansion into new activities, and rising exposures of some banks in the Balkans. To some extent, this credit expansion reflects greater financial intermediation in the wake of liberalization, a process that relatively low debt-income ratios suggest is still incomplete.

- **The external current account deficit widened**. Strong domestic demand, supported by credit growth, has led to inflationary pressures, while a centralized wage bargaining system has delivered higher unit labor cost growth than elsewhere in the euro area. The cumulative wage increase of over 11 percent in the 2006–07 two-year private sector wage settlement continued this trend. As a result, the real exchange rate has appreciated steadily, opening up a growing competitiveness gap vis-à-vis trading-partner countries, and the current account deficit widened to an estimated 7½ percent of GDP in 2006 (balance of payments basis) (Box 1). [2] Membership in the monetary union keeps long-term interest rate premia low (about 30 basis points against Germany), but a substantially smaller current account deficit would be needed to stabilize the net foreign asset position.[3]

2. **Structural reforms have been put in place, but impediments to higher productivity remain**. A decade of strong growth has narrowed the gap in real per capita income with the EU-15 average. Nevertheless, businesses face unduly high start-up costs and labor restrictions (Table 3), and chronically weak FDI inflows suggest a poor investment climate. Labor markets perform very poorly by international comparison (Figure 2).

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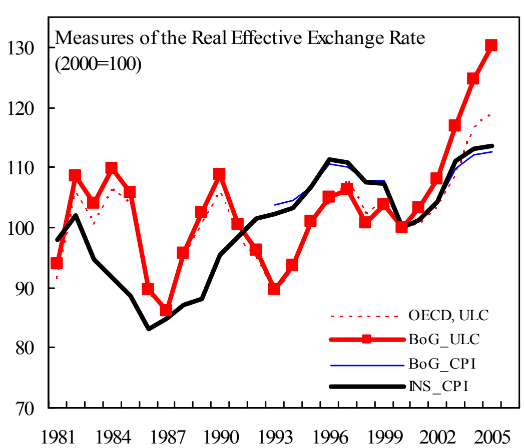
[2] The discussion of competitiveness and the current account, both here and below, draws on Chapter 1 of the Selected Issues Paper.

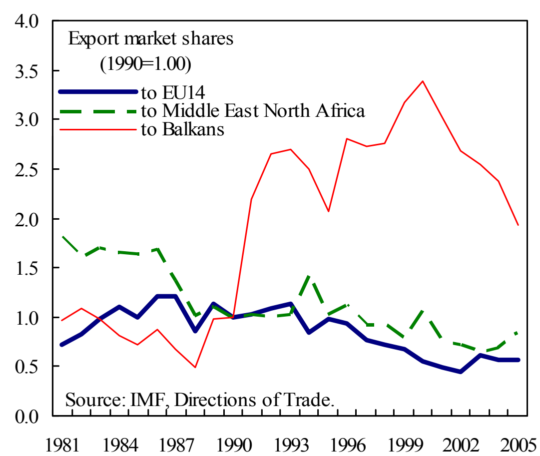
[3] As an illustration, a current account deficit of 3½ percent of GDP would be needed to stabilize the 2005 ratio of net external liabilities to GDP of 65 percent.

Box 1. External Competitiveness

Indicators suggest a significant erosion of cost and price competitiveness since EMU accession. The real effective exchange rate has appreciated by 20–30 percent on a ULC basis and by 10 percent on a CPI basis, and the export deflator rose by 10 percent, the highest among euro-area countries. Staff estimates based on the macroeconomic balance and external sustainability approaches, though subject to high margins of error, imply a real overvaluation of 12–22 percent. In addition to cost measures, Greece scores low relative to other euro-area members on international competitiveness rankings.

The erosion of competitiveness is reflected in weak export performance, notwithstanding a recent pickup. Greece has lost export market share, and export growth in the past five years has been the second weakest among euro area countries.





Greece scores low in international competitiveness rankings

	Portugal	Spain	Italy	Greece
	(Country ranking)			
Global Competitiveness Index, 2006, WEF	34	28	42	47
Institutions	28	39	71	41
Competitiveness index (2006), IMD	43	36	56	42
Government efficiency	42	40	60	46
Index of Economic Freedom (2006), Heritage Foundation	30	33	42	57
Inward FDI performance index (2003-05), UNCTAD	69	76	107	121

Greece: Policy Recommendations and Implementation

Policy Area	Staff Recommendation in Previous Article IV Consultations	Implementation
Fiscal Policy	Substantial deficit reduction in 2005-06; budget balance by 2010 and surplus after that. Adjustment should be in current primary spending. Tax administration and expenditure management need reform.	Deficit was reduced by 4 percent of GDP in 2005-06. The adjustment was mainly on spending, but shifted to revenue in 2006. Authorities' medium-term objective is budget balance or better by 2012. Tax and expenditure reforms have begun.
Pension Reform	Reform urgently needed. Immediately, new estimates of costs should be produced and social dialog intensified.	Cost estimates are being produced, though somewhat slowly, and a commission set up to analyze the issue. Reform measures will await the next parliament.
Financial Sector	Strengthen risk management to guard against vulnerabilities posed by very high credit growth and moves into new, untested markets.	The supervisor has tightened prudential measures, including to encourage improved risk management.
Structural Reform	Both product and labor market reforms needed to improve competitiveness and sustain growth.	Substantial progress on product market reform in a number of areas, but less has been done on labor markets.

II. Policy Discussions

The short-term economic outlook is strong, but challenges to sustained medium-term growth are posed by a weakening international competitive position, a large current account deficit, and sustained high private-sector credit growth. Against this backdrop, the discussions focused on how to foster a soft landing in the medium term. The mission discussed the pace and nature of medium-term fiscal adjustment, reform of tax administration and expenditure management, the pension reform process, financial sector vulnerabilities, the need for further structural reform in product and labor markets, and the national accounts revisions.

A. The Outlook

3. **Growth is set to remain strong in the short term in a context of global expansion, and in particular a revival of activity in the EU**. Staff projects real GDP will rise by 4.1 percent in 2006, slightly above the staff estimate of potential (3.9 percent). [4] Indicators from the first half of the year suggest continued strength in private domestic demand (Figure 3). The external sector remains a drag on growth, but, benefiting from the pickup in world growth, goods exports have recently shown surprising resilience in the face of eroding cost competitiveness. For 2007, while the key factors contributing to recent strength seem likely to continue, staff projects growth to ease to 3¾ percent, reflecting a mild slowing of consumption and investment from the rebound in 2006. Inflation is projected to ease somewhat as oil prices stabilize at levels lower than were seen earlier this year, while the current account deficit is projected to remain at about 7½ percent of GDP. Projection uncertainties for 2007 include the robustness of both consumption and investment and, on the external side, the effects of an appreciation of the euro and a slowdown in the United States.

4. **For the medium term, staff projects a gradual slowing of growth, but continuing economic imbalances pose downside risks**. The staff baseline projection assumes growth will fall somewhat below potential (about 3 percent) as consumers' taste for increased debt begins to wane and lost competitiveness weighs on the traded goods sector and weakens investment. As a result, inflationary pressures ease and the current account deficit narrows, although adjustment is incomplete over the projection horizon as competitiveness and export market share deteriorate somewhat further (Tables 4 and 5). However, persistent real exchange rate appreciation and unsustainable current account deficits raise the prospect of a sharper slowdown. The experience of other euro area countries suggests that such a slowdown could be triggered by lower consumption growth as households adjust to rapidly rising debt burdens, the cumulative effects of deteriorating competitiveness, or the end of asset (house) price increases (Box 2). In Greece, a very pronounced slowdown—growth of about ¾ percent a year for two years in Figure 4—while unlikely, would result in a higher fiscal deficit and a rise in the debt-GDP ratio.

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[4] The November Consensus Forecast is 3.7 percent in 2006 and 3.3 percent in 2007. See "Growth in Greece: Can Better Performance be Sustained?" in last year's Selected Issues Paper (Country Report No. 06/05) for an analysis of potential output.

Box 2. The Greek Cycle in a Euro-area Context

This box compares Greek economic developments in the last 10 years with those of four other high-growth euro-area countries. Two of them, the Netherlands and Portugal, suffered sharp economic downturns in the first half of this decade (Figure 5), while Ireland and Spain continued to grow strongly (Figure 6), as has Greece. As all countries except the Netherlands began the 1990s with per capita incomes well below the euro-area average, their high growth could be viewed as catch-up.

Indications of demand pressures are evident during large parts of the 10-year period in all five countries. Credit grew strongly and rose substantially in relation to GDP. House prices also increased strongly in the Netherlands, Ireland, and Spain, although less so in Portugal and Greece. All countries experienced sustained inflation rate differentials, declining competitiveness, and deteriorating current accounts, although Ireland began from a strong surplus position. A key policy development in all countries except Greece and Portugal was the correction during the 1990s of substantial fiscal deficits.

The Netherlands experienced a sharp slowdown in the early 2000s, as eroding competitiveness hurt exports, and slowing house price increases and higher pension contributions sapped domestic demand. However, many of the imbalances that had built up were reversed: inflation differentials were closed, competitiveness erosion stopped, and the current account recovered.

The Portuguese economy fell into recession in 2003, as households curtailed demand in response to high debt levels, while investment collapsed amid low business confidence and weak economic prospects. The resulting adjustment of imbalances has been far from complete, although the inflation differential with the euro area closed.

Greece (like Ireland and Spain) has escaped such a slowdown, but vulnerabilities remain. The fiscal position has improved, although it is not as strong as it was in the Netherlands, which benefited from an established medium-term budget framework. Also, credit growth remains very high. However, Greece does not have the high levels of indebtedness that characterized both the Netherlands and Portugal, nor the rapid house price increases of the Netherlands, prior to their slowdowns. These factors suggest that imbalances may unwind gradually, in line with staff's central projection.

5. **The authorities shared concerns about competitiveness and the current account, but were optimistic about medium-term growth prospects**. They pointed to the room for productivity catch-up, a resurgence in tourism, and promising Greek commercial prospects in southeastern Europe. They expected aggregate supply to be augmented by robust investment, supported by EU funds, and structural reforms. They noted that export growth picked up in 2005, and expected another strong result in 2006; they felt that improved efforts to market Greek products abroad had bolstered exports. The mission agreed that the Greek economy has consistently surprised on the upside in recent years, and that the staff projection that potential will slow by nearly one percentage point in the next 5 years may not materialize, but argued that sustaining this performance would require further structural reform. Moreover, the substantial erosion of competitiveness will take time to reverse, requiring strong productivity growth and considerable wage moderation (Box 3).

Box 3. Restoring External Competitiveness

Restoring competitiveness will require cutting unit labor cost growth below the corresponding growth rate in other euro area countries, either by moderating wage growth or further raising productivity growth. To illustrate the difficulty involved, on the staff's baseline productivity assumptions it would take 5 years to eliminate the estimated competitiveness gap if nominal wages were frozen, and twice as long if nominal wages grew at 2 percent a year.

Structural reforms could contribute significantly to the process by boosting labor productivity and, by strengthening competition, holding down prices. For example, a 1 percentage point increase in productivity growth and a 0.3 percentage point decline in inflation (a temporary effect lasting only while competition intensified) would shorten the time needed to close the competitiveness gap by 1½ years.

The elimination of the competitiveness gap could, all else equal, reduce the current account deficit by about 3 percent of GDP. Completing the adjustment in 5 years through exports alone, however, would require nominal export growth of about 12 percent a year for 5 years, some 4¼ percentage points higher than in the staff baseline scenario. Notwithstanding the rebound in exports in 2005–06, this is ambitious, and suggests that some of the adjustment will have to come from lower demand.

B. Fiscal Policy

6. **The authorities began cutting the deficit sharply in 2005**. The deficit fell to 4.2 percent of GDP in 2005, and the 2006 budget targets 2.1 percent of GDP (2.6 percent on the old national accounts basis). For the two years 2005–06, 2.4 percentage points of the cumulative estimated deficit decline of 4 percent of GDP was primary spending restraint (including 1.3 percentage points attributable to the end of the Olympics); 0.9 percentage point was accounted for by revenue increases. However, in contrast to 2005, the focus in 2006 shifted to revenue increases, reflecting progress in combating tax fraud, a 1 percentage point increase in the VAT, and the introduction in mid-2006 of higher excise taxes on tobacco and mobile phones.

7. **It was agreed that, notwithstanding the adjustment to date, further deficit cuts will be needed in the years ahead**. The authorities have announced their intention of achieving budget balance or surplus by 2012, although since they have not articulated medium-term policies to achieve this outcome the deficit reductions in the staff baseline scenario are much smaller. This goal is somewhat less ambitious than the staff's recommendation of a cyclically adjusted balance by 2010 and a surplus after that (Table 6). The mission argued that further declines in the deficit would be appropriately countercyclical in the short term, provide greater room for a fiscal cushion should the economy slow, and foster a rapid reduction of the public debt before the costs of population aging begin to mount around the middle of the next decade.

8. **The mission emphasized the need for high-quality consolidation that would leave room for needed investment and tax cuts**. International experience strongly suggests that a focus on restraint of current primary spending promotes sustained fiscal adjustment.[5] By comparison with other countries, the Greek public-sector wage bill, defense, and, to a lesser extent, social transfers are relatively high, suggesting restraint in these areas might be warranted. The authorities agreed on the need to control spending, especially in view of their intention to continue with tax reform (see below).

9. **The 2007 budget targets little deficit reduction**. As a fraction of GDP, the general government deficit falls by only 0.2 percent of GDP, reflecting lower interest payments, while both revenues and primary spending are little changed. The authorities stressed that, having front-loaded deficit cuts in 2005–06, it is appropriate for the pace of consolidation to ease. Moreover, they noted that temporary measures built into the 2006 budget (worth 0.3 percent of GDP) will not be repeated in 2007, which they viewed as implying a structural improvement of 0.5 percent of GDP. The mission, while welcoming the end of the temporary measures and the consequent improvement in the quality of adjustment, argued that a larger actual deficit cut was warranted, both for countercyclical purposes and as a step toward the medium-term objective of budget balance.

Greece: Budget 2007
(In percent of GDP)

	2006		2007	
	Old GDP	New GDP	Old GDP	New GDP
Central government				
Expenditure	25.6	20.3	25.4	20.2
Revenue	30.0	23.8	29.7	23.6
Balance	-4.4	-3.5	-4.3	-3.4
General government				
Expenditure	46.4	36.8	46.2	36.6
Revenue	43.8	34.7	43.7	34.7
Balance	-2.6	-2.1	-2.4	-1.9
General government gross debt	104.8	83.2	100.8	80.0

10. **The authorities are introducing tax reforms which may entail some fiscal cost**. The corporate tax rate is scheduled to fall to 25 percent (20 percent for smaller firms) in 2007. The government is also reforming the personal income tax to increase the basic exemption and reduce marginal tax rates (except the top 40 percent rate for incomes over €75,000). Because the reform is phased in, the authorities judged the revenue implications for 2007 to be very small. The mission underscored that revenue losses should be minimized by reducing distortionary exemptions—especially since a simplification of the tax code would help to improve tax administration—or compensated by further spending compression.

11. **Crucial reforms of tax administration and public expenditure management are beginning to be put in place**. In 2005, FAD provided advice on these issues, as well as a fiscal transparency ROSC.

[5] See Chapter 2 of the Selected Issues Paper for the international evidence and application to Greece.

- On the tax side, the authorities noted the formation of a compliance improvement committee, reform of auditing services, strengthening of VAT operations, stronger enforcement of arrears collection, and improvements in the penalties and appeals process. Nevertheless, a number of measures—including regional tax directorates, risk-based enforcement and auditing, simplification of VAT returns, and adjustment of penalties to improve compliance—are under consideration but not yet implemented, and the larger problem of widespread tax evasion persists.

- On the expenditure side, a new audit directorate is to be established in the Ministry of Economics and Finance (MoEF). The mission emphasized that its audits would have to go well beyond the current practice of focusing on proper paperwork, and instead examine whether programs meet objectives and spending is efficient, a point the authorities agreed with. Initial steps have been taken on program-based budgeting (PBB), with the current administratively based spending system being translated into nine broad program categories. The mission argued that this approach would have to be developed further to ensure that the categories are detailed enough to match policy objectives and that budgeting start with PBB and then be translated into specific spending items. The authorities had no immediate plans to introduce a medium-term budget framework, which the mission argued would help in setting fiscal priorities.

