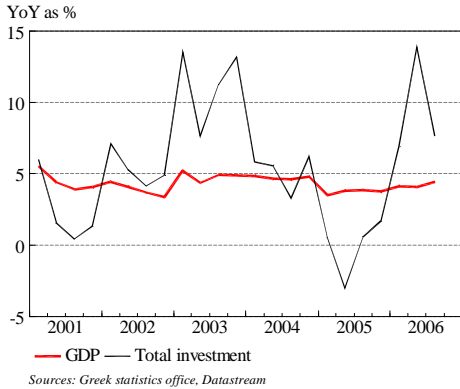


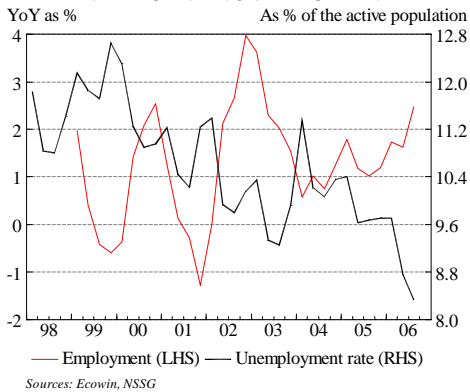
## INVESTMENT IS BOOMING AGAIN

*Buoyed by a pick-up in investment and robust consumption, growth in the Greek economy exceeded 4% in 2006. The economic reforms implemented by the conservatives since 2004 are bearing fruit and the stabilisation in public finances is on track. However, given the hardening in monetary conditions, a reduction in the rate of growth, to 3.6%, looks likely this year.*

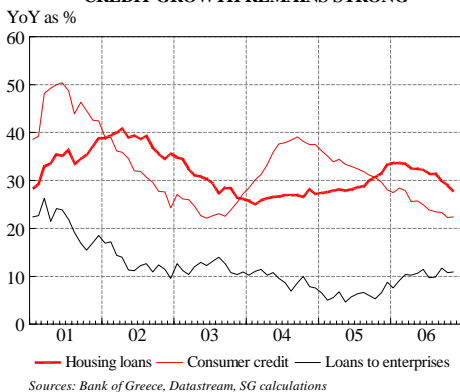
### A RECOVERY IN INVESTMENT



### A NET DECLINE IN UNEMPLOYMENT



### CREDIT GROWTH REMAINS STRONG



### 2006 marked by a sharp increase in investment

In 2005, the stabilisation in investment caused a significant slowdown in growth. Conversely, 2006 was marked by a sharp increase of over 8% by volume of this GDP component. This performance was linked to higher expenditure under the Public Investment Programme (PIP), which contrasts with the collapse seen in 2005 following the disappearance of infrastructure expenditure related to the Olympic Games. In 2006, expenditure under the PIP should therefore have risen by more than 7.5% in nominal terms, after a steep 21% decline in 2005. Private investment has also been affected by this trend. In the construction sector, in addition to civil engineering works, household residential investment has also been on the increase. Flexible monetary conditions have enabled households to take on more debt to purchase housing (household lending was up 27.7% on the year in November 2006). Moreover, the number of building permits shot up at end-2005, in anticipation of the 19% VAT charge introduced on new builds on 1<sup>st</sup> January 2006. This added to growth in terms of volume of activity last year. On our estimates, equipment investment increased by around 8% by volume. Once again credit growth played a key role as loans to companies rose by 12.5% on the year in November. Other factors also contributed, such as:

- (i) the fall in corporate tax rates to 29% (versus 32% in 2005 and 35% in 2004);
- (ii) the new private investment incentive law;
- (iii) public-private partnerships, and
- (iv) more generally, the implementation of structural reforms creating a more favourable framework for companies (reforms on working hours and the status of public enterprises etc.).

Domestic demand also benefited from robust consumer spending. Greek households continue to catch up with the average European standard of life. According to the Greek authorities, real disposal income increased by an average 4.3% a year over the last two years. These gains in purchasing power can be explained by the upward trend in wages and employment growth, which increased sharply in 2006 (+2.5% year-on-year in Q3). On average, for the year, the increase could hit the 2% mark, versus 1.3% in 2005. In parallel, the unemployment rate fell to 8.3% of the active population in Q3 2006, its lowest recorded level for eight years. In addition, the growth in consumer credit remained particularly strong last year. Overall, consumer spending should have risen by 3.7% in 2006.

On the trade front, a sharp uptick in domestic demand, particularly investment, resulted in a net increase in imports of goods and services. In contrast, imports fell by over 2% in volume in 2005. As a consequence, the contribution from foreign trade to growth, which was clearly positive in 2005 (1.25 points of GDP) has become negative, despite the positive performance of exports. Exports of goods and services posted robust growth in 2006, primarily as a result of the tourism sector.

### Higher interest rates - a synonym for a slight dip in activity in 2007

The 200 basis point increase in the ECB's refinancing rate between December 2005 and June 2007 will weigh on the credit dynamic (smoothed by the decrease in bank interest rate margins). This is because mortgage loans are in the majority of cases based on variable interest rates. The rise in credit costs will mean households are less solvent

and will weigh on housing demand at a time when the housing supply, boosted by a "VAT effect", has increased significantly. The housing market is therefore likely to slow rather than collapse. Households, which take on more debt to purchase housing, will see their monthly payments rise, which could weigh on their expenditure. The final effect on consumption, should however, remain limited thanks to consecutive disinflation relating to the decline in oil prices and the continued upturn in the labour market. All things considered, personal consumption should grow by 3.5% in 2007.

