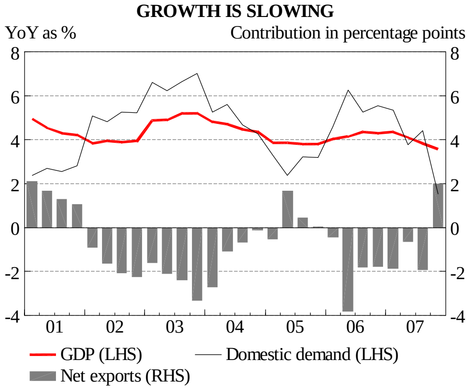
GROWTH SLOWS, WHILE REFORMS CONTINUE

Growth stalled somewhat in 2007 due to the slowdown in domestic demand and despite a less negative contribution from foreign trade. Domestic demand is expected to weaken further, causing growth (at 4% in 2007) to fall to around 3% this year. The conservative government of Costas Caramanlis, reappointed as head of the country last September, is holding the line on structural reforms in an attempt to ensure that public expenditure is reined in and to provide the basis for sustainable growth.

2007 Basic data	
Population: 11.2 million inhab. (3.5% of the EMU)	
GDP (current prices): € 228.9 billion (2.6% of the EMU)	
GDP/inhab. (PPP): $26,565	Minimum wage: €658/month (Fr= 1254; Sp.: 665.7*)
Breakdown of GDP (current prices):	
Services: 73.3 %	Manufacturing: 14.8%
Construction : 8.3 %	Agriculture : 3.6 %

** for Spain, Eurostat uses the minimum annual wage in effect in 2007, divided by 12 months. In reality, the minimum monthly wage was € 570 in 2007, but Spaniards traditionally receive two bonuses (including one at Christmas). Sources: Eurostat, EIU, National Statistical Service of Greece*

GROWTH IS SLOWING



Sources: Datastream, Eurostat, SG

MODERATE SLOWDOWN IN GROWTH

	2005	2006	2007	2008(f)	2009(f)
Priv. Consumption	4.2	4.2	3.1	3.0	2.8
Pub. Consumption	1.4	-0.7	3.2	2.4	2.0
Investment	0.9	12.9	5.9	3.6	4.0
Domestic demand*	3.4	6.2	4.6	3.6	3.4
Net exports*	0.4	-2.0	-0.6	-0.6	-0.4
GDP	3.8	4.2	4.0	3.0	3.0

** Contribution to GDP growth in percentage points*
Sources: National Satistical Service Of Greece, SG forecasts

Revision of Greece's nominal GDP

At the start of 2007, we referred to a wave of a magic wand that could lift Greece's annual GDP by more than 25%, the key being significant consequences on the public finances ratios (cf. Monthly Economic Report, January 2007). In October last year, Eurostat finally approved a more minimal revision that results in a raise of 9.6% of the value of the GDP of the base year (2000, though this upward revision naturally impacts both the previous and following years).

As a direct consequence of this revision, the public deficit expressed as a percentage of GDP was reduced by 0.6 of a percentage point, 0.7 p.p., 0.5 p.p. and 0.2 p.p. in 2003, 2004, 2005 and 2006, respectively. For those same years, the public debt ratio was mechanically reduced by ten or so points of GDP.

Another consequence of this revision is the delay with respect to the other European countries in terms of standard of living appears less great that the former calculation method indicated. The lion's share of the catch-up seems to have been done. According to Eurostat data, the GDP per inhabitant expressed in purchasing power standards grew from 84.9% to 98% of the EU average (EU27) between 1997 and 2007 – or from 74.2 to 90% of the euro zone average.

In 2007, Greece's nominal GDP stood at € 228.9 billion. Greece's economy is dominated by services (generating more than 73% of value added), largely due to its two flagship sectors: shipping and tourism. Manufacturing accounts for nearly 15%, with a strong concentration on textiles and food production. Construction comes next, providing a little more than 8% of the GDP.

Growth began to stall in 2007

In real terms this time, GDP growth declined in 2007. Economic growth settled at 4%, compared with 4.2% in 2006. This slight decline comes from the deceleration of private domestic demand. Private consumption grew at a rate nearly 1 point lower than that recorded in 2006 (+3.1% following on from +4.2%). Meanwhile, the tremendous growth in private investment also dipped in H2 of 2007, hit by investment in housing.

Conversely, public consumption, which contracted in 2006, sped up by more than 3% in 2007, boosted in particular by the cost of organising the early elections of autumn 2007 and by compensation paid to victims of last summer's forest fires.

Lastly, external demand has seen its negative contribution to growth decline slightly. Net trade, which had taken two percentage points off growth in 2006, only trimmed the 2007 figures by 0.6 percentage point. Growth in imports decelerated from 8.7% in 2006 to 6.1% in 2007, since domestic demand was weaker, while conversely, exports accelerated to 7.6%, from 5.1% in 2006, thanks largely to a rebound in receipts from shipping freight services.