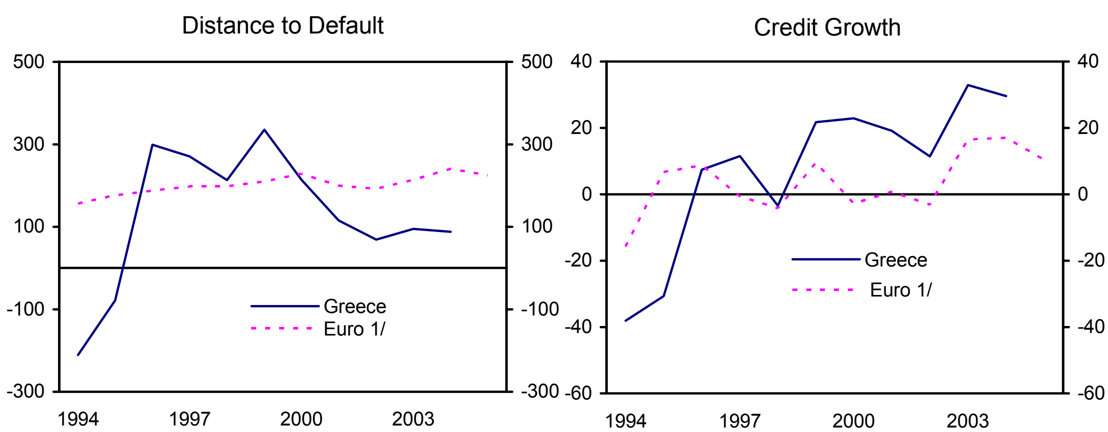
12. **Pension and health-care costs will begin to rise early in the coming decade and deep reforms will be needed to avoid jeopardizing the public finances**. Estimates dating from 2000 imply that these costs will rise by some 10½ percent of GDP by 2050, among the largest increases in the EU. The mission urged that the reform process be stepped up, noting that the preparation of new cost estimates seemed to be taking longer than expected, in part because the National Actuarial Authority (NAA), which is charged with the task, is still understaffed. These estimates are to be used by a high-level commission (the "Analytis Commission") to inform the political debate and by the ILO to provide a pension model. The mission also expressed concern that the social dialog needed to prepare the ground for reform had not advanced far. The authorities planned no reforms before the next election, in accordance with a previous election pledge, but did intend to step up enforcement of certain past reforms and had intensified efforts to reduce contribution evasion. They also felt that the process of formulating policies was on schedule, and agreed that discussion among the social partners and the public would be key. Regarding health care, the authorities are introducing better controls, especially over procurement (a source of overruns and arrears in the past). The mission agreed that these measures would prove useful, but cautioned that international experience illustrated the difficulties of containing costs while providing high quality medical services.

C. The Financial Sector

13. **The banking sector appears generally sound**. Solvency and liquidity are satisfactory and recent stress tests conducted by the Bank of Greece (BoG, the banking supervisor) indicate that capital adequacy ratios would remain well above regulatory

thresholds even if credit risks materialized.[6] Profits are robust, driven by rising lending volumes in Greece and southeastern Europe, wide margins (themselves, however, potentially a sign of insufficient competition), and some cost cutting (Tables 7, 8, and 9).

14. **However, vulnerabilities identified in the FSAP remain, suggesting a need to continue close supervision**. The rapid rise in credit (Figure 7) may result in households becoming overextended (although credit-GDP ratios are still low by international standards) and mask weaknesses in banks' loan portfolio. Persistently high NPLs in the face of rapid loan growth suggest that banks continue to lend to poor risks. And, with loan outstripping deposit growth, banks increasingly turn to higher-cost market funding, although the level of the deposit-loan ratio is still relatively high. Vulnerabilities could be exacerbated in the event of a marked economic downturn, the impact of which is uncertain since the liberalized banking system has yet to experience a full cycle. Also, staff analysis shows that, in contrast to other euro area countries, the increase in Greek banks' vulnerability since the late 1990s has coincided with the pickup in credit growth.[7] Moreover, Greek banks with higher credit growth seem to be more vulnerable to economic slowdowns. The mission argued that these considerations call for heightened prudential measures, including sharpening banks' incentives to manage risk by further increasing provisioning and write-offs of NPLs, for intensified monitoring of risks by the BoG, and for urging banks to continue to improve their risk management tools and practices.



Sources: Bankscope; IMF, International Financial Statistics; and staff estimates.
1/ Excluding Greece.

15. **The authorities have responded to such risks in a number of ways**. The BoG has intensified its monitoring of credit developments, including by studying the characteristics of

[6] The BoG examined retail credit risk, and tested for sensitivity by raising the probability of default by 30 percent.

[7] See Chapter 3 of the Selected Issues Paper. The vulnerability of banks is measured by their distance-to-default, which indicates the probability of a loss exceeding equity capital.

debtors to assess risks better. It has also introduced prudential measures to limit credit to highly indebted households and increase provisioning and write-offs of NPLs. Commercial banking representatives argued that sophisticated risk-management tools and strategies were in place and, like the BoG, saw no pertinent systemic risks. Regarding the expansion of Greek commercial banks into southeastern Europe—recently, the National Bank of Greece acquired a Turkish and a Serbian bank—the authorities reported that they had strong and open relationships with other supervisors in the region, and that they monitor the risk management systems Greek banks use in countries in the region.

16. **The other parts of the financial sector have not benefited from liberalization nearly as much as banks have**. The capital market, second pillar pension, and insurance sectors remain very small, and the last is in weak financial condition. While supervision of the first two seems adequate, insurance supervision has in the past been weak. Legislation for a new, independent insurance supervisor was passed in early 2004, and the authorities reported that, after several postponements, the new body would be fully operational in early 2007. The mission urged that the transition to the new body be rapid, but also as smooth as possible to avoid either disruption in the industry or gaps in supervision. Meanwhile, both the authorities and industry representatives reported that the existing supervisor, part of the Ministry of Development, has stepped up its activity, including by conducting more on-site inspections and closing some insurers.

D. Structural Reform and Medium-Term Growth

17. **An overarching goal of the authorities' economic policies is to enhance productivity and improve the business climate**. The staff supported these objectives, noting that key policy requirements are further reform of product and labor markets to improve the business climate, and continued infrastructure investment.

18. **In product markets, a number of important reforms have been implemented, but the process is still incomplete**. Simplified procedures for manufacturing business startups and "one-stop shops" are in place, overtime regulations have been eased somewhat, network industries (telecoms, electricity, and gas) are being liberalized, and state-owned enterprises (SOE) are being reformed by changing work rules to those in the private sector (for newly hired employees) and increasing oversight of their business plans. The authorities were considering extending the simplified startup procedures to the much larger commercial sector, and the overhaul of antiquated bankruptcy legislation appears to be nearing fruition. The authorities are also drawing up plans to improve the currently very low returns on public properties, and are continuing privatization, most recently by selling stakes in three banks and planning a further offering of the telephone operator OTE.

19. **The authorities stressed the importance of dealing with the unrecorded economy and fighting corruption**. This issue has an important fiscal dimension, and the national accounts revisions have thrown the size of the untaxed economy into relief: Greece's statutory tax rates are similar to those in other European countries, but the ratio of revenue to

GDP, at about 34½ percent, is relatively low, indicating the extent to which the tax base has been eroded by avoidance and evasion.[8] The authorities reformed the tax inspectorate in 2005, and have begun to press on social security contribution evasion. However, they noted that the culture of evasion appears to be deeply rooted.

20. **Rather less progress has been made on labor markets**. The authorities planned no further reforms in this area until after the elections, although they agreed that measures to increase participation rates and lower unemployment rates would be key to sustaining growth and relieving wage pressures, thereby improving international competitiveness. Noting that centralized collective bargaining agreements (including minimum wages) resulted in somewhat high (relative to productivity) minimum wages and a compressed wage scale (Figure 8), the mission argued a more decentralized system would be beneficial. Banks have been attempting to decentralize bargaining in their sector, but face stiff union resistance. The mission also argued for easing employment protection legislation to encourage hiring.

21. **There was agreement on the importance of infrastructure investment for medium-term growth**. The 2005 public-private partnership (PPP) law, meant to increase the efficiency of infrastructure investments, has gone into operation, with a number of projects in the bidding or planning stage. The authorities stressed that PPPs have to pass cost-benefit considerations and will be subject to full cost accounting and transparency. Only smaller projects (less than €200 million) fall under the law, a situation that is likely to remain unchanged. However, even larger projects are to be examined by the same MoEF staff that analyzes the smaller ones before approval. EU funds have been an important source of infrastructure financing in Greece, and the authorities reported that they planned to continue efforts to step up absorption under CSF3. The authorities have developed plans to streamline absorption under CSF4, and they noted that the national accounts revisions, which raised Greek per capita GDP and therefore would in the future reduce eligibility for EU funds, are expected to have very little effect under CSF4.

E. Data Issues

22. **The authorities announced, at end-September 2006, large revisions to the national accounts (Box 4)**. GDP has been revised up by some 26 percent for 2000–05, sharply reducing many fiscal ratios as well as the current account deficit as a ratio to GDP. The authorities explained that the new estimates were official and that, beginning in 2006, national accounts are no longer being produced using the old methodology. Nevertheless, the figures for 2002–05 are still provisional, because information from new surveys has not been fully incorporated. The initial reception in the press and among some analysts was one of some skepticism, given the size of the revision and the pressure on Greece to bring its deficit below 3 percent of GDP this year. The authorities, noting that the 2006 deficit was set to fall below that mark even on the old output estimates, emphasized the technical nature of the

[8] The situation may be worse still, because the national accountants do not believe the revisions captured the full underground economy.

revisions and the independence of the statistical service (NSSG). Nevertheless, the incident suggested to staff that the public credibility of the NSSG should be strengthened, especially as it had been called into question in 2004 when the fiscal numbers were significantly restated. The mission therefore encouraged the authorities to make the NSSG independent of the MoEF, and the authorities concurred. The authorities also agreed that revisions should be more timely, perhaps at five-year intervals, to avoid such large changes in the future.

Box 4. National Accounts Revisions

At end-September, 2006 the Greek authorities announced large revisions to the national accounts for 2000–05. The level of GDP was revised up by about 26 percent, although real growth rates were little changed. Since the nominal values of the general government deficit and public debt were not affected, their ratios as percentage of GDP became markedly smaller. This was the first major revision since the application of ESA79 to the base year of 1988, which resulted in a 20 percent revision of GDP.

The authorities emphasized that the revisions are meant to bring Greece national accounts into conformity with ESA95 and resolve a number of reservations raised by Eurostat regarding earlier estimates. Indeed, the bulk of the revision (20.9 percentage points of the 25.7 percent revision in 2000, the new base year) are accounted for by this latter factor. The estimates for 2002−05 are still provisional because the results of the new surveys have yet to be incorporated.

The revision incorporates the 2001 general census, new surveys on retail and wholesale commerce, transport, hotels, and dwellings, better use of administrative databases, and new estimates of rents, the capital stock, and capital consumption. For 2000, the census raised estimates of total employment of persons by 10.4 percent. More than half the output revision is concentrated in four branches: wholesale trade (16.4 percent), hotels and restaurants (15.4 percent), construction (11.1 percent), and other business activities (10 percent).

Greece: Revision of National Accounts Data

	2000	2001	2002	2003	2004	2005
GDP at current prices 1/						
Old	124.4	133.1	143.5	155.5	168.4	181.1
New	156.5	168.0	181.0	196.6	212.7	228.2
Change	25.8	26.2	26.2	26.4	26.3	26.0
General Government Deficit						
in percent of old GDP	-4.0	-4.9	-5.2	-6.1	-7.8	-5.2
in percent of new GDP	-3.2	-3.9	-4.1	-4.9	-6.2	-4.2
General Government Debt						
in percent of old GDP	113.3	114.1	110.7	107.8	108.5	107.5
in percent of new GDP	90.1	90.4	87.8	85.3	85.9	85.3
Current Account Deficit						
in percent of old GDP	-8.5	-8.0	-7.1	-7.1	-6.2	-7.8
in percent of new GDP	-6.8	-6.3	-5.6	-5.6	-4.9	-6.2
Unemployment Rate						
Old	11.7	11.2	10.9	10.4	11.0	10.4
New	11.4	10.8	10.3	9.7	10.5	9.9

Source: National Statistical Service of Greece.
1/ In billions of euros.

23. **Data have improved substantially in many areas and are adequate for surveillance**. Following the large fiscal revisions, noncentral government fiscal data, especially on pension funds, have improved considerably with the institution of a quarterly census of the relevant bodies. Nonetheless, apparently undetected arrears built up in the hospital sector, causing another (relatively small) fiscal restatement in 2005, and the general government deficit was revised up by ¼ to ¾ percent of GDP for 2002−05, reflecting the new census on pension funds. The mission encouraged the authorities to publish financing-side fiscal data and properly seasonally adjusted quarterly national accounts data. Regarding the latter, the authorities reported that the project to improve the quarterly data is near completion and new series are due for publication in 2007.

III. Staff Appraisal

24. **The economic boom of the past several years continued in 2006, and growth is likely to be strong in 2007 as well**. Domestic demand is supported by low interest rates, rapid credit expansion, and rising employment. Two years of sharp fiscal consolidation are over, corporate tax cuts and structural reforms have begun to underpin activity, world oil prices have moderated, and Greece's prospects in southeastern European markets seem favorable. The external sector remains a drag on growth, but despite several years of eroding cost competitiveness goods exports have shown resilience, reflecting in part the pickup in export markets. There are nevertheless risks, including the effects of euro appreciation and the possibility that the U.S. and world economies may slow more sharply than now expected.

25. **Medium-term growth will probably slow gradually as imbalances that have built up during the boom unwind, but there is a risk of a sharper correction**. The large current account reflects strong domestic demand, and persistent wage and price inflation differentials with the euro area which have eroded competitiveness. The very high rates of credit growth observed in recent years, while in part a desirable and natural consequence of financial market liberalization, are unsustainable in the medium term. Indeed, the persistence of these imbalances would pose a medium-term threat of a sharper output adjustment. An orderly transition to a sustainable path will involve less domestic demand growth, more moderate wage increases—less than Greek productivity growth plus the euro-area inflation rate to reverse past competitive losses—and further reform of product and labor markets to raise potential growth and reduce the need for slower domestic demand growth.

26. **Fiscal consolidation has been the most urgent policy priority for the past three years, and the substantial deficit reductions in 2005–06 are commendable**. This effort was appropriately concentrated on expenditure, and appears to have imposed little cost in terms of output or employment losses. On currently available information, the 2006 budget deficit target seems likely to have been attained. However, adjustment shifted toward reliance on revenues, including through some one-off measures and increases in some indirect taxes.

27. **A steady and cumulatively significant strengthening of the public finances is still needed in the years ahead**, with the objective of achieving a cyclically adjusted budget balance in 2010 and a surplus after that. Further deficit cuts would help restrain domestic

demand and ease cost pressures, cushion the public finances in the event of an economic downturn, and promote a rapid reduction of the public debt to help deal with the looming costs of population aging. A focus on controlling current primary spending would preserve room for needed infrastructure investments and further tax cuts, and maximize the probability that fiscal adjustment will prove durable.

28. **The 2007 budget offers little further consolidation, although the buoyant economy provides an opportunity to take bolder action**. As a fraction of GDP, the general government deficit falls only slightly, reflecting mainly lower interest payments, and both revenues and primary spending are little changed. Any opportunity to cut the deficit more in the course of 2007 should be seized. The decision to end the recourse to the temporary measures of 2006 is a welcome improvement to the quality of fiscal adjustment; looking forward, only durable measures should be used to meet deficit-reduction goals.

29. **Further tax reforms are welcome, but should not be allowed to jeopardize needed fiscal consolidation**. The reduction of the corporate tax rate will improve the business climate. Regarding personal income tax reform, the most significant benefits would flow from broadening the tax base by phasing out the long list of distortionary exemptions, which would improve economic efficiency, reduce the burden on taxpayers, and foster improvements in tax administration.

30. **Substantial reforms to tax administration and expenditure management are welcome, and need to be pressed further**. They will be critical to sustaining fiscal consolidation, strengthening the operations of the state, and improving the business climate. The full benefits of program-based budgeting will be reaped only when this approach is fully integrated into budget preparation and execution. The new directorate of fiscal audit should focus on evaluating programs against objectives and ensuring value for money. A medium-term budget framework should also be developed, as it would help to guide fiscal strategy and prioritize policy objectives, including during the further consolidation needed in the years ahead. Tax evasion remains a particular problem, undermining revenues and imposing a high burden on those in the formal economy. The authorities' initiatives to tackle this problem, which appear to have borne fruit in 2006, should therefore be redoubled.

31. **Unless the social security system is fundamentally reformed, the long-term costs of population aging will threaten the sustainability of the public finances**. The necessary task of estimating aging costs has proceeded slowly, and therefore the National Actuarial Authority should quickly be brought up to full strength and data provision by social security funds speeded up. It will be crucial for an early adoption of concrete measures that all social partners step up efforts to build momentum for reform. Welcome reforms are underway in the health-care sector, but the key challenge remains providing quality medical services while containing costs.

32. **The banking system appears to be sound, but persistently high loan expansion and nonperforming loans raise vulnerabilities**. Households may become overextended and asset quality degraded as credit continues to grow at very high rates, and the persistence of high NPL ratios indicates that banks may need to refine their risk management practices

further. The proactive approach of the Bank of Greece is commendable. Looking forward, it will be important to continue to carefully supervise banks' risk management practices, intensify monitoring of risks, and strengthen banks' incentives to contain risks, including by ensuring sufficient provisioning and further writeoffs of NPLs. With the increasing presence of Greek banks in southeastern Europe, the BoG needs to maintain close relations with other supervisors in the region. Regarding the insurance sector, the new supervisor should be made fully operational and care taken to ensure a smooth transition as it takes up its duties.

33. **Strengthening international competitiveness will require further reforms to product and labor markets, and public administration**. Greece still lags on many indicators of competitiveness. The program of product market reform should be extended, including by extending simplified business licensing procedures to all sectors, hastening liberalization of network industries, and redoubling efforts to combat corruption and widespread tax evasion. Further initiatives in the labor market, which has seen less reform, include relaxation of strong employment protection legislation and decentralization of the bargaining system.