Moreover, the tightening of monetary conditions should weigh on investment. However, once again, a number of factors will soften the impact. Companies will benefit from a new reduction (25% versus 29% in 2006) in the corporate tax rate. Civil engineering works will be buoyed by on-going initiatives under the Public Investment Programme, with expenditure projected to increase by 8%. Following a rise of more than 8% in 2006, investment for this year is forecast at just under 6%.

The slight slowdown in domestic demand, particularly in investment, should result in a reduction in import growth. Nonetheless, if at the same time exports, the strong euro and the slowdown in world trade result in a loss of impetus, then trade's contribution to growth will remain virtually unchanged. All in all, we envisage GDP growth of 3.6% this year, slightly down on 2006.

### The end of excessive deficits

In 2006 Greece should have seen its public deficit fall back below the 3% of GDP mark, which should open the way to a suspension in the excessive deficit procedure initiated in 2004 by the European Commission. The Greek authorities confirm they have managed, as forecast, to bring the deficit down to 2.6% of GDP for last year. The performance was all the more remarkable given that the 2005 deficit was revised upwards from 4.5% to 5.2% of GDP, following a downward revision to the social security cash surplus. In the 2007 budget, approved at the end of December, the government maintains its target of reducing the deficit to 2.4% of GDP<sup>1</sup>. The method is very similar to that used in 2006: an increase in indirect taxes, a clamp-down on tax evasion and controlled expenditure, mainly with regard to wages and civil servant pensions. The government forecasts a 6.4% increase in its wage bill this year (stable over GDP at 7.1% as in 2006). A number of demonstrations by civil servants (teachers, firemen etc.) have taken place, who have been protesting against the wage freeze in real terms. Critics from the opposition and trade unions have also been attacking the government's privatisation plan, primarily the future placing of a share of the telecoms operator OTE (the government's stake is ready to reduce its stake from 38% to 20%). Income from privatisations stood at €2.1bn in 2005, while in 2006 it was in excess of €1.7bn, and the government expects a further €1.7bn in revenue this year. Bringing the deficit under control and the income from privatisations will result in a net reduction in government debt: from 108.5% of GDP in 2004 to 100.5% in 2007, i.e. a fall of at least 8%.

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INTEREST RATES ON NEW LOANS TO HOUSEHOLDS

	2003	2004	2005	Oct-06	Nov-06
Consumer (variable)	10.57	9.55	8.47	8.15	8.19
Housing (variable)	4.51	4.30	4.06	4.64	4.50
ECB refl rate	2.33	2.00	2.02	3.17	3.25

NB: the majority of loans are at variable rates

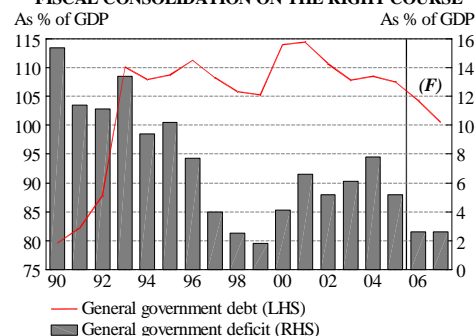
GENTLE SLOWDOWN IN GROWTH

	2003	2004	2005	2006(f)	2007(f)
Private consumption	4.2	4.6	3.7	3.7	3.5
Public consumption	-1.3	2.5	-0.5	2.2	1.0
Investment	11.4	5.2	0.0	8.2	5.7
Inventory change*	-0.1	0.0	-0.1	-0.1	0.1
Domestic demand*	5.5	5.0	2.5	4.9	4.2
Net exports*	-0.7	-0.3	1.3	-0.7	-0.6
<b>GDP</b>	<b>4.9</b>	<b>4.7</b>	<b>3.7</b>	<b>4.2</b>	<b>3.6</b>

Source: General Secretariat Of National Statistical Service Of Greece

\* Contribution to GDP growth, in percentage points

PUBLIC FINANCES:  
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NB: excluding proceeds from sales of UMTS licences in 2001  
Sources: EUROSTAT, Datastream, SG forecasts

<sup>1</sup> The reduction in the 2006 deficit included non-recurrent income representing 0.4% of GDP. Although the target of reducing the deficit from 2.6% to 2.4% in 2007 seems modest, it could prove to be too ambitious. We are banking on a deficit stabilized at 2.6% of GDP next year.

As a %	2003	2004	2005	2006 (f)	2007 (f)
Real GDP	4.9	4.7	3.7	4.2	3.6
Consumer prices	3.4	3.0	3.5	3.3	2.4
Unemployment rate	9.7	10.5	9.9	8.7	8.3
Current acc. bal. (% GDP*)	-7.0	-6.3	-8.1	-12.2	-12.0
Pub. sector bal. (% GDP*)	-6.1	-7.8	-5.2	-2.6	-2.6

\* GDP, old methodology (refer to Worth Watching)

## WORTH WATCHING

**A wave of the statistical wand in sight!** The Greek statistics office revised the nominal GDP figure upwards by a little more than 25%, i.e. for 2005 the figure was €228.2bn instead of €181.1bn. The new method includes a better valuation of services, Census data from 2001 and more reliable figures for the black economy. If EUROSTAT were to validate this figure, the public finance ratios would differ dramatically. In 2005 therefore, government debt would no longer be 107.5% of GDP but 85.3%, and the deficit would be 4.2% instead of 5.2%. Furthermore, in terms of GNP per capita, Greece would cross the 90% EU-average threshold and therefore would not be eligible for aid under the Cohesion Fund starting in 2010.

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