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An improved outlook regarding job creation

Macroeconomic Indicators & Fiscal Outlook in pages 18-28

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- After 6 years of severe recession that led to a cumulative loss of 1.1 million jobs, the Greek labor market has started to show signs of recovery. Employment contracted by only -0.9% y-o-y in Q1:2014, compared with -2.9% in Q4:2013 and -4.9% y-o-y in FY:2013, whereas the latest readings for conjunctural and forward-looking indicators signal an expansion in employment in Q3:2014.
- More than two thirds of employment losses in the private sector (730,000 jobs) are due to the closure of about 220,000 micro and small firms (30% of the existing micro & small enterprise population) together with layoffs in this segment. Most of these jobs were lost in firms with a domestic orientation and with less flexible labor market structures, and thus reflects the Greek economy's adjustment to a more sustainable growth model, comprising larger and more export-oriented firms. Indeed, job losses in medium and large sized firms were half that of the small firms (-17% cumulatively since 2008).
- NBG Research's composite indicator of employment trends, that combines information from forward-looking and coincident indicators, points to an employment growth of +0.6% y-o-y in Q3:2014 (or +20,000 jobs) and +0.9% y-o-y (or +32,000 jobs) in Q4:2014 compared with the same period of 2013. The improvement rises to +1.0% y-o-y (about +36,000 jobs) in Q3:2014 and +1.3% y-o-y (+45,000 jobs) in Q4:2014, if one includes the net impact of labor market support programs.
- As a result of the intensive wage adjustment (wages fell by 23% in the period 2009-2013) and employment contraction (-24% cumulatively during 2009-13), the wage share in the economy fell to the low level of 48% of GDP -- 13 pps below its 25-year average. On the other hand, capital income, mainly comprising the gross operating surplus of the business sector, has proved more resilient -- reflecting an ongoing corporate restructuring and lower labor costs -- declining by 19.7% in the five years to 2013.
- This conjuncture has become increasingly favorable for new hirings, as improving business profit margins should lead to higher investment and business expansion. Results from NBG's VAR model, linking employment to corporate profitability and output growth, suggest that it will be profitable for Greek firms to increase their employment by an average pace of 2.5% per annum until 2020, or 19.6% cumulatively during 2014-2020 (720,000 employment positions), pushing the unemployment rate below 21% in 2016 and 12% by end-2020. Such employment creation will clearly depend on the timely implementation of the programme, including its growth-enhancing structural reform agenda.

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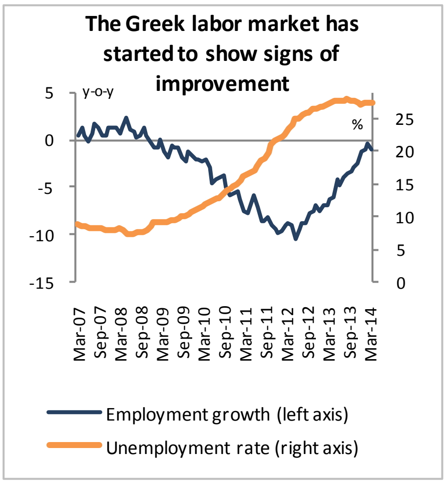
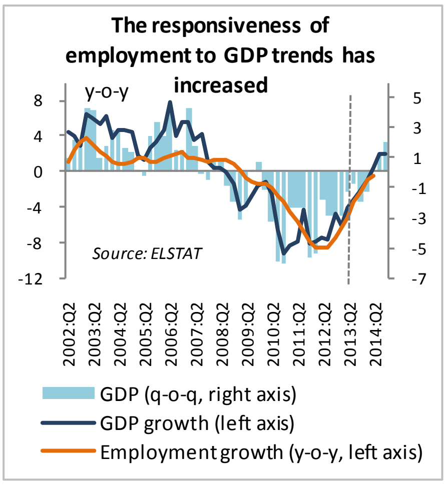
Labor market responsiveness to economic activity increases against a backdrop of business restructuring and declining labor costs

Introduction



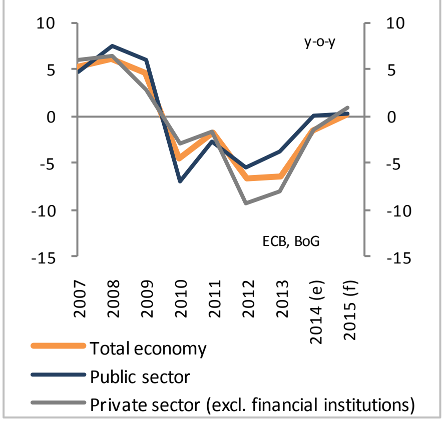
After 6 years of severe recession that led to a cumulative loss of 1.1 million jobs, the Greek labor market has started to show signs of recovery. LFS data for Q1:2014 point to a significant slowing in employment contraction (only -0.9% y-o-y compared with -2.9% in Q4:2013 and -4.9% y-o-y in FY:2013), whereas the latest readings for conjunctural and forward-looking indicators signal an expansion in employment in Q3:2014, when real GDP is also expected to grow by (+0.7% s.a. q-o-q and +1.7% y-o-y according to NBG estimates, *NBG Macro View - March 2014*)

NBG Research's composite indicator of employment trends, that combines information from monthly labor market indicators, points to an employment growth of almost +0.6% y-o-y in Q3:2014 (or +20,000 jobs). The improvement rises to +1.0% y-o-y (about +36,000 jobs) if one includes the net impact of existing labor market support programs.