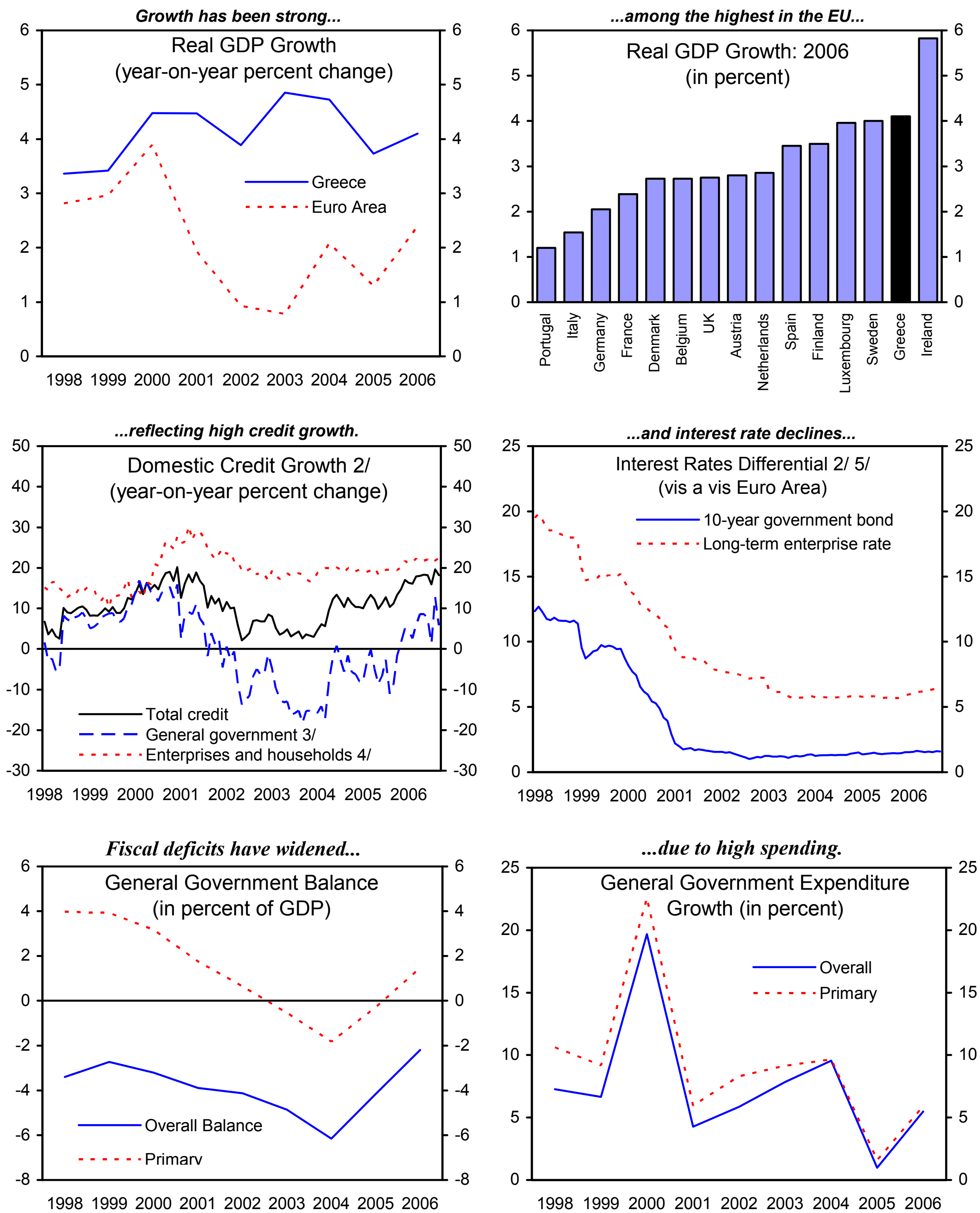
34. **Recent moves to improve the performance of state-owned enterprises (SOEs) are welcome**. However, as a group these enterprises remain relatively inefficient and, by registering commercial losses, are a cost to the budget. Therefore, their management should be strengthened further and held accountable for performance, and the newly submitted business plans followed up carefully. Further privatizations, most recently the sale of stakes in the telephone operator OTE and three banks, are also welcome, and should be continued, including by privatizing those SOEs that have been put on a commercial footing.

35. **The new public-private partnership (PPP) law provides a framework for this increasingly important method of financing infrastructure investment**. Although projects are just beginning to be put in place under the new law, the intention to subject projects considered for PPP financing to cost-benefit tests and to integrate them into the wider public investment strategy is welcome. A full accounting for the costs, including future budgetary obligations, should be presented in a transparent way alongside the budget.

36. **Economic statistics have improved in recent years, but need to be strengthened appreciably further**. Improvements to the quarterly national accounts, which are in train, and the publication of full financing-side fiscal data are two urgent priorities. The recently announced revision to the national accounts points to desirability of a policy of timely updates, and the initial skeptical reaction in many quarters to the announcement of the revisions suggests the need to strengthen the credibility of the national statistical office, particularly by granting it independent status.

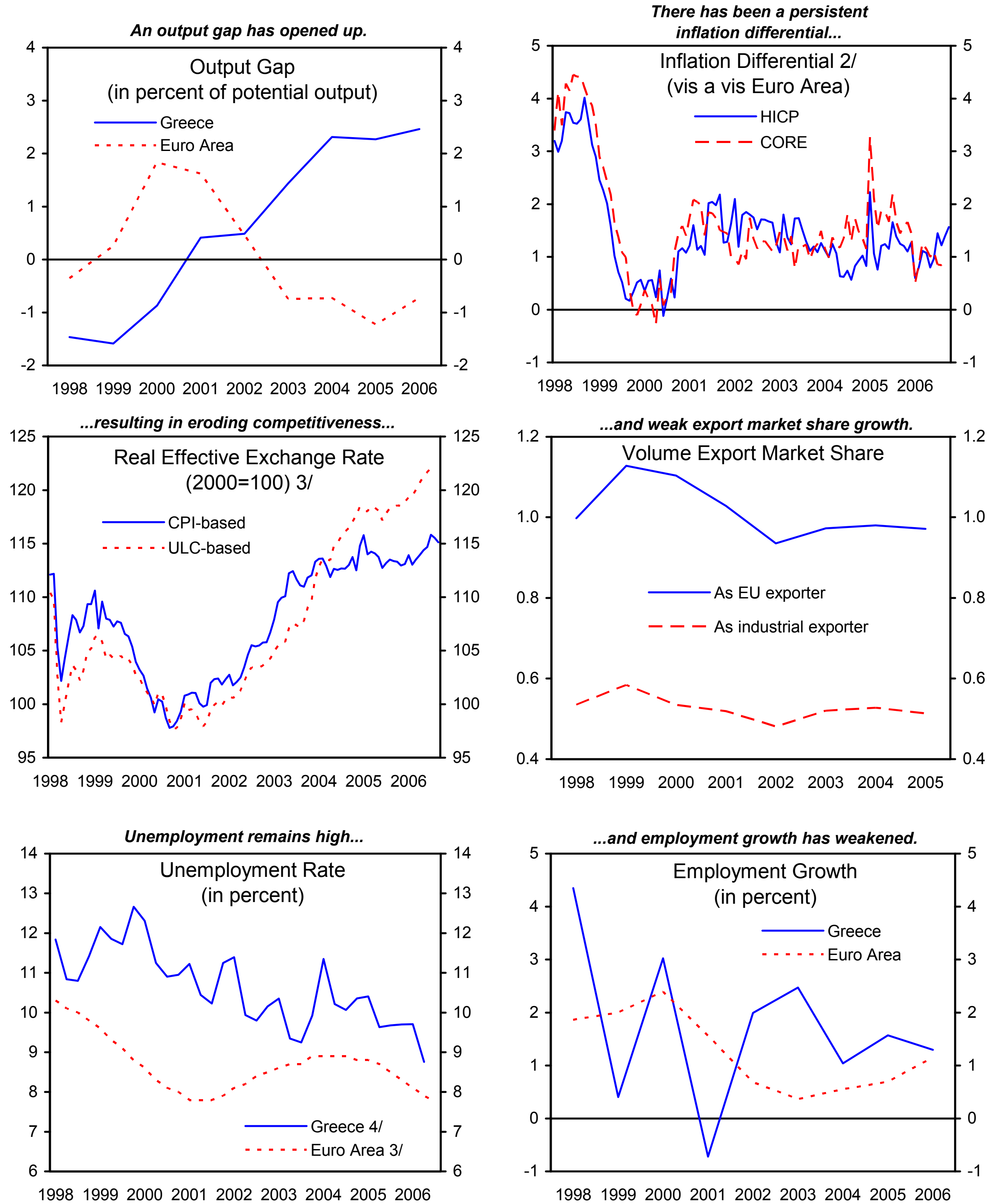
37. It is recommended that the next Article IV consultation take place on the normal 12-month cycle.

Figure 1. Greece: Selected Indicators, 1998–2006 1/



Sources: IMF, *International Financial Statistics;* IMF, *World Economic Outlook;* National Statistical Service Greece; Bank of Greece, *Bulletin of Conjunctural Indicators*; and Bloomberg.
1/ Projections for 2006 unless otherwise noted.
2/ Data for 2006 as of September.
3/ Data prior to 1999 refer to public sector.
4/ Data prior to 1999 refer to private sector.
5/ Enterprise lending rate from 2003 onwards.

Figure 1. Greece: Selected Indicators, 1998–2006 (Concl.) 1/



Sources: IMF, *Information Notice System;* IMF, *World Economic Outlook;* and National Statistical Service of Greece.

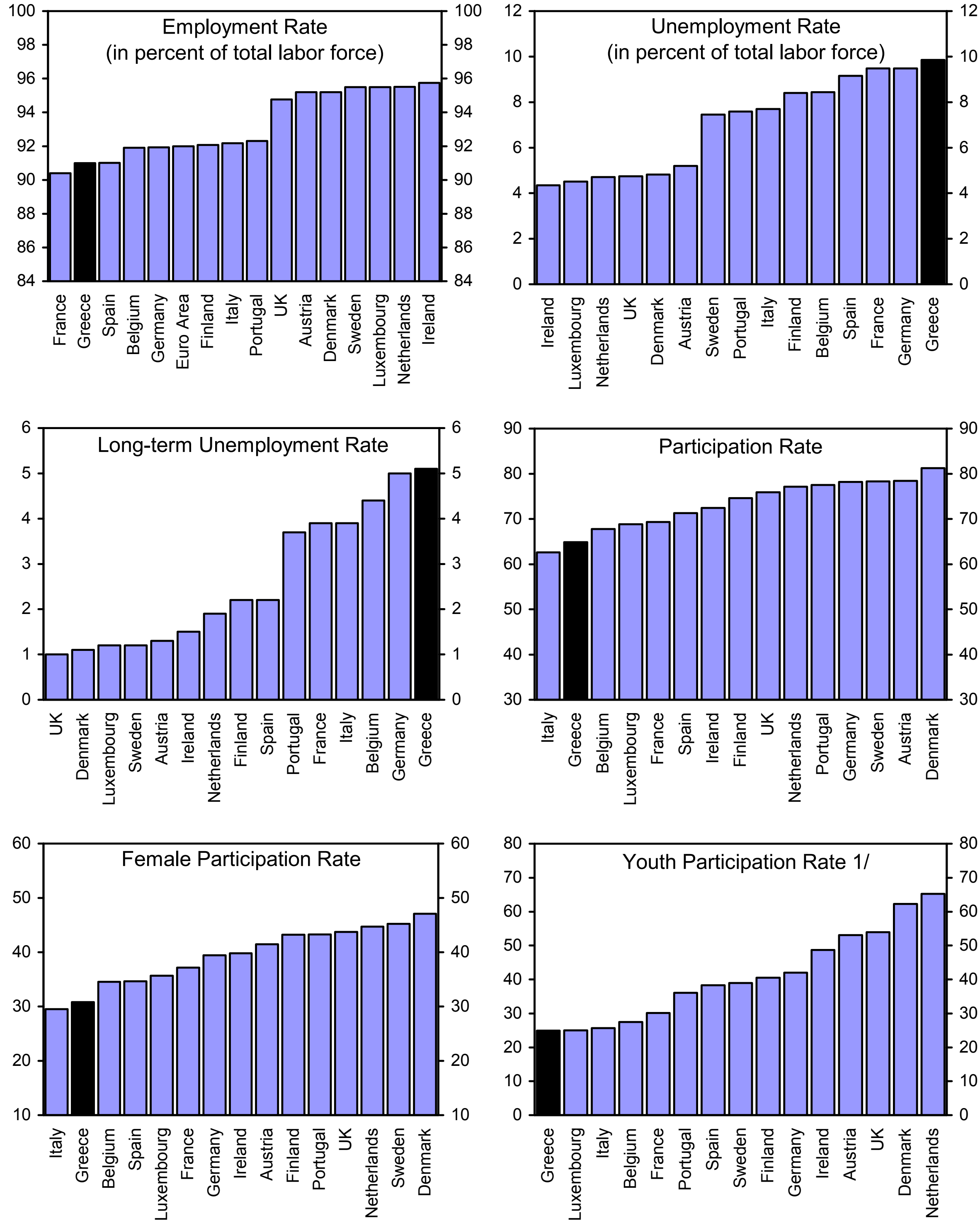
1/ Projections for 2006 unless otherwise noted.

2/ Data for 2006 as of October.

3/ Data for 2006 as of September.

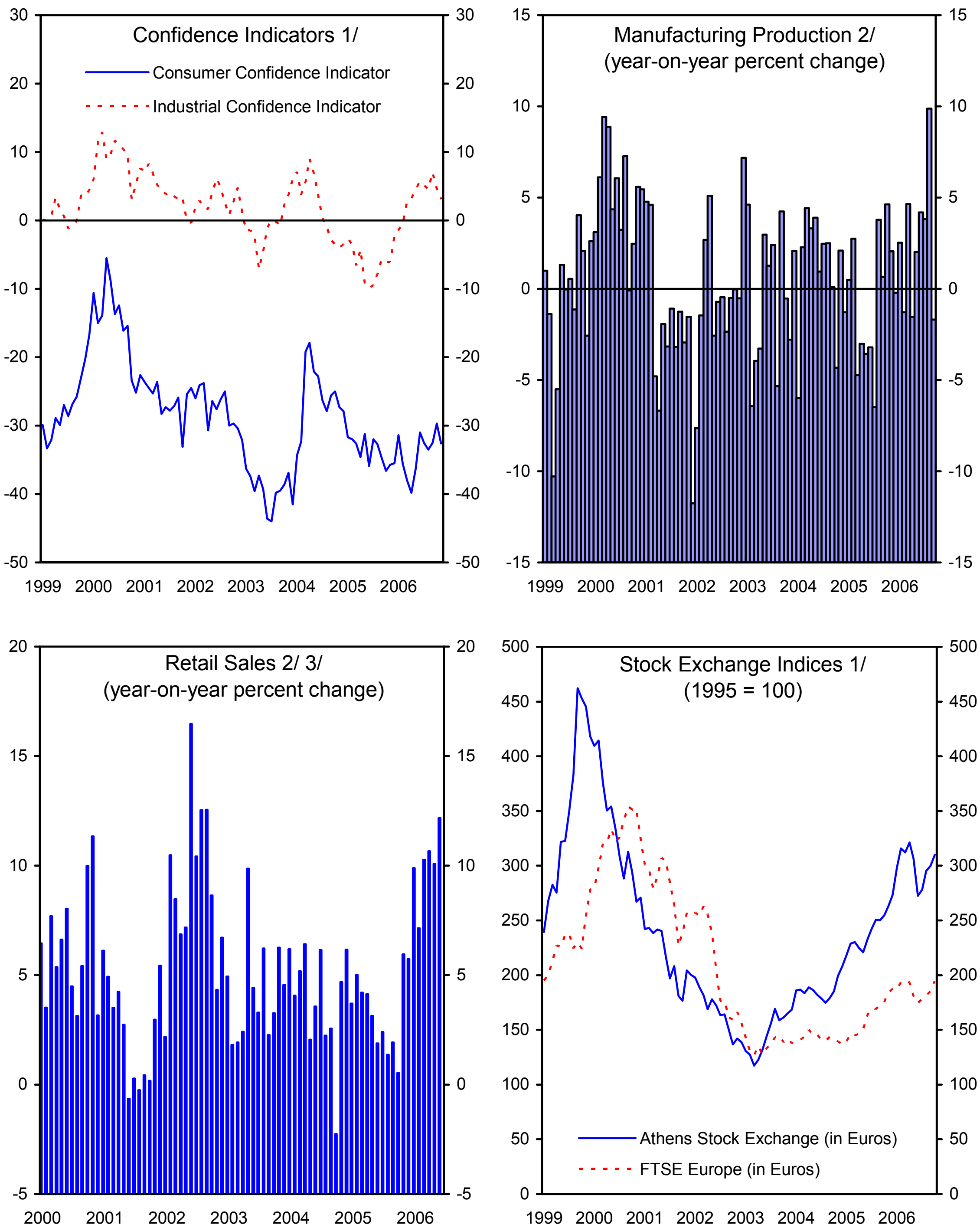
4/ Data for 2006 as of June.