Slowing of growth will continue this year

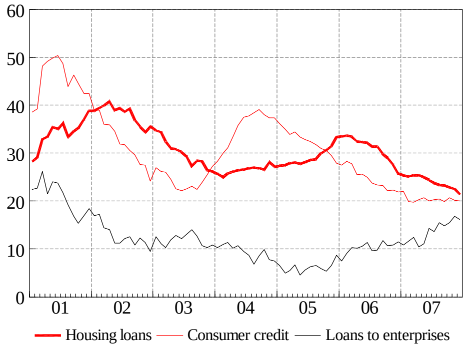
The slowdown that began in 2007 is expected to continue. We are expecting a moderate slowdown in economic growth, to end up at around 3% in 2008 and 2009. Even if credit is still continuing to increase quite strongly, evidenced, for instance, by an acceleration of loans to companies in 2007, the higher interest rates and the crisis on the interbank markets will dampen the strength of credit, which has been at the heart of the economic boom in the last ten years. Slower growth in household credit, along with slightly more constrained growth in real wages, should bring about a new slowdown in growth of consumption, which could settle at slightly below the 3% mark in 2009. In volume terms, the government would need to contain the increase in public consumption, but public investment should continue to growth quite strongly (with a development of public-private partnerships and a faster absorption of European funds).

The major weakness on the domestic demand side will continue to be investment in residential construction, which has already declined severely in 2007 and will likely contract further in 2008 and 2009. Evidence for this comes from the fact that the number of building permits applied for in 2007 was down. Additionally, the weakening of the rise in housing prices also shows very clearly that stresses in the residential property market are easing.

Given the weakening of the strength of domestic demand, growth in imports will decline. However, since concurrently the growth in exports, in an environment of a slowdown in world demand, is also likely to ease, the contribution of net trade to growth is likely to remain negative in 2008 and 2009.

Other than economic ups and downs, it is of note that the competitiveness of the exports of Greek goods to Europe is worsening as a result of Greece posting a positive differential against the euro zone in terms of increase in the unit cost of labour, and in terms of inflation (by about one point). This handicap, along with the strong growth in domestic demand seen in recent years, explains why such a massive current account deficit has accumulated. In 2007, the current account reflected a deficit amounting to a little more than 14% of GDP.

SLOWDOWN IN GROWTH OF CREDIT TO HOUSEHOLDS



Sources: Bank of Greece, Datastream, SG calculations

Reforms to continue

In this context, and to aim at long-term sustainable growth, the Greek government, led by the Prime Minister, Costas Caramanlis, reappointed as head of the country in September last year, is seeking to continue the structural reforms.

After creating a more favourable environment for companies in the previous parliament, particularly by lowering the corporation tax (from 35% in 2004 to 25% in 2007) and by adopting a law providing incentive for private investment, the government is now tackling the pensions issue. Despite large-scale demonstrations and strikes, and after the failure of a vote of no-confidence on 28 March this year (a motion rejected in the parliament by 152 votes to 138, with 10 abstentions), the reform was adopted in the end. The provisions that will now gradually come into effect provide for the number of special schemes – and with that, the number of funds – will be reduced (from 133 funds to 13); the criteria to access early retirement will be tightened and taking early retirement will attract a financial penalty as of 2010; moreover, employees will be encouraged to work after the legal retirement age (65 for men and 60 for women) starting in 2013; lastly, some pension allocations will be reduced, while contributions are expected to be increased.

The emphasis on budgetary consolidation has also been reaffirmed. The 2007 deficit, amounting to 2.8% of GDP, exceeded the government's objectives due to unexpected expenditures (in particular, reconstruction work and compensation payments following the summer 2007 forest fires), adding up to 0.6 of a point of GDP. The government plans to bring down the deficit to 1.6% of GDP this year. It is worth stressing that the efforts aiming to contain the expansion of public expenditure are still too timid because, according to official projections, it can be expected to continue to grow faster than the nominal GDP.

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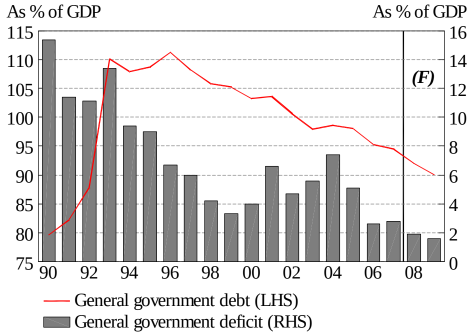

NB: excluding proceeds from sales of UMTS licences in 2001
Sources: EUROSTAT, Datastream, SG forecasts

As %	2005	2006	2007	2008 (f)	2009 (f)
Real GDP	3.8	4.2	4.0	3.0	3.0
Consumer prices	3.5	3.3	3.0	3.8	2.6
Unemployment rate	9.9	8.9	8.3	7.6	7.4
Current account (% GDP)	-7.3	-11.1	-14.1	-14.3	-12.5
Budget balance (% GDP)	-5.2	-2.5	-2.8	-1.9	-1.6

Worth watching

Wages: In 2008, wages in the public service will increase by 4.5% and public sector retirees' pensions will increase by 5%. This is less than in the private sector, after the agreement just signed by employers, unions and government for the next two years, which allows for a retroactive raise of 3.45% on 1st January, a new increase of 3% in September, and lastly, a 5.5% revaluation in May 2009.