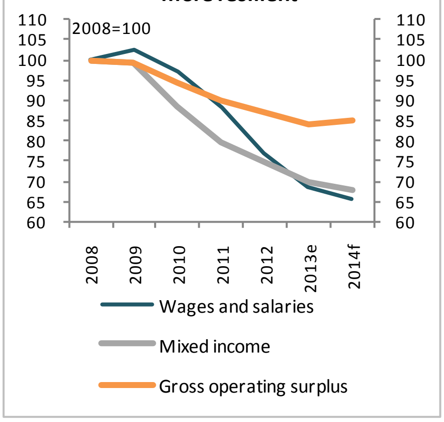
A concurrent turnaround of GDP and employment, compared with the traditional lagging relationship, is an encouraging development in view of the extremely high unemployment rate (27.3% in Q1:2014) and the traditionally low responsiveness of employment to GDP that had characterized the Greek economy in the past. Indeed, a sustainable increase in the job intensity of growth is necessary to overturn the massive employment losses of the past 5 years. NBG analysis suggests that significantly reduced wage costs and broad-based business restructuring will result in significant employment gains in the following years (see below).

The Greek economy reacted to the sharp deterioration in economic conditions mainly through micro and small firm closures and concomitant layoffs. Specifically, the sharp drop in domestic demand since 2008 led to a once-in-a-generation contraction in business activity -- especially as regards micro businesses operating in the non-tradables segment -- which is reflected in the closure of about 220,000 micro and small firms or almost 30% of the existing micro & small enterprise population of 2008. The closure of these firms translated into a cumulative loss of 470,000 jobs (56% of employment losses in the private sector during 2009-13). Taking into account the layoffs from micro and small firms as well, the total contribution of micro/small firm segment in total employment contraction in the economy reaches 730,000 jobs or 67% of the total employment contraction during 2009-2013.



Wage costs fell sharply...

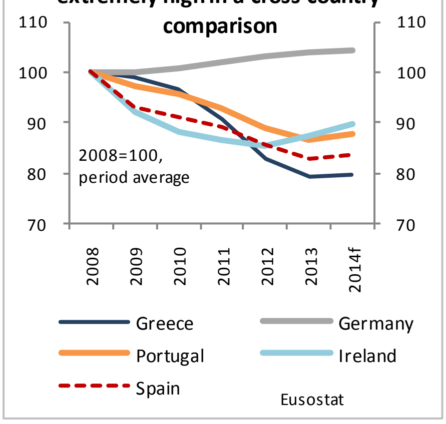
The adjustment in compensation and working hours also played an important role, gaining importance in 2012-2013. Indeed, the significant reforms in the wage setting framework since late-2011, which gradually passed through to the economy through the revision of all existing collective wage agreements, led to a broad-based reduction of wage costs, complementing the adjustment made through the increased use of lower-costing personal contracts.



...while capital income was far more resilient

In this environment, wages fell by 23% cumulatively in the period 2009-2013. The above figure takes into account NBG estimates of the adjustment in labor compensation through the revision of personal contracts, which gained importance in the economy since the beginning of the crisis, and contributed to the contraction of wages to even lower levels compared with the impact from collective wage agreements. Moreover, the fall in imputed compensation of the self-employed, which also exceeded the average adjustment in compensation through collective agreements, also factors in our estimations.

As a result of the intensive wage adjustment and employment contraction, the wage share in the economy fell to the historically low level of 48% of GDP -- 13 pps below its 25-year average and to 9.0 pps below the euro area average.



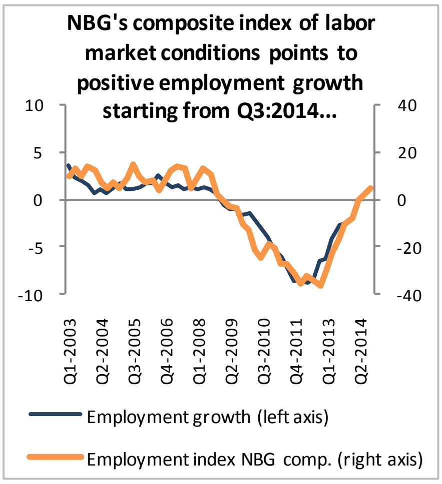
Employment losses were extremely high in a cross country comparison

This development is also suggestive of the relative resilience of capital income, which contracted significantly less than labor income (-19.7% cumulatively, for gross operating surplus, including "mixed income" of unincorporated enterprises in the 5 years to 2013 compared with -44% for labor income, including employment reduction). Business profitability of medium and large-sized firms -- as measured by the gross operating surplus -- already exhibits signs of recovery since early 2014, especially as regards firms with significant exporting activity. In sum, it appears that the current juncture is increasingly supportive of new job creation as confidence in the economy increases, visibility regarding the stabilization of domestic demand is regained, and the relative returns on business capital and new investment rise.