Figure 2. Greece: Labor Market Indicators, 2005



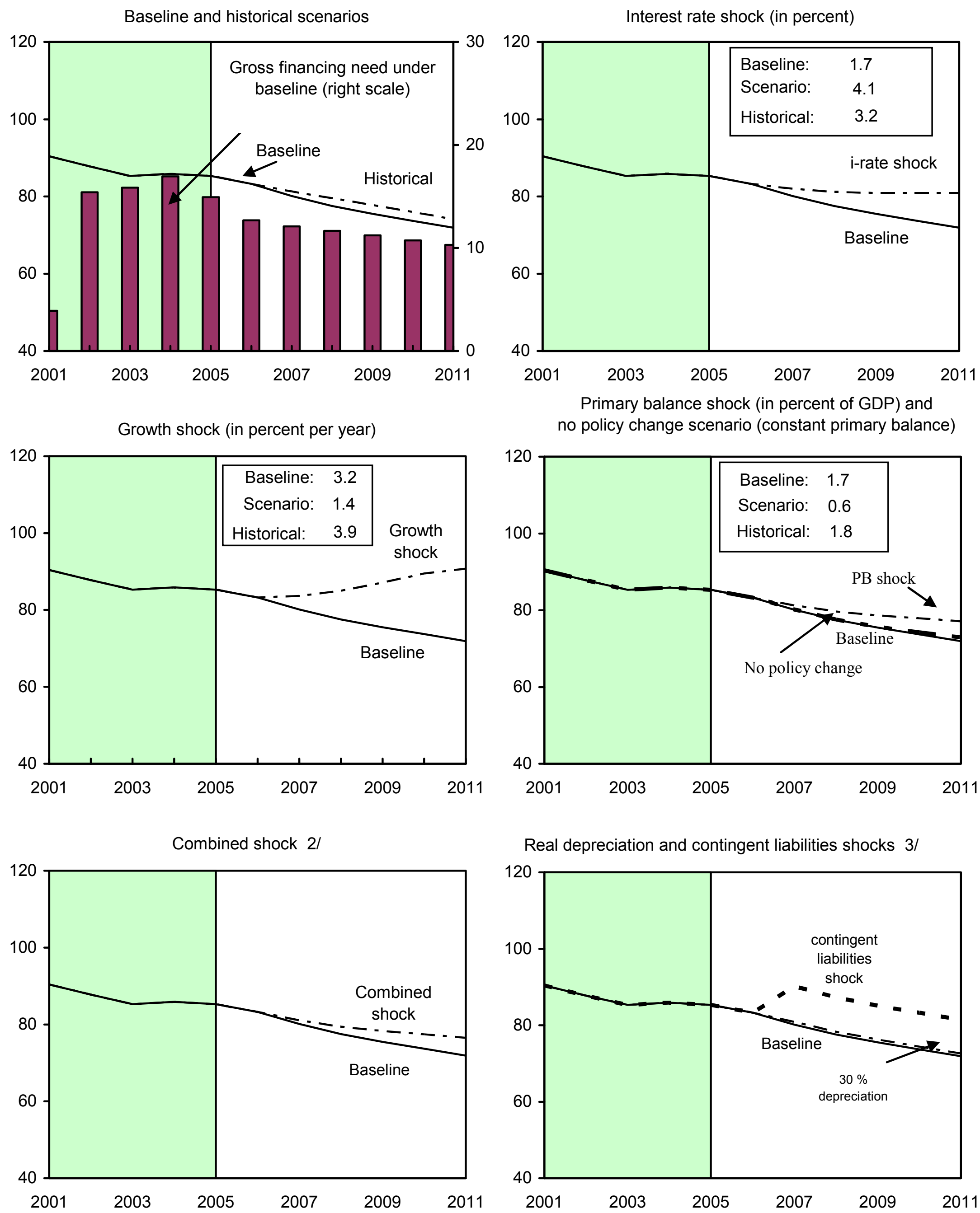
Sources: Eurostat; IMF, *World Economic Outlook;* and OECD, *Economic Outlook.*
1/ Youths are between 15 and 24 years of age.

Figure 3. Greece: Cyclical Indicators, 1999–2006



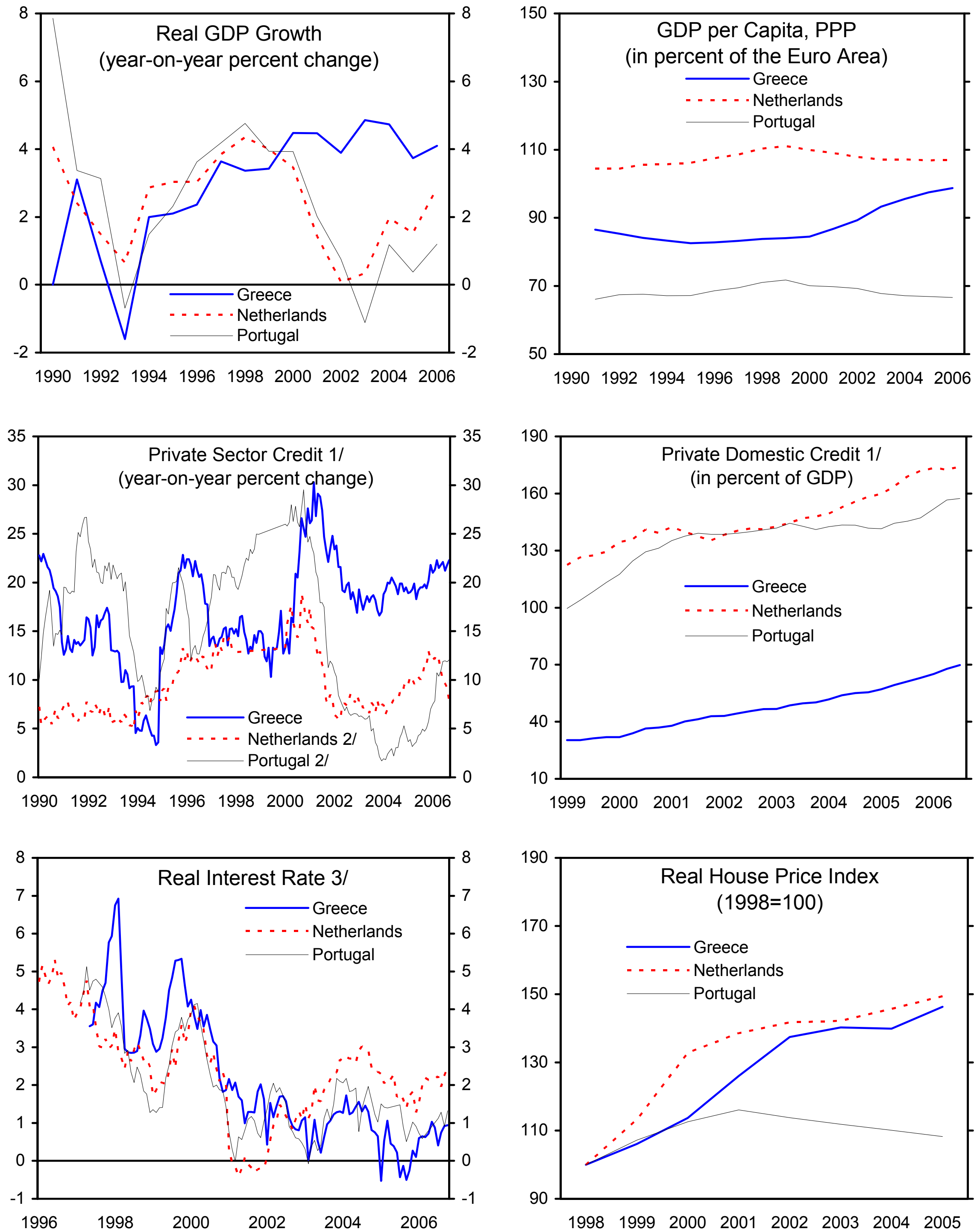
Sources: IMF, *International Financial Statistics;* OECD; Bank of Greece, Bulletin of Conjunctural Indicators; and Bloomberg.
1/ Data for 2006 as of November.
2/ Data for 2006 as of September.
3/ Seasonally adjusted.
4/ Data for 2006 as of October.

Figure 4. Greece: Public Debt Sustainability: Bound Tests 1/
(Public debt in percent of GDP)



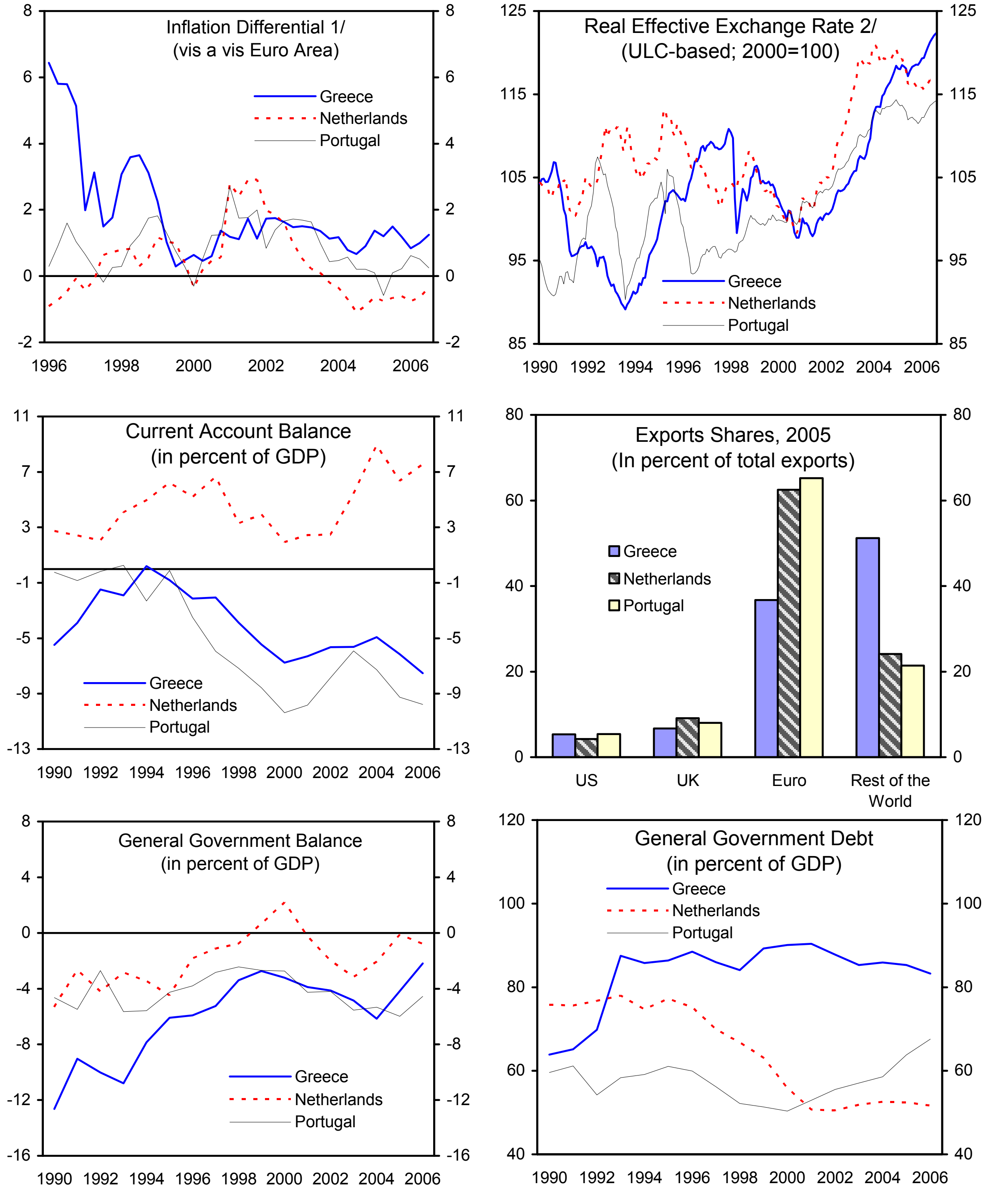
Sources: International Monetary Fund, Country desk data, and staff estimates.
1/ Shaded areas represent actual data.Individual shocks are permanent one-half standard deviation shocks exept for the interest rate and growth shocks. The growth shock assumes that real GDP growth drops to 0.7 percent in 2007 and it recovers gradually to 2.8 percent by 2011. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and primary balance.
3/ One-time real depreciation of 30 percent and 10 percent of GDP shock to contingent liabilities occur in 2007, with real depreciation defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).

Figure 5. Greece, Netherlands and Portugal, 1990–2006



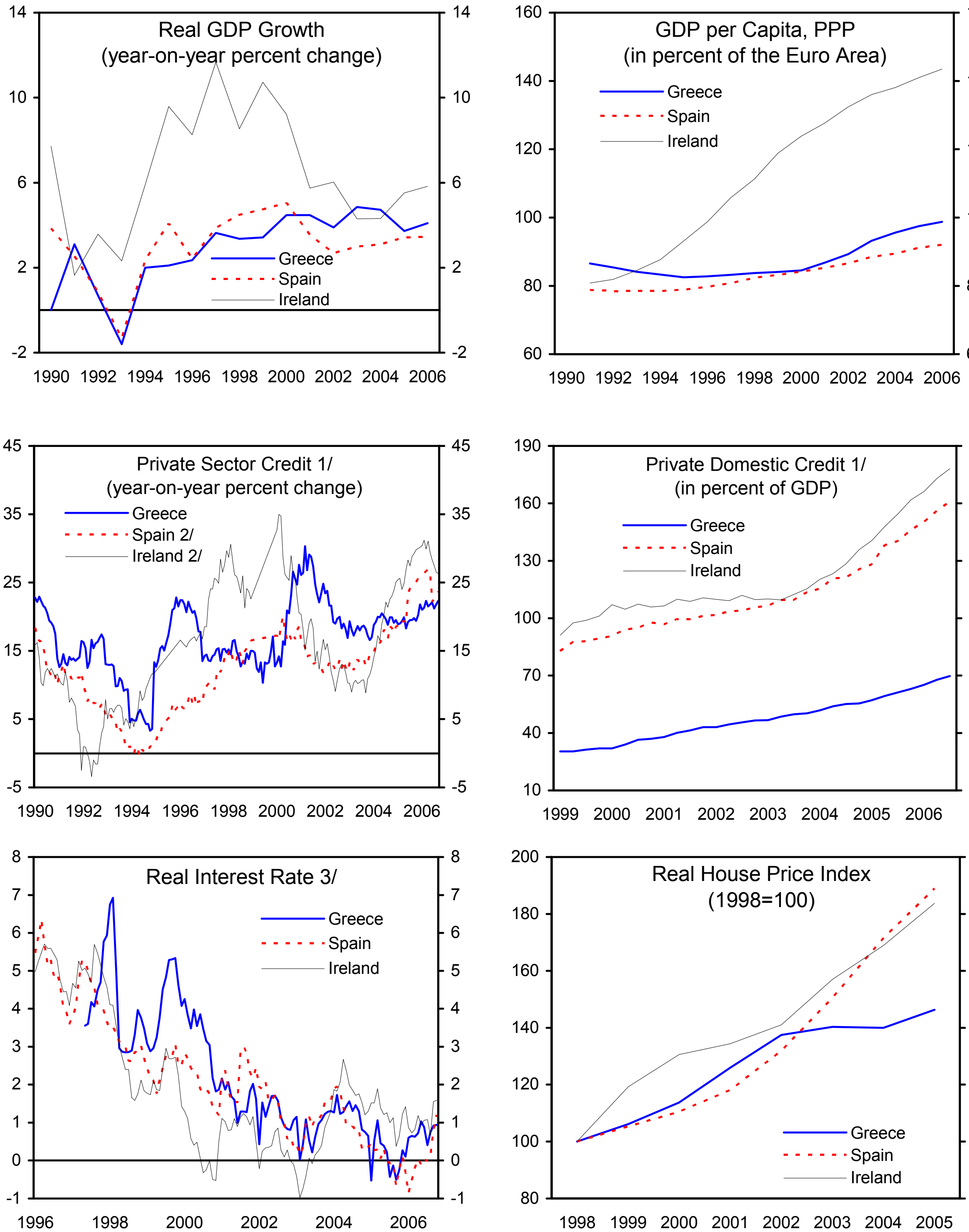
Sources: IMF, *International Financial Statistics;* IMF, *World Economic Outlook;* Bank of Greece, *Bulletin of Conjunctural Indicator*; and Bloomberg.
1/ Data for 2006 as of September.
2/ Break in series for 1998 with adoption of Euro.
3/ Data for 2006 as of October.

Figure 5. Greece, Netherlands and Portugal, 1990–2006 (Concl.)



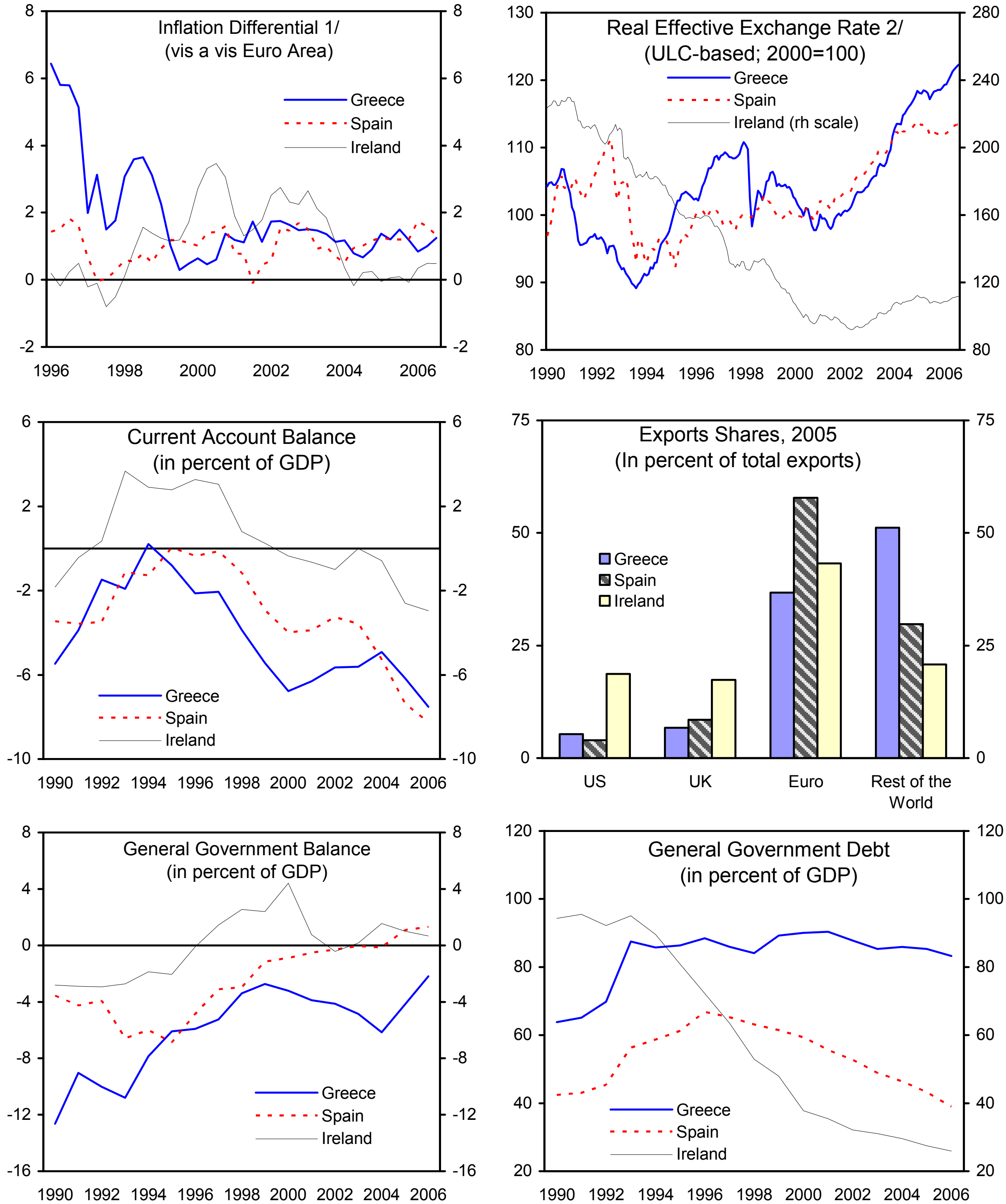
Sources: IMF, *World Economic Outlook;* and IMF, *Direction of Trade.*
1/ Data for 2006 as of September.
2/ Data for 2006 as of August.

Figure 6. Greece, Ireland, and Spain, 1990–2006



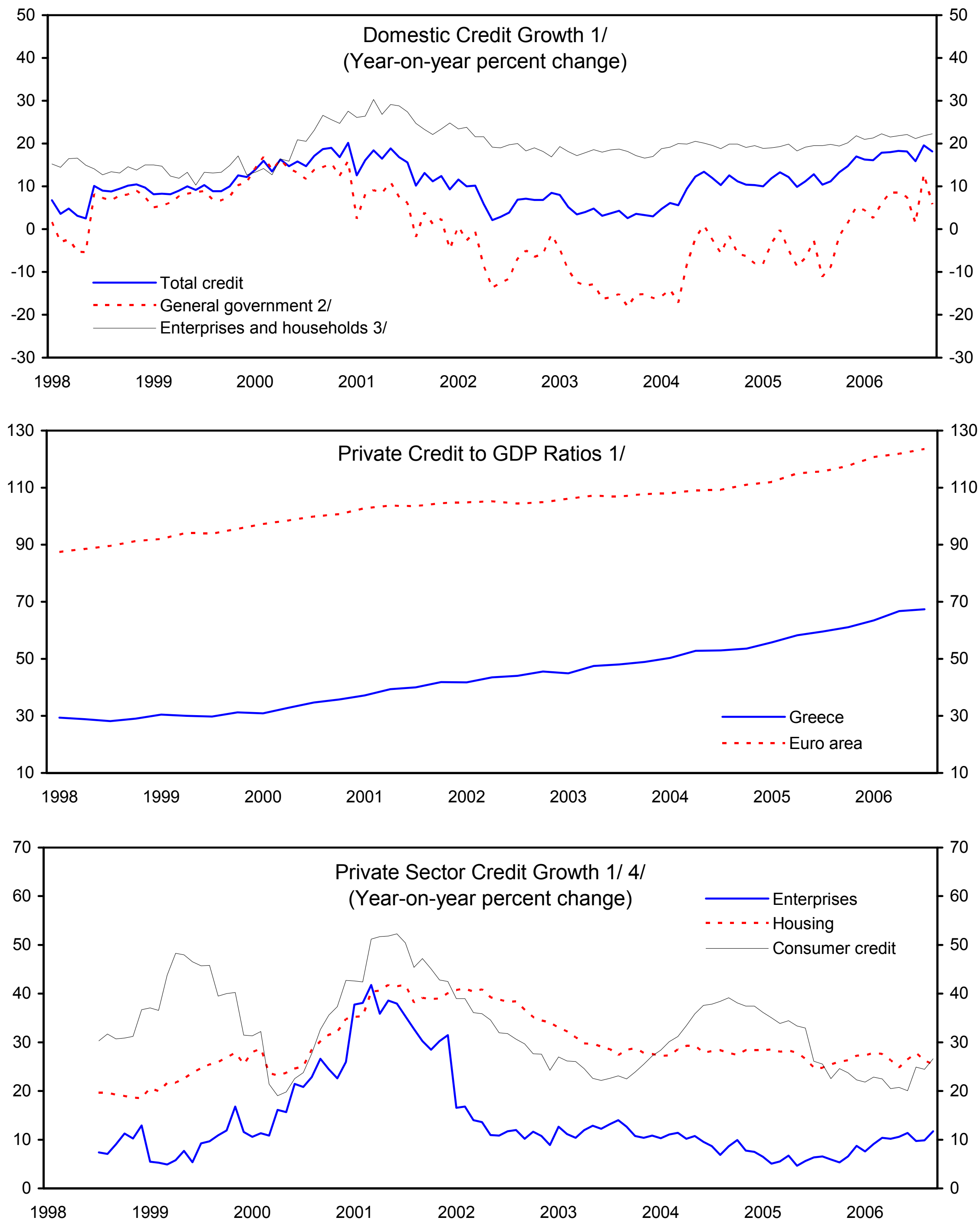
Sources: IMF, *International Financial Statistics;* IMF, *World Economic Outlook;* Bank of Greece, *Bulletin of Conjunctural Indicator*; and Bloomberg.
1/ Data for 2006 as of September.
2/ Break in series for 1998 with adoption of Euro.
3/ Data for 2006 as of October.

Figure 6. Greece, Ireland, and Spain, 1990–2006 (Concl.)



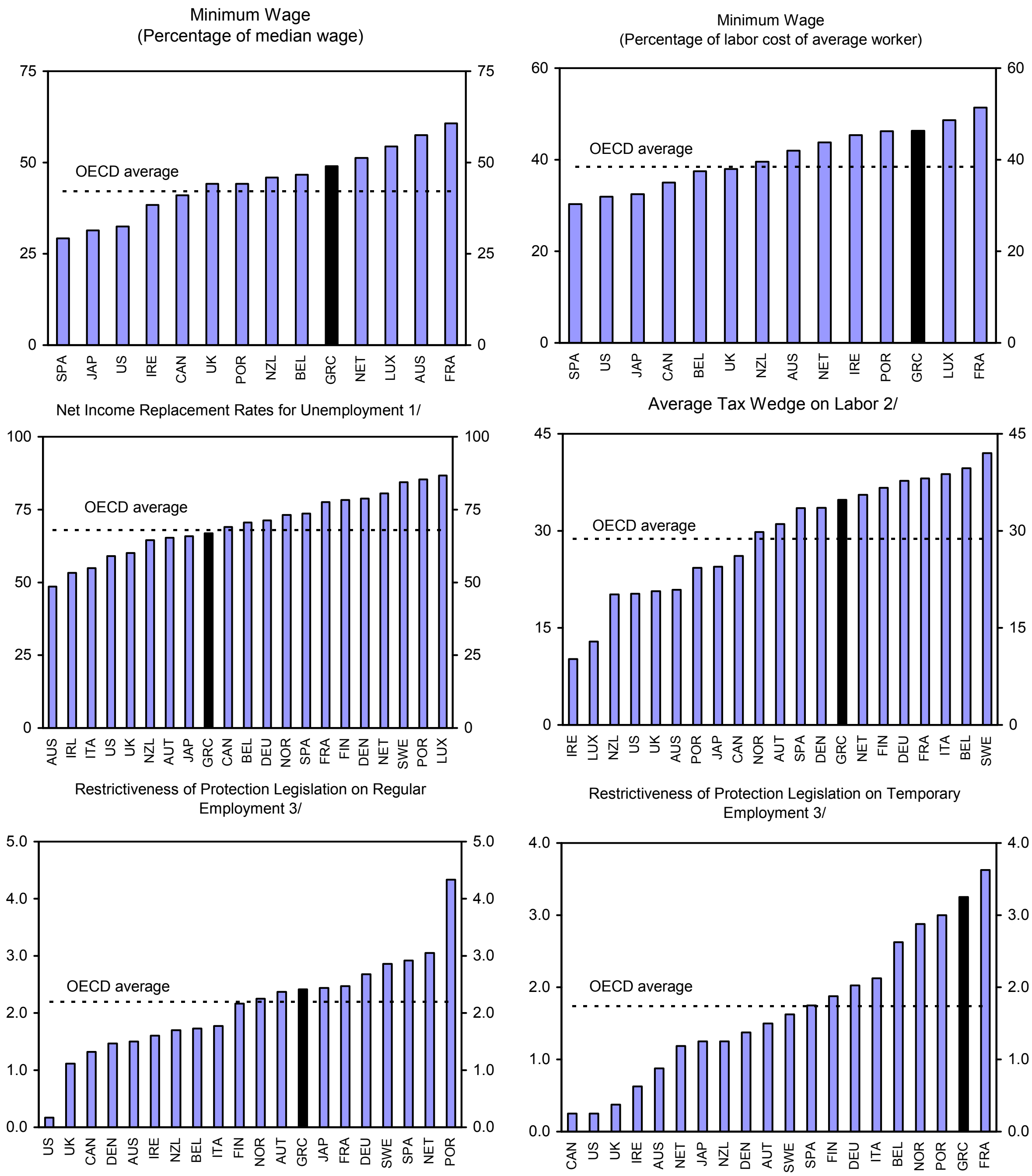
Sources: IMF, *World Economic Outlook*; and IMF, *Direction of Trade*.
1/ Data for 2006 as of September.
2/ Data for 2006 as of August.

Figure 7. Greece: Credit Developments, 1998–2006
(In percent)



Source: IMF, *International Financial Statistics*; National Statistical Service of Greece; and Bank of Greece, *Bulletin of Conjunctural Indicators.*
1/ Data for 2006 as of September.
2/ Data prior to 1999 refer to public sector.
3/ Data prior to 1999 refer to private sector.
4/ Data prior to 2000 refers to commercial bank credit.

Figure 8. Greece: Labor Market Policy Indicators, 2003



Source: OECD.
1/ Replacement rates for short-term unemployment.
2/ At 100 percent of average worker earnings. Data as of 2004.
3/ Index scale of 0-6 from least to most restrictive.

Table 1. Greece: Selected Economic Indicators, 2001–07

	2001	2002	2003	2004	2005	2006	2007
						Proj.	
	(Percentage changes, unless otherwise indicated)						
Domestic economy							
GDP	4.5	3.9	4.9	4.7	3.7	4.1	3.8
Output gap	0.4	0.5	1.5	2.4	2.3	2.5	2.4
Domestic demand	3.9	4.5	5.4	4.6	2.4	4.7	4.0
Private consumption	4.8	3.8	4.2	4.6	3.7	3.9	3.4
Public consumption	0.4	6.5	-1.3	2.5	-0.5	2.1	1.7
Gross fixed capital formation	3.2	5.6	13.3	5.8	0.2	8.2	7.0
Change in stocks (contribution)	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Foreign balance (contribution)	0.4	-1.0	-0.7	-0.3	1.3	-0.9	-0.6
Exports	-3.0	-7.7	4.0	7.5	3.7	4.5	4.8
Imports	-3.3	-1.7	4.9	5.6	-2.1	6.4	5.4
Unemployment rate 1/	10.8	10.3	9.7	10.5	9.9	9.0	8.8
Employment	-0.1	2.2	2.4	0.9	1.3	1.9	1.1
Unit labor costs (economy wide)	2.8	3.0	2.4	3.2	3.3	3.0	3.0
Consumer prices (HICP), period average	3.7	3.9	3.4	3.0	3.5	3.3	3.2
Core prices, period average	3.5	3.6	3.0	3.2	3.3	...	...
GDP deflator	2.7	3.7	3.6	3.3	3.4	3.4	3.3
	(In percent of GDP, settlements basis)						
Current Account	-6.3	-5.6	-5.6	-4.9	-6.2	-7.5	-7.4
Trade balance	-7.4	-6.6	-5.7	-4.7	-5.2	-6.1	-6.1
Export of goods and services	20.0	17.4	16.6	18.5	18.3	18.3	18.5
Export of goods	6.9	5.8	5.7	5.9	6.2	6.5	6.6
Exports of services	13.1	11.7	10.9	12.6	12.1	11.8	11.9
Imports of goods and services	27.4	24.0	22.2	23.2	23.5	24.4	24.6
Balance on capital account	4.1	5.7	4.9	3.5	5.4	6.7	6.6
Of which: Direct investment inflows	1.1	0.0	0.3	0.5	-0.1	0.2	0.2
Portfolio investment inflows	5.9	7.3	10.7	11.9	11.3	9.8	9.5
Change in reserves (- is an increase in reserves)	3.7	-1.1	2.2	1.2	0.0	0.0	0.0
Public finances (general government)	(In percent of GDP)						
Total revenues	36.5	35.6	34.5	33.7	33.4	34.6	34.7
Total expenditures	40.4	39.7	39.4	39.9	37.6	36.8	36.6
Primary expenditures	34.7	34.9	35.1	35.6	33.7	33.1	33.1
Overall balance	-3.9	-4.1	-4.9	-6.2	-4.2	-2.2	-2.0
Primary balance	1.8	0.6	-0.5	-1.8	-0.3	1.5	1.5
Structural overall balance	-4.0	-4.3	-5.4	-7.0	-4.9	-3.1	-2.8
Gross debt	90.4	87.8	85.3	85.9	85.3	83.3	80.2
Memorandum items:							
Nominal effective exchange rate 2/	0.7	1.7	3.6	0.9	-2.7	0.9	...
Real effective exchange rate (consumer prices) 2/	1.0	2.9	4.9	1.3	-1.5	1.5	...
Real effective exchange rate (manufacturing ULCs) 2/	0.5	3.1	4.2	1.9	0.4	3.3	...
Nominal GDP (in billions of euros)	168	181	197	213	228	246	263

Sources: National Statistical Service; Ministry of National Economy; Bank of Greece; and Fund staff estimates.

1/ Labor Force Survey. Figures for 2004 not fully comparable with those for previous years because of new sample as of 2004.

2/ Latest data is for September.

Table 2. Greece: General Government Accounts, 2001–07 (Baseline Scenario)

	2001	2002	2003	2004	2005	2006 Authorities' Estimate	2006 Staff Projection	2007 Authorities' Estimate	2007 Staff Projection
					(Billions of Euro)				
Revenues	61.3	64.4	67.9	71.7	76.2	85.3	85.0	91.2	91.2
Taxes on production and imports	19.4	20.2	20.8	21.6	22.8	25.5	25.4	28.0	28.0
Taxes on income and property	12.5	13.4	13.5	14.7	16.8	17.5	17.5	18.6	18.6
Social insurance contributions	18.4	21.3	23.7	24.7	26.1	28.2	28.2	30.7	30.7
Other	8.9	7.6	7.3	7.3	7.5	10.0	9.7	9.5	9.5
Capital transfers	2.1	1.9	2.6	3.4	3.1	4.1	4.1	4.5	4.5
Expenditures	67.9	71.8	77.5	84.9	85.7	90.5	90.4	96.3	96.5
of which: wage bill	15.2	17.3	18.4	21.1	21.9	23.3	23.3	24.7	24.7
Consumption	25.8	28.9	29.5	31.7	32.5	34.3	34.3	35.9	35.9
Social transfers, excl. those in kind	22.5	24.2	27.3	28.9	31.5	33.9	33.9	37.0	37.0
Interest	9.5	8.6	8.5	9.2	8.8	9.0	9.0	9.2	9.2
Subsidies	0.2	0.2	0.2	0.2	0.3	0.1	0.1	0.1	0.1
Other current expenditure	1.4	1.6	2.1	2.7	2.8	2.8	2.8	2.9	3.0
Investment expenditure	8.4	8.4	9.8	12.2	9.8	10.3	10.3	11.2	11.2
of which: Olympics related expenditures	0.2	1.2	1.7	2.7	0.6	0.0	0.0	0.0	0.0
Overall balance	-6.5	-7.5	-9.6	-13.1	-9.5	-5.2	-5.4	-5.1	-5.2
Primary expenditures	58.4	63.2	69.0	75.6	76.8	81.5	81.4	87.1	87.2
Primary balance	3.0	1.2	-1.1	-3.9	-0.7	3.8	3.6	4.1	4.0
					(In percent of GDP)				
Revenues	36.5	35.6	34.5	33.7	33.4	34.8	34.6	34.7	34.7
Taxes on production and imports	11.6	11.1	10.6	10.2	10.0	10.4	10.4	10.6	10.6
Taxes on income and property	7.5	7.4	6.9	6.9	7.3	7.1	7.1	7.1	7.1
Social insurance contributions	11.0	11.8	12.1	11.6	11.4	11.5	11.5	11.7	11.7
Other	5.3	4.2	3.7	3.4	3.3	4.1	4.0	3.6	3.6
Capital transfers	1.2	1.1	1.3	1.6	1.4	1.7	1.7	1.7	1.7
Expenditures	40.4	39.7	39.4	39.9	37.6	36.8	36.8	36.6	36.6
of which: wage bill	9.0	9.6	9.4	9.9	9.6	9.5	9.5	9.4	9.4
Consumption	15.4	15.9	15.0	14.9	14.2	14.0	14.0	13.7	13.6
Social transfers, excl. those in kind	13.4	13.4	13.9	13.6	13.8	13.8	13.8	14.0	14.0
Interest	5.7	4.8	4.3	4.3	3.9	3.7	3.7	3.5	3.5
Subsidies	0.1	0.1	0.1	0.1	0.1	0.0	0.0	0.0	0.0
Other current expenditure	0.9	0.9	1.0	1.2	1.2	1.2	1.1	1.1	1.2
Investment expenditure	5.0	4.6	5.0	5.7	4.3	4.2	4.2	4.3	4.3
of which: Olympics related expenditures	0.1	0.7	0.9	1.3	0.3	0.0	0.0	0.0	0.0
Overall balance	-3.9	-4.1	-4.9	-6.2	-4.2	-2.1	-2.2	-1.9	-2.0
Primary expenditures	34.7	34.9	35.1	35.6	33.7	33.2	33.1	33.1	33.1
Primary balance	1.8	0.6	-0.5	-1.8	-0.3	1.6	1.5	1.6	1.5
Structural primary balance	1.6	0.5	-1.1	-2.6	-1.1	...	0.6	...	0.7
Structural overall balance	-4.0	-4.3	-5.4	-7.0	-4.9	...	-3.1	...	-2.8
Memorandum items									
Gross debt	90	88	85	86	85	83	83	80	80
Nominal GDP (in billions of euros)	168	181	197	213	228	246	246	263	263

Sources: National Statistical Service; Ministry of National Economy; Bank of Greece; and Fund staff projections.

Table 3. Greece: Doing Business─Selected Indicators, 2005 1/

	Greece	EU-15 average (excl. Greece and Luxembourg)
Starting a Business		
Number of procedures	15.0	6.5
Time (days)	38.0	22.8
Cost (% of income per capita)	24.6	6.9
Licenses and Permits		
Number of procedures	17.0	13.7
Time (days)	176.0	179.9
Cost (% of income per capita)	71.9	84.0
Closing a Business		
Time (years)	2.0	1.4
Cost (% of estate)	9.0	9.4
Labor indices 2/		
Difficulty of Hiring Index	78.0	35.0
Rigidity of Hours Index	80.0	60.0
Difficulty of Firing Index	40.0	35.4
Rigidity of Employment Index	66.0	43.6
Firing costs (weeks of wages)	68.8	43.0

Source: World Bank, Doing Business 2006.

1/ Data are benchmarked to January 2005.
2/ Unless otherwise indicated, the figures are indices which range from 0 to 100, with higher numbers indicating greater rigidity.

Table 4. Greece: Medium–Term Baseline Scenario, 2004-11

	2004	2005	2006	2007	2008	2009	2010	2011
			Projections					
Domestic economy				(Percentage changes)				
GDP	4.7	3.7	4.1	3.8	3.5	3.0	2.8	2.8
Output gap	2.4	2.3	2.5	2.4	2.1	1.4	0.6	0.0
Domestic demand	4.6	2.4	4.7	4.0	3.4	2.8	2.6	2.6
Private consumption	4.6	3.7	3.9	3.4	2.8	2.8	2.6	2.6
Public consumption	2.5	-0.5	2.1	1.7	2.0	2.0	2.0	2.5
Gross fixed capital formation	5.8	0.2	8.2	7.0	5.7	3.3	2.7	2.5
Foreign balance (contribution)	-0.3	1.3	-0.9	-0.6	-0.2	-0.1	0.0	0.0
Exports	7.5	3.7	4.5	4.8	4.8	5.0	5.0	5.0
Imports	5.6	-2.1	6.4	5.4	4.0	3.6	3.4	3.4
Unemployment rate	10.5	9.9	9.0	8.8	8.6	9.0	9.3	9.5
Employment	0.9	1.3	1.9	1.1	1.1	0.5	0.6	0.6
Unit labor costs (economy wide)	3.2	3.3	3.0	3.0	3.0	3.0	3.0	3.0
Consumer prices (HICP), end of period	3.1	3.5	3.3	3.2	3.2	3.0	2.7	2.5
Consumer prices (HICP), period average	3.0	3.5	3.3	3.2	3.2	3.0	2.7	2.5
GDP deflator	3.3	3.4	3.4	3.3	3.3	3.0	2.7	2.5
				(In percent of GDP)				
External sector								
Current account (national accounts; settlements basis)	-4.9	-6.2	-7.5	-7.4	-6.9	-6.3	-5.9	-5.4
Trade balance (in percent of GDP, settlements basis)	-4.7	-5.2	-6.1	-6.1	-5.7	-5.2	-4.8	-4.4
Exports of goods and services	18.5	18.3	18.3	18.5	18.7	19.1	19.5	19.9
Imports of goods and services	23.2	23.5	24.4	24.6	24.4	24.3	24.2	24.3
Current transfers	1.7	1.4	1.3	1.2	1.1	1.1	1.0	1.0
Net income receipts	-1.9	-2.4	-2.7	-2.5	-2.3	-2.2	-2.1	-2.0
Capital account	1.1	0.9	0.8	0.8	0.7	0.7	0.7	0.6
Financial account	3.5	5.4	6.7	6.6	6.1	5.7	5.2	4.8
Direct investment (net)	0.3	-0.4	0.0	0.0	-0.1	0.0	-0.1	-0.1
Portfolio investment (net)	6.5	3.2	4.5	4.1	3.5	3.5	3.3	3.1
Other investment	-4.3	2.6	2.2	2.6	2.8	2.2	2.0	1.8
Change in reserves	1	0	0	0	0	0	0	0
Public finances (general government) 1/								
Total revenues	33.7	33.4	34.6	34.7	34.6	34.8	35.1	35.5
Total expenditures	39.9	37.6	36.8	36.6	36.5	36.6	36.7	36.9
Primary expenditures	35.6	33.7	33.1	33.1	33.1	33.2	33.3	33.5
Interest expenditures	4.3	3.9	3.7	3.5	3.4	3.4	3.4	3.3
Overall balance	-6.2	-4.2	-2.2	-2.0	-1.9	-1.8	-1.6	-1.4
Primary balance	-1.8	-0.3	1.5	1.5	1.5	1.6	1.8	2.0
Structural primary balance	-2.6	-1.1	0.6	0.7	0.7	1.1	1.6	2.0
Structural overall balance	-7.0	-4.9	-3.1	-2.8	-2.6	-2.3	-1.8	-1.4
Real primary spending growth	6.1	-1.7	2.4	3.8	3.4	3.4	3.0	3.4
Gross debt	86	85	83	80	78	76	74	72
Memorandum item								
Nominal GDP (in billions of euros)	213	228	246	263	281	299	315	332

Source: Fund staff estimates and projections.
1/ Assumes broadly constant ratio of revenue and primary expenditures to GDP as in 2005, and full utilization of EU structural funds.

Table 5. Greece: Summary of Balance of Payments

				Proj.					
	2003	2004	2005	2006	2007	2008	2009	2010	2011
				(In billions of euro)					
Current account balance	-11.0	-10.5	-14.0	-18.5	-19.4	-19.3	-18.9	-18.4	-18.0
Balance of goods and services	-11.1	-10.0	-11.8	-15.1	-16.0	-15.9	-15.5	-15.0	-14.6
Goods balance	-22.6	-25.4	-27.5	-30.9	-33.1	-34.7	-36.1	-37.5	-39.0
Exports of goods	11.1	12.7	14.2	16.0	17.4	18.9	20.5	22.2	23.9
Imports of goods	33.8	38.1	41.7	46.9	50.5	53.6	56.6	59.6	62.9
Services balance	11.5	15.5	15.7	15.8	17.1	18.7	20.6	22.4	24.5
Credit	21.4	26.7	27.6	28.9	31.2	33.7	36.4	39.1	42.1
Debit	9.9	11.3	11.9	13.1	14.1	15.0	15.8	16.7	17.6
Income balance	-3.8	-4.1	-5.4	-6.6	-6.6	-6.6	-6.6	-6.6	-6.6
Credit	2.3	2.5	2.9	2.9	2.9	2.9	2.9	2.9	2.9
Debit	6.0	6.6	8.2	9.4	9.4	9.4	9.4	9.4	9.4
Current transfers (net)	3.8	3.6	3.2	3.2	3.2	3.2	3.2	3.2	3.2
Capital and financial account balance	10.9	9.9	14.4	18.5	19.4	19.3	18.9	18.4	18.0
Capital account balance	1.2	2.4	2.0	2.0	2.0	2.0	2.0	2.0	2.0
Financial account	9.6	7.5	12.3	16.4	17.4	17.3	16.9	16.4	15.9
Direct investment	0.5	0.6	-1.0	0.1	-0.1	-0.3	-0.1	-0.2	-0.2
Portfolio investment	12.3	13.7	7.3	11.1	10.7	9.7	10.5	10.3	10.2
Financial derivatives	0.0	-0.3	0.0	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Other investment	-7.6	-9.1	5.9	5.3	6.9	8.0	6.6	6.4	6.1
Reserve assets	4.4	2.6	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net errors and omissions	0.1	0.2	-0.3	0.0	0.0	0.0	0.0	0.0	0.0
				(In percent of GDP)					
Memorandum items									
Current account balance	-5.6	-4.9	-6.2	-7.5	-7.4	-6.9	-6.3	-5.9	-5.4
Balance on goods and services	-5.7	-4.7	-5.2	-6.1	-6.1	-5.7	-5.2	-4.8	-4.4
Goods balance	-11.5	-12.0	-12.1	-12.6	-12.6	-12.3	-12.1	-11.9	-11.8
Services balance	5.9	7.3	6.9	6.4	6.5	6.7	6.9	7.1	7.4
Income balance	-1.9	-1.9	-2.4	-2.7	-2.5	-2.3	-2.2	-2.1	-2.0
Current transfers	2.0	1.7	1.4	1.3	1.2	1.1	1.1	1.0	1.0
Capital and financial account balance	5.5	4.6	6.3	7.5	7.4	6.9	6.3	5.9	5.4
Of which:									
Direct Investment	0.3	0.3	-0.4	0.0	0.0	-0.1	0.0	-0.1	-0.1
Portfolio Investment	6.3	6.5	3.2	4.5	4.1	3.5	3.5	3.3	3.1
Other Investment	-3.9	-4.3	2.6	2.2	2.6	2.8	2.2	2.0	1.8

Sources: National Statistical Service; and Fund staff estimates.

Table 6. Greece: Medium–Term Staff Policy (Adjustment) Scenario, 2002–12

(In percent of GDP)

	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
								Proj.			
Total revenues	35.6	34.5	33.7	33.4	34.6	34.7	34.6	34.8	35.1	35.5	35.7
Total expenditures	39.7	39.4	39.9	37.6	36.8	36.2	35.6	35.3	35.1	35.0	34.7
Primary expenditures	34.9	35.1	35.6	33.7	33.1	32.7	32.2	32.0	31.9	31.8	31.7
Interest expenditures	4.8	4.3	4.3	3.9	3.7	3.5	3.4	3.3	3.3	3.2	3.0
Overall balance	-4.1	-4.9	-6.2	-4.2	-2.2	-1.6	-1.0	-0.5	0.0	0.5	1.0
Primary balance	0.6	-0.5	-1.8	-0.3	1.5	1.9	2.4	2.9	3.3	3.6	4.0
Structural primary balance	0.5	-1.1	-2.6	-1.1	0.6	1.1	1.6	2.4	3.1	3.6	4.0
Structural overall balance	-4.3	-5.4	-7.0	-4.9	-3.1	-2.4	-1.7	-0.9	-0.2	0.5	1.0
Memorandum items:											
Gross debt	88	85	86	85	83	80	76	73	70	66	63
Real GDP growth	3.9	4.9	4.7	3.7	4.1	3.8	3.5	3.0	2.8	2.8	2.6
Real primary spending growth	4.4	5.4	6.1	-1.7	2.4	2.5	1.9	2.1	2.4	2.7	2.2
Real current primary spending growth	5.8	4.2	3.8	2.2	2.4	2.0	1.5	2.0	3.1	2.7	2.1

Sources: National Statistical Service; Ministry of National Economy; and Fund staff estimates and projections.

Table 7. The Core Set of Financial Soundness Indicators for Deposit Taking Institutions 1/

(1998−June 2006 unless otherwise indicated)

	1998	1999	2000	2001	2002	2003	2004	2005	2006 2/
Regulatory capital to risk-weighted assets 3/ 4/	10.2	16.2	13.6	12.4	10.5	12.0	12.8	13.2	12.3
Regulatory Tier I capital to risk-weighted assets 3/ 4/	9.7	15.3	13.5	10.9	8.8	9.8	10.0	10.9	10.3
Nonperforming loans net of provisions to capital 3/ 5/	29.3	24.1	23.2	17.4	18.7	16.1	16.3	18.0	19.1
Nonperforming loans to total gross loans 3/ 6/	8.7	11.2	7.2	5.6	5.5	5.1	5.4	5.5	5.5
Sectoral distribution of loans to total loans 7/ (enterprises and households, domestic and other euro area residents)									
Insurance corporations and pension funds 7/	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Other financial intermediaries 7/	0.7	0.4	1.1	2.2	3.2	2.6	2.3	1.6	1.5
Non-financial corporations 7/	75.0	72.2	70.5	65.7	60.4	57.7	54.4	50.4	49.5
Consumer credit 7/	7.3	8.4	9.3	10.6	11.3	12.3	14.3	15.2	15.7
Lending for house purchase 7/	17.0	18.8	18.8	21.0	24.3	26.1	27.6	31.4	32.0
Other lending to households and non-profit institutions serving households 7/	0.1	0.2	0.3	0.4	0.6	1.2	1.2	1.2	1.2
Return on assets (after taxes; on a non-consolidated basis) 8/	0.7	2.4	1.4	1.0	0.5	0.6	0.3	0.9	1.2
Return on equity (after taxes; on a non-consolidated basis) 8/	13.7	28.6	15.4	12.4	6.8	8.9	5.6	16.2	21.7
Interest margin to gross income 8/	55.1	44.5	54.5	62.8	72.5	73.9	76.3	75.3	71.1
Non-interest expenses to gross income 8/	62	48	53	59	69	63	62	55	48
Liquid assets to total assets 7/	55.2	50.3	46.4	41.1	39.5	37.0	33.4	34.0	34.2
Liquid assets to short-term liabilities 7/	62.6	64.6	60.7	53.0	48.7	46.5	43.2	47.0	46.8
Net open position in foreign exchange to capital 4/	...	...	...	3.5	7.2	5.8	3.5	2.9	0.6

Source: Bank of Greece.

1/ These may be grouped in different peer groups based on control, bsuiness lines, or group structure.
2/ June 2006 figures refer to Greek quoted banks unless otherwise indicated
3/ June 2006 figures refer to all banks
4/ Data on a consolidated basis
5/ This figure does not include ATEbank and rescheduled loans. If rescheduled loans were included, then the relevant ratios would become 18.7 for 2005 and 20 for June 2006.
6/ This figure does not include ATEbank and rescheduled loans. If rescheduled loans were included, then the relevant ratios would become 5.6 for 2005 and 5.6 for June 2006.
7/ 2006 figures refer to July 2006 and to all banks on a non-consolidated basis (i.e. commercial, cooperative and foreign branches)
8/ On a non-consolidated basis. From 2004 in accordance with IFRS.