In this context, NBG estimates, on the basis of a VAR model linking employment growth to profitability trends and GDP growth, point to an average annual employment growth of 2.5% during 2014-2020. This corresponds to a cumulative increase in employment of almost 19.6% by end-2020 (720,000 employment positions), which could push the unemployment rate below 21% in 2016 and 12% in 2020.

A composite leading indicator of labor market conditions points to an expansion of employment in Q2:2014

NBG research constructed a composite leading indicator for short-run employment dynamics. It is based on information from: i) net employment flows for wage earners from the ERGANI system (adjusted for the impact of active labor market programs and once-off effects); and ii) the weighted average of sectoral employment prospects from EC business survey data, with the weights corresponding to relative contribution of the sectors in domestic value added. Actual data from the LFS on employment growth in the previous quarter (lagged endogenous variable) are also included in the model to improve further the empirical fit. The indicator is appropriate for near-term forecasting and appears to track closely employment growth 1 to 2 quarters ahead.

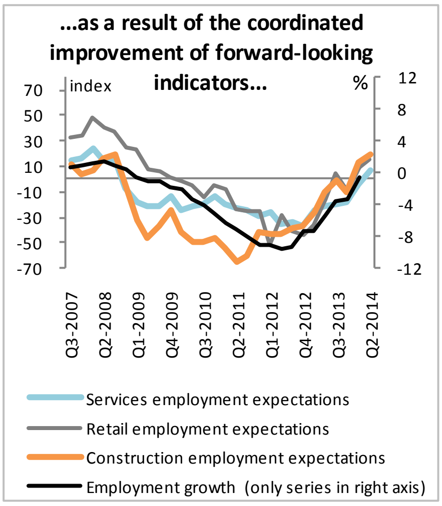


The composite indicator entered expansionary territory since May 2014, reflecting the following:

i) most components of employment trends in business surveys (construction, services, industry, trade) are stabilizing or expanding in Q2:2014;

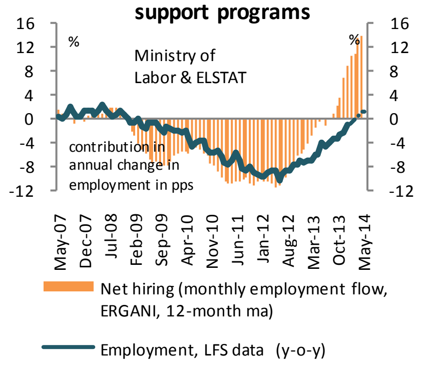
ii) the positive balance of net employment creation for wage earners according to the on-line registration system ERGANI (adjusted for the impact of labor market programs), indicate that the net dependent employment flows are increasing steadily since January 2014; and

iii) the pace of employment contraction (lagged variable) slowed to -0.9% y-o-y in Q1:2014 (LFS data);

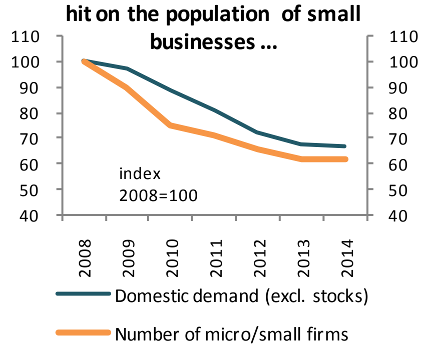


In fact, the current level of the indicator corresponds to an annual employment growth of 0.6% (or +20,000 jobs) in Q3:2014 and +0.9% y-o-y (or 32,000 jobs) in Q4:2014 -- for the first time since Q4:2008 (22 quarters). The above figures increase to +1.0% and +1.4%, respectively (about +45,000 jobs in Q4:2014 compared to Q4:2013), when including the impact of existing labor market support programs. This employment growth appears sufficient to bring the unemployment rate to below 26.8% in Q3:2014 and to 26.2% in Q4:2014. The annual employment growth in 2014 is estimated to reach +0.3%.

...and the ongoing creation of jobs for wage earners, which is amplified by labor market support programs



The sharp drop in domestic demand took an unprecedented hit on the population of small businesses ...



Sources: EU Commission SBA, ELSTAT & NBG estimates