Table 8. Greece: The Encouraged Set of Financial Soundness Indicators

(1998−June 2006 unless otherwise indicated)

	1998	1999	2000	2001	2002	2003	2004	2005	2006 1/
Corporate Sector									
Total debt to equity 2/	33.7	18.8	38.3	58.9	84.0	77.0	73.0	61.6	62.2
Return on equity 3/	...	...	...	...	13.8	14.2	12.7	14.6	...
Number of applications for protection from creditors 4/ 5/	2228	2029	1788	1463	1458	1545	2141	2036	827
Deposit-taking institutions 6/									
Capital to assets 7/	6.5	10.6	9.2	8.5	6.9	6.9	5.0	5.8	5.2
Geographical distribution of loans to total loans (enterprises and households) 3/ 8/									
Domestic 32/	95.3	90.8	93.9	94.7	95.6	96.3	96.6	96.8	96.9
Other euro area countries 3/	0.2	0.2	0.2	0.2	0.2	0.1	0.1	0.1	0.1
Non-euro area countries 3/	4.4	9.1	5.9	5.1	4.2	3.5	3.2	3.1	3.0
Large exposures to capital 8/	...	...	...	...	154.1	190.8	123.7	144.5	145.5
Trading income to total income 7/ 9/	14.8	27.5	17.3	13.1	4.9	4.6	3.2	1.6	4.2
Personnel expenses to noninterest expenses 7/	66.8	63.6	61.8	59.8	59.0	58.2	59.6	60.3	61.6
Spread between reference lending and deposit rates 3/	9.0	6.7	6.3	6.1	6.1	5.8	5.9	6.0	6.1
Customer deposits to total (non-interbank) loans 3/	191.1	190.8	176.3	166.0	147.4	135.3	130.6	127.5	124.2
Foreign currency-denominated liabilities to total liabilities 3/	34.5	25.7	24.5	16.6	12.8	13.2	12.9	12.5	12.5
Net open position in equities in capital 10/	...	...	...	21.5	12.9	10.4	5.8	3.4	4.6
Market liquidity									
Average bid-ask spread in the securities market 11/	45.5	23.7	14.0	9.8	9.4	8.2	6.1	7.9	7.8
Average daily turnover ratio in the securities market 11/ 12/	...	...	0.1	0.2	0.2	0.1	0.2	0.1	0.1
Other financial corporations									
Assets to total financial system assets 2/	106.7	124.9	114.3	112.9	105.7	105.7	103.9	111.0	113.9
Assets to GDP 2/	32.2	54.4	39.1	34.3	28.8	30.9	30.4	28.9	28.4
Households									
Household debt to GDP 2/ 3/	9.1	10.7	13.6	18.1	22.3	26.5	32.0	38.4	41.0
Real estate markets									
Residential real estate loans to total loans 3/ 13/	8.2	9.0	10.2	13.2	16.7	18.2	20.7	22.9	23.8

1/ June 2006 figures refer to Greek quoted banks unless otherwise indicated.
2/ For 2006 Q1 figures only. Figures refer to all banks on a non-consolidated basis (i.e. commercial, cooperative and foreign branches).
3/ 2006 figures refer to July 2006 and to all banks on a non-consolidated basis (i.e. commercial, cooperative and foreign branches.
4/ Other indicators of corporate distress would include spreads on corporate bonds, credit rating upgrades/downgrades, and delayed payments on loans or bonds.
5/ The figure for 2006 refers to May 2006.
6/ These may be grouped in different categories based on ownership, business lines, or group structure.
7/ Data on a non-consolidated basis. From 2004 in accordance with IFRS.
8/ May want to include indicators of connected lending such as the proportion of laons to controlling shareholders.
9/ If available, a breakdown of such income into fees from off-balance sheet activities might indicate the importance of such activities.
10/ Data on a consolidated basis.
11/ Or in other markets that are most relevant to bank liquidity, such as foreign exchange markets.
12/ Figures refer to volumes of securities traded and not numbers.
13/ Revised series. Interbank loans are included.

Table 9. Greece: Financial System Structure (1998−July 2006)

	1998	1999	2000	2001	2002	2003	2004	2005	2006 1/
Number									
Banks	23	20	19	23	24	22	21	21	22
Private commercial	12	10	8	12	12	12	13	13	13
State-owned	8	7	7	7	7	6	3	3	3
Foreign-owned subsidiaries	3	3	4	4	5	4	5	5	6
Branches of foreign banks	23	22	22	21	21	20	23	23	23
Securities companies	65	75	90	88	103	98	75	65	62
Life insurance companies 2/	22	21	20	18	18	19			
General insurance companies 2/	104	93	90	89	84	81	89	86	87
Other credit institutions	14	15	16	17	17	17	18	18	17
Concentration									
Banks 3/	9	7	7	7	7	7	7	7	7
Assets 4/									
Banks	100.2	124.9	145.7	158.7	165.5	174.0	186.6	228.6	254.6
Private commercial	26.1	41.8	43.2	44.8	46.7	52.4	115.6	134.7	145.4
State-owned	69.6	74.4	84.4	92.6	92.1	91.5	40.7	44.2	35.7
Foreign-owned subsidiaries	4.5	8.7	18.1	21.3	26.8	30.1	30.4	49.7	73.6
Branches of foreign banks	16.4	17.9	22.3	17.8	17.4	19.2	23.0	28.5	31.2
General insurance companies	5.0	7.2	7.8	7.9	8.4	9.6	...	15.5	17.7
Other credit institutions	12.1	12.7	13.6	15.2	16.6	17.7	20.7	24.3	13.2
Deposits 4/									
Banks	76.0	82.7	89.9	98.6	102.9	112.4	125.8	151.3	169.6
Private commercial	18.4	25.4	23.6	25.9	26.9	30.8	69.5	86.9	93.1
State-owned	54.5	53.4	55.9	59.0	59.9	63.2	31.3	34.0	29.7
Foreign-owned subsidiaries	3.1	3.9	10.3	13.6	16.1	18.4	25.0	30.4	46.8
Branches of foreign banks	8.2	7.5	8.5	8.9	8.9	9.5	12.7	16.9	18.3

Source: National authorities.

1/ 2006 figures refer to July 2006 unless otherwise indicated.
2/ All insurance companies. 2006 figures refer to Q1 2006.
3/ Number of institutions with 75 percent of total assets (of all credit institutions operating in Greece, i.e. banks, branches of foreign banks and other credit institutions).
4/ Euro billion.

Table 10. Greece: Indicators of External and Financial Vulnerability, 2001–06

(In percent of GDP, unless otherwise indicated)

	2001	2002	2003	2004	2005	2006	
						Estimates or latest data	Date
External indicators							
Exports of goods (annual percent change, in U.S. dollars)	-0.5	-4.7	27.5	25.2	12.5	21.0	Sep-06
Imports of goods (annual percent change, in U.S. dollars)	-4.0	5.4	22.0	24.1	9.8	21.4	Sep-06
Terms of trade (annual percent change)	-0.3	1.7	6.3	4.9	-6.3	0.9	...
Current account balance (settlements basis)	-6.3	-5.6	-5.6	-4.9	-6.2	-2.7	Sep-06
Capital and financial account balance	1.8	7.7	3.5	3.7	6.4	...	...
Of which: Inward portfolio investment (debt securities etc.)	6.0	7.2	10.6	11.8	11.4	...	...
Inward foreign direct investment and other investments	-3.9	5.2	-1.1	-0.6	5.9	...	...
Official reserves (in U.S. dollars, millions, end of period)	5,154	8,083	4,361	1,191	506	703	Sep-06
Official reserves in months of imports GS	1.5	2.4	1.1	0.2	0.1	-0.04	Sep-06
Net international investment position	-38.4	-42.2	-46.9	-58.3	-64.9	-69.8	Mar-06
External central government debt	5.1	2.6	1.7	1.2	1.2	1.1	...
External interest payments to exports GS (in percent)	10.4	9.7	16.0	14.5	16.4	23.4	Jun-06
Exchange rate (per U.S. dollar, period average)	1.1	1.1	0.9	0.8	0.8	0.8	Oct-06
Financial market indicators							
Public sector debt (Maastricht definition) 1/	114.7	111.6	108.8	109.3	108.7	...	...
Greek contribution to euro area M3 excluding currency in circulation (percent change, 12-month ba	8.3	-2.1	5.2	8.2	7.3	10.3	Sep-06
Private sector credit (percent change, 12-month basis)	24.8	16.9	17.0	19.5	21.8	22.3	Sep-06
12-month T-bill yield	4.1	3.5	2.3	2.3	2.3	3.8	Oct-06
12-month T-bill yield (real)	0.4	-0.4	-1.1	-0.8	-1.2	0.5	Oct-06
Stock market index	2,592	1,748	2,264	2,786	3,664	4,129	Oct-06
Share prices of financial institutions	4,788	2,688	4,247	6,129	7,904	6,002	Oct-06
Spread of 12-month treasury bill rate with Germany (percentage points, end of period)	0.4	0.5	0.4	0.3	0.3	0.5	Oct-06
Spread of 10-year bond with Germany (percentage points, end of period)	0.6	0.5	0.5	0.5	0.4	0.3	Oct-06
Financial sector risk factors							
Foreign exchange loans to the private sector (in millions of U.S. dollars)	6,542	6,054	6,252	6,528	8,356	9,371	Sep-06
Share of foreign exchange loans in total lending to the private sector	9.9	7.4	5.5	4.5	4.9	4.8	Sep-06
Deposits in foreign exchange (in millions of U.S. dollars)	19,905	16,026	19,899	22,621	26,191	27,288	Sep-06
Share of foreign deposits in total deposits	21.8	16.3	15.2	14.2	13.4	13.0	Sep-06
Share of mortgages in private credit	21.1	24.5	26.2	28.3	31.5	32.1	Sep-06
Commercial banks' return on assets (after tax)	1.0	0.5	0.6	0.3	0.9	1.2	Jun-06
Interest rate margin to gross income	62.8	72.5	73.9	76.3	75.3	71.1	Jun-06
Share of nonperforming loans in total loans 2/	5.6	5.5	5.1	5.4	5.5	5.5	Jun-06
Regulatory capital to risk-weighted assets	12.4	10.5	12.0	12.8	13.2	12.3	Jun-06

Sources: Bank of Greece, *Monthly Statistical Bulletin;* data provided by the authorities; and IMF, *International Financial Statistics*.

1/ Data provided by Eurostat.
2/ This figure does not include ATEbank and rescheduled loans. If rescheduled loans were included, then the relevant ratios would become 5.6 for 2005 and 5.6 for June 2006.

APPENDIX I. GREECE: FUND RELATIONS

(As of October 31, 2006)

- Mission: October 9–20, 2006.
- Team: Mr. Ford (head), Ms. Moreno Badia, Messrs. Gagales and Rossi (all EUR).
- Meetings: Ministry of Economy and Finance, Bank of Greece, other government ministries and agencies, trade unions, industrialists, and banks.
- Fund Relations: Greece has accepted the obligations of Article VIII, Sections 2, 3, and 4 and maintains an exchange system free of restrictions apart from those resulting from European Council regulations, which were last notified to the Fund in accordance with Decision 144. Greece subscribes to SDDS, and has undertaken an FSAP and fiscal and data ROSCs.
- Outreach: The mission met with trade unions and industrialists. The concluding statement was published and a press conference held at the end of the mission.

I. **Membership Status**: Joined December 27, 1945; Article VIII

II.	**General Resources Account**:	**SDR Million**	**% Quota**
	Quota	823.00	100.00
	Fund holdings of currency	737.89	89.66
	Reserve position in Fund	85.16	10.35

III.	**SDR Department**:	**SDR Million**	**% Allocation**
	Net cumulative allocation	103.54	100.00
	Holdings	19.84	19.16

IV. **Outstanding Purchases and Loans**: None

V. **Financial Arrangements**: None

VI. Projected Obligations to Fund (SDR million; based on existing use of resources and present holdings of SDRs)

	Forthcoming				
	2006	2007	2008	2009	2010
Principal					
Charges/Interest	0.81	3.39	3.40	3.39	3.39
Total	0.81	3.39	3.40	3.39	3.39

VII. **Implementation of HIPC Initiative:** Not Applicable.

VIII. **Exchange Rate Arrangements**:

Greece entered the final stage of European Economic and Monetary Union on January 1, 2001, at a rate of 340.750 Greek drachmas per 1 euro. Greece maintains restrictions on the making of payments for current international transactions vis-à-vis Iraq. These restrictions were last notified to the Fund in accordance with Decision 144.

IX. **Article IV Consultation**: Greece is on a 12-month consultation cycle; the last Article IV consultation discussions were concluded on December 14, 2005.

X. **ROSCs**

Standard Code Assessment	**Date of Issuance**	**Document Number**
Fiscal Transparency	October 6, 1999	CR/99/138
Fiscal Transparency	February 8, 2001	CR/01/52
Fiscal Transparency	February 4, 2002	CR/02/56
Fiscal Transparency	May 5, 2003	CR/03/158
Data Module	September 17, 2003	CR/03/318
Data Module Update	December 22, 2004	CR/05/45
Fiscal Transparency	December 22, 2004	CR/05/42
Anti-Money Laundering and Combating the Financing of Terrorism	November 22, 2005	CR/06/6
Banking Supervision	November 22, 2005	CR/06/6
Insurance Supervision	November 22, 2005	CR/06/6
Securities Regulation	November 22, 2005	CR/06/6
Data Module Update	November 22, 2005	CR/06/5
Fiscal Transparency	January 20, 2006	CR/06/49

XI. **Technical Assistance**:

Year	**Dept.**	**Purpose**	**Date**
1993	FAD	Treasury Reform	June
1993	MAE	Central Bank Independence in the Context of the Maastricht Treaty	June
1994	MAE	Development of Primary and Secondary Markets in Government Securities	September
2002	STA	Action plan and time frame for SDDS subscription	June
2003	FAD	Tax Policy and Tax Administration Reform	July
2005	FAD	Public Expenditure Management	May
2005	FAD	Tax Administration	July
2005	FAD	Fiscal Transparency	July

XII. **Resident Representative**: None

APPENDIX II. GREECE: STATISTICAL ISSUES

Economic data are adequate for surveillance, but should be strengthened. Substantial progress has been made in statistical methodologies and practices to fulfill responsibilities as a member of the European Union and the euro area. Greece subscribed to the Special Data Dissemination Standard (SDDS) on November 8, 2002. A data module of the Report on the Observance of Standards and Codes (ROSC) was published in 2003, and it was updated in 2004 and 2005 in the context of the Article IV staff report.

National accounts produced by the National Statistical Service of Greece (NSSG) have recently been revised substantially, in part to achieve compliance with the European System of Accounts (ESA95). The new benchmark year is 2000. Data for 2002–2005 are still provisional since the NSSG has yet to incorporate the results of new statistical surveys for these years, and the NSGG has yet to produce estimates on the new basis for 1995–1999.

The seasonal adjustment of quarterly national accounts estimates relies on indicator series rather than standard techniques. The resulting series retain strong seasonal patterns which render them inadequate for assessing short-term economic developments. The NSGG plans to introduce properly seasonally adjusted quarterly national accounts in 2007.

Balance of payments data present some departures from the fifth edition of the *Balance of Payments Manual* (*BPM5*), but progress has been made implementing the recommendations of the 2003 data ROSC. Significant differences remain in comparison to national-accounts-based current account data, although the recent revisions to the national accounts are meant to ameliorate this situation.

The NSSG compiles data on general government revenue, expenditure, and deficit on an accrual basis in the context of the *1995 ESA* Transmission Program and the Excessive Deficit Procedure. The absence of financing data impedes checks on data consistency, including reconciliation between the government deficit and debt, and between government statistics and other macroeconomic datasets.

The interpretation of labor market developments continues to be hampered by difficulties in covering immigrants, which constitute, compared with other EU countries, a relatively large fraction of the Greek labor market, and by the large size of the unrecorded economy, which the recent national accounts revisions may not have fully captured.

Under the Coordinated Compilation Exercise for Financial Soundness Indicators conducted by the Fund, the authorities recently produced a set of indicators broadly consistent with the Fund's FSI Compilation Guide.

GREECE: TABLE OF COMMON INDICATORS REQUIRED FOR SURVEILLANCE
(as of November 30, 2006)

	Date of latest observation	Date received	Frequency of Data[6]	Frequency of Reporting[6]	Frequency of Publication[6]	Memo Items:	
						Data Quality – Methodological soundness[7]	Data Quality – Accuracy and reliability[8]
Exchange Rates	11/16/06	11/16/06	D and M	D and M	D and M		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	Sep. 06	10/24/06	M	M	M		
Reserve/Base Money	Oct. 06	11/15/06	M	M	M	O, O, O, O	LO, O, O, O, O
Broad Money	Sep. 06	11/15/06	M	M	M		
Central Bank Balance Sheet	Sep. 06	11/15/06	M	M	M		
Consolidated Balance Sheet of the Banking System	Sep. 06	11/15/06	M	M	M		
Interest Rates[2]	11/16/06	11/16/06	D and M	D and M	D and M		
Consumer Price Index	Oct. 06	11/9/06	M	M	M	O, O, O, O	O, LO, O, O, O
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	2005	3/31/06	A	A	A	LO, LO, LO, O	LO, O, O, O, NA
Revenue, Expenditure, Balance and Composition of Financing[3] – Central Government	Sep. 06	10/31/06	M	M	M		
Stocks of Central Government and Central Government-Guaranteed Debt[5]	2006 Q2	8/22/06	Q	Q	Q		
External Current Account Balance	Aug. 06	10/20/06	M	M	M	O, LO, LO, O	O, O, O, O, O
Exports and Imports of Goods and Services	Aug. 06	10/20/06	M	M	M		
GDP/GNP	2006 Q3	11/14/06	Q	Q	Q	O, O, O, O	LO, LO, O, O, LO
Gross External Debt	2006 Q2	9/30/06	Q	Q	Q		

[1] Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.
[2] Both market-based and officially determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.
[3] Foreign, domestic bank, and domestic nonbank financing.
[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.
[5] Including currency and maturity composition.
[6] Daily (D); weekly (W); monthly (M); quarterly (Q); annually (A); irregular (I); and not available (NA).
[7] Reflects the assessment provided in the data ROSC (published in October 2003, and based on the findings of the mission that took place during November 2002) for the dataset corresponding to the variable in each row. The assessment indicates whether international standards concerning concepts and definitions, scope, classification/sectorization, and basis for recording are fully observed (O); largely observed (LO); largely not observed (LNO); not observed (NO); and not available (NA).
[8] Same as footnote 7, except referring to international standards concerning source data, statistical techniques, assessment and validation of source data, assessment and validation of intermediate data and statistical outputs, and revision studies.

INTERNATIONAL MONETARY FUND
Public Information Notice
EXTERNAL RELATIONS DEPARTMENT

Public Information Notice (PIN) No. 07/10
FOR IMMEDIATE RELEASE
January 25, 2007

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Concludes 2006 Article IV Consultation with Greece

On January 22, 2007, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Greece.[1]

Background

Economic growth has been very strong for several years, underpinned by a rapid increase in private sector credit, following the liberalization of the financial sector and the sharp drop in interest rates due to euro adoption, and an expansionary fiscal stance. In 2006, real GDP rose by an estimated 4.1 percent, driven by private domestic demand and a pick up in goods exports.[2] After peaking in 2004, the fiscal deficit has fallen sharply to under 3 percent of GDP in 2006. Private sector credit has risen very rapidly and inflationary pressures have continued, resulting in a gradual but steady erosion of competitiveness and a large current account deficit. Despite the long economic expansion, labor markets continue to perform poorly by international standards, although unemployment rates have been falling recently.

In 2006, the authorities continued the fiscal consolidation started a year earlier, reducing the budget deficit to 2.2 percent of GDP and the debt-GDP ratio to 83.3 percent of GDP (2.8 percent and 104.9 percent on the old national account estimates) on staff estimates. In contrast to 2005, however, the adjustment shifted toward reliance on revenue increases,

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[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities.

[2] The national accounts were recently revised significantly, raising the level of output in 2000–05 by about 26 percent.

including some one-off measures and increases in some indirect taxes. The 2007 budget targets a small deficit reduction of 0.2 percent of GDP, reflecting lower interest payments, while both revenues and primary spending are little changed.

Economic growth in 2007 and beyond is projected by staff to slow gradually, as the erosion of international competitiveness and past rapid rises in households' indebtedness imply a softening of foreign and domestic demand. Although growth is expected to remain comfortably above the euro-area average, the further real rate exchange rate appreciation and the persistence of large current account deficits pose risks of a sharper slowdown.

The banking sector appears sound, with high profitability and strong capital and liquidity positions. However, continued strong credit expansion raises concerns that households may become overextended and asset quality degraded, and persistently high non-performing loans ratios suggest that banks continue to lend to poor risks. The Bank of Greece has responded to these risks by stepping up its monitoring of banks' lending standards, strengthening provisioning requirements, and introducing prudential measures to limit credit to highly indebted households.

The authorities have introduced a number of significant structural measures to improve product markets. These include simplified business licensing procedures for industrial firms, more flexible overtime, liberalization of network industries, and reforms to state-owned enterprises. More initiatives are in the works, including the overhaul of bankruptcy legislation and further privatization. Labor market reform has been more limited.

Executive Board Assessment

Executive Directors welcomed the extended period of robust economic growth, which had significantly narrowed the gap in living standards between Greece and the rest of the European Union. They agreed that economic prospects are strong in the near term, but noted that very high credit growth, persistent inflationary pressures, eroding competitiveness, and a large current account deficit pose downside risks in the medium term.

Directors commended the authorities for the substantial reduction of the fiscal deficit in 2005–06 as a substantive step towards restoring the health of the public finances. Regarding 2007, Directors urged the authorities to look for opportunities that emerge to achieve a larger deficit cut than currently budgeted to maintain an appropriately countercyclical fiscal stance and to make further progress toward a medium-term budget surplus. They welcomed reforms to corporate and personal income taxes, while urging that any budgetary costs be offset by savings elsewhere in the budget.

While several Directors considered that balancing the budget by 2012 and moving to a surplus after that was appropriate, several others recommended balancing the budget by 2010, given the need to achieve fiscal consolidation. Directors considered that medium-term consolidation, which should focus on primary spending, is necessary to cushion public finances in the event of an economic downturn and to help prepare for the costs of population-aging. Directors pointed out that further reforms to tax administration and expenditure management would be key to balancing the budget. Priorities in this respect include combating tax evasion, integrating program-based budgeting into budget preparation and execution, using fiscal audits to evaluate programs against objectives and to ensure value for money, and developing a medium-term budget framework to guide fiscal strategy and prioritize policy objectives.

Directors noted that the costs of population aging pose a threat to the long-term sustainability of the public finances. They called on the authorities to accelerate preparation of the pension reform, including by speeding up data provision by social security funds and completing revised estimates of aging costs, and to ensure an early implementation of the reform. In this respect, Directors considered that constructive involvement of all social partners will be crucial for an early adoption of concrete measures. Reforms to the health-care sector should aim to provide quality medical services while containing costs.

Directors noted that the banking system appears sound, but cautioned that persistent rapid loan expansion and high levels of nonperforming loans (NPLs) can raise vulnerabilities. While commending the proactive approach of the Bank of Greece, they called for the continued supervision of banks’ risk management practices, close monitoring of banks’ assets and NPLs, and strengthened incentives for banks to contain risks, including through sufficient provisioning and write-offs of NPLs. With the increasing presence of Greek banks in southeastern Europe, close cooperation with other supervisors in the region would also be essential. Directors urged the authorities to ensure a smooth and rapid establishment of a fully operational independent insurance supervisor.

Directors pointed out that further reforms to product and labor markets would be required to sustain medium-term growth and strengthen international competitiveness. They commended the authorities for progress already made in product market reform, and encouraged them to implement further measures, including extending simplified business licensing procedures to all sectors, accelerating the liberalization of network industries, and redoubling efforts to combat corruption and widespread tax evasion. They also urged further initiatives in the labor market, including relaxation of strong employment protection legislation and decentralization of the bargaining system.

Directors welcomed the proposed reforms to state-owned enterprises and the new framework law for public-private partnerships. They stressed that better governance of state-owned enterprises would help to improve efficiency, reduce losses, and pave the way for further privatization. Directors were of the view that public-private partnerships could help foster needed infrastructure investment, but cautioned that a full and transparent cost accounting is essential.

Directors encouraged the authorities to continue strengthening economic statistics. They called on the authorities to improve the quarterly national accounts and publish full financing-side fiscal data. Directors also considered that more timely updates of the national accounts will also be important, and encouraged the authorities to grant formal independence to the national statistical office to strengthen its credibility.

Public Information Notices (PINs) form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case. The staff report (use the free Adobe Acrobat Reader to view this pdf file) for the 2006 Article IV Consultation with Greece is also available.

Greece: Selected Economic Indicators, 2002–07

	2002	2003	2004	2005	2006 Proj.	2007 Proj.
Real economy (change in percent)						
Real GDP	3.9	4.9	4.7	3.7	4.1	3.8
Final domestic demand	4.5	5.4	4.6	2.4	4.7	4.0
Private consumption	3.8	4.2	4.6	3.7	3.9	3.4
Public consumption	6.5	-1.3	2.5	-0.5	2.1	1.7
Gross fixed capital formation	5.6	13.3	5.8	0.2	8.2	7.0
Foreign balance (contribution)	-1.0	-0.7	-0.3	1.3	-0.9	-0.6
Unemployment rate (in percent)	10.3	9.7	10.5	9.9	9.0	8.8
Employment	2.2	2.4	0.9	1.3	1.9	1.1
Unit labor costs (economy wide)	3.0	2.4	3.2	3.3	3.0	3.0
GDP deflator	3.7	3.6	3.3	3.4	3.4	3.3
HICP (year average)	3.9	3.4	3.0	3.5	3.3	3.2
Public finance (percent of GDP)						
General government balance	-4.1	-4.9	-6.2	-4.2	-2.2	-2.0
General government primary balance	0.6	-0.5	-1.8	-0.3	1.5	1.5
General government structural balance	-4.3	-5.4	-7.0	-4.9	-3.1	-2.8
General government gross debt	88	85	86	85	83	80
Money and credit (end of year, percent change)						
Domestic credit 1/	8.5	3.0	10.3	17.0	15.7	...
Interest rates (percent)						
Deposit rate 2/	2.8	2.5	2.3	2.2	2.6	...
Government bond yield 1/	5.1	4.3	4.3	3.6	4.1	...
Exports of goods and services	17.4	16.6	18.5	18.3	18.3	18.5
Imports of goods and services	24.0	22.2	23.2	23.5	24.4	24.6
Trade balance	-6.6	-5.7	-4.7	-5.2	-6.1	-6.1
Current account	-5.6	-5.6	-4.9	-6.2	-7.5	-7.4
Exchange rate						
Exchange rate regime						Euro area
Present rate (January 5, 2007)						0.76
Nominal effective exchange rate (1990=100) 1/	103.6	109.3	110.9	110.3	110.6	...
Real effective exchange rate (1990=100) 1/	104.3	111.1	113.0	113.7	115.1	...

Sources: National Statistical Service; Ministry of National Economy; Bank of Greece; IMF, *World Economic Outlook;* and IMF staff estimates and projections.

1/ Data for 2006 as of October.
2/ Data for 2006 as of March.

Statement by Miranda Xafa, Alternate Executive Director for Greece
January 22, 2007

I would like to express my authorities' appreciation to staff for the fruitful discussions they held during the 2006 Article IV consultation and for their excellent report. The authorities broadly agree with staff's analysis and recommendations, including on the challenges in the years ahead.

Key issues

As staff notes, the strong growth of the Greek economy in recent years is partly due to a favorable external environment and to exceptional factors, including joining the Euro-area and hosting of the 2004 Olympic Games. However, growth has become more sustainable in the last two years through a marked shift away from demand management based on debt-financed expansionary fiscal policy toward supply-side reforms aimed at increasing productivity and potential growth. These policies succeeded in sustaining the growth momentum post-Olympics despite substantial fiscal consolidation in 2005-6.

The authorities are more optimistic than staff on the growth outlook, based on their expectation that consumption will remain strong as the oil bubble continues to deflate while investment and exports are boosted by supply-side reforms. The December 2006 update of Greece's Stability Program projects that GDP growth will be sustained around 4.0 percent in 2007-09, while staff projects that growth will gradually decline to 3.0 percent in 2009. We would note that staff's projections have been unduly pessimistic in the past: The 2004 and 2005 Article IV reports projected 2006 GDP growth at 3.0 and 3.3 percent respectively, compared with an estimated outcome of 4.0 percent.

Strong domestic demand, partly fueled by credit growth, contributed to a widening of the current account deficit to 10.8 percent of GDP in 2006 (based on unrevised GDP data). Export growth, on the other hand, remains buoyant despite a persistent inflation differential with the Euro area. Though aware of the risks to competitiveness and the need for wage moderation, the authorities prefer to address the growing external deficit by expanding supply through structural reforms. After substantial spending restraint in 2005-06, further fiscal consolidation should be carried out at a pace that does not jeopardize economic growth.

GDP revision

A long-overdue comprehensive revision of the national accounts was carried out in 2006 using the ESA95 methodology, which permits better measurement of services and thus resulted in a significant upward revision of GDP. The main changes relate to the re-benchmarking of data using 2000 as the base year, better estimation of activity in the construction and services sectors, as well as the use of the 2001 census data and surveys that were conducted for the first time. As staff notes, the bulk of the revision address deficiencies in past national accounts estimates that Eurostat had long identified. New primary sources of information have been established to avoid heavy reliance on projections and extrapolations. Moreover, existing sources of information have been utilized for the first time, including VAT returns and shipping activity going through the Greek banking system. The new GDP data are consequently more in line with Bank of Greece balance of payments data. In future, GDP re-benchmarking will be undertaken on a regular basis to avoid large revisions.

Fiscal policy

As discussed in the latest Stability Program, a front-loaded adjustment effort brought the deficit below the 3 percent of GDP threshold within two years, in compliance with the EU Council notice of February 2005 under the Excessive Deficit Procedure – a cumulative adjustment of 5.2 percent of GDP in 2005-06. The bulk of the adjustment was achieved by expenditure restraint, while improvements in tax administration and indirect tax increases resulted in higher revenues even as corporate tax rates were cut. On the basis of preliminary data, the general government deficit reached a 10-year low of 2.6 percent of GDP in 2006 (based on the unrevised GDP figures), and is budgeted to fall further to 2.4 percent of GDP in 2007. Even though the 2007 fiscal effort appears small, the quality of fiscal adjustment is set to improve as one-off measures amounting to 0.4 percent of GDP in 2006 are replaced by permanent measures in the 2007 budget. In cyclically adjusted terms, the primary balance shifted from a deficit of 0.7 percent of GDP in 2005 to a surplus of 1.2 percent in 2006, estimated to rise to 1.7 percent of GDP in 2007.

Notwithstanding the progress achieved, the authorities agree that the debt burden remains high while the improvement in recent years partly reflects a low interest rate environment. They thus remain committed to continuing the fiscal consolidation effort to achieve balance or better by 2012. A multi-year fiscal strategy and reforms to budgeting, expenditure management, and tax administration already launched will be important elements in entrenching fiscal discipline. Pension and health care reforms will also be critical to address the challenges of population aging. The stock-flow discrepancy in the Greek fiscal accounts is being gradually reduced by hardening the budget constraints on public enterprises and entities. PPP projects approved under the recent law are subject to strict evaluation and monitoring standards, and will be transparently recorded in the fiscal accounts.

Tax reform

Following the gradual reduction in the corporate tax rate from 35 to 25 percent over the 3-year period 2004-06, Parliament approved a personal income tax reform law in December 2006. The personal exemption was raised from €11,000 to €12,000 (it was € 10,000 in 2004) with effect from 2007, while personal income tax rates are set to decline gradually over the period 2007-09 from 30 to 25 percent for low incomes (€12,000-30,000) and from 40 to 35 percent for middle incomes (€30,000-75,000). Thus, the top marginal tax rate of 40 percent will only apply to incomes above €75,000 (compared to the current €30,000). Several tax exemptions were simultaneously abolished, thus broadening the tax base.

Public enterprise reform

An important law on public enterprise reform was approved by Parliament in November 2005. The law aims at increasing the commercial orientation of public enterprises and streamlining their operations to reduce their reliance on debt guarantees and budget transfers. Public enterprises have to submit annual business plans and longer-term strategic plans for approval by the Ministry of Economy and Finance, and draw up charters of "obligations to the consumer" defining their obligations regarding the services they deliver. To facilitate fulfillment of these goals, the law provides for greater flexibility in personnel management by ending the civil service status of newly-hired employees, who will no longer have life tenure. It also provides for the adoption of international accounting standards and best practices of corporate governance.

Pension reform

The authorities are fully aware that aging-related issues pose a threat to long-term fiscal sustainability. They are also keenly aware of the need to build broad consensus before embarking on pension reform. Much preparatory work also needs to be done to collect comparable data from Greece's highly fragmented pension system, consisting of more than seventy pension funds, pending the creation of a national register. To this effect, a high-level committee was given the mandate to make a technical assessment of the situation of the pension system and to prepare actuarial projections with the assistance of the ILO. The committee is due to present its findings for public debate in the fall of 2007. Efforts are also underway in order to control the finances of the health care system – partly funded by the pension funds – mainly by centralizing and reforming their procurement practices. The accumulation of arrears to suppliers in the past were eventually taken over by the government and added to the public debt.

Other structural reforms

Greece has made strides in closing the gap in living standards with the euro area, but has still some way to go. Despite the sharp drop in the inflation rate compared to the pre-EMU era, there is a persistent inflation differential relative to the euro area, pointing to the need to improve productivity and competitiveness. To this end, important steps have been taken to make the product and labor markets more flexible, promote competition, and improve the business climate by reducing administrative barriers and costs along with the tax burden. Network industries are being gradually liberalized, and a strategic ally is being sought by the government in the incumbent telecom company. The authorities recognize that further progress is needed in deregulation and privatization if Greece is to become a more attractive destination for foreign direct investment and reap the benefits of rapid advances in technology.

Financial stability

The banking sector, which accounts for more than 80 percent of the financial sector, appears generally sound. Profitability, solvency and liquidity are satisfactory and recent stress tests conducted by the Bank of Greece show that capital adequacy ratios would remain well above regulatory thresholds even if credit risks materialized under severe conditions. The BoG has taken an appropriately proactive stance, building on FSAP and previous Article IV consultation recommendations. Greece's AML/CFT system has been fully adjusted to a risk-based approach, and so has the framework for banks' internal controls, compliance and risk management functions. BoG introduced compulsory liquidity ratios in order to address the increasing reliance on non-retail funding, while country risk monitoring has been requested for internationally active Greek banking groups.

Continued rapid credit growth and persistently high NPLs warrant continued vigilance. As the risk management systems are in a transitional period between Basel I and II, the BoG has been gradually exploiting the new methodologies and the enhanced availability of data. By requiring increased write-offs and improved risk monitoring by banks, the BoG expects a material reduction in the NPL ratio by the end of 2007. In particular, the BoG has asked risk managers to set their risk appetite at an NPL ratio of 3-4 percent, well below the current level of 5.5 percent of total loans. To limit credit to highly indebted households, the BoG has introduced prudential measures that have already been incorporated in the credit and scoring systems of banks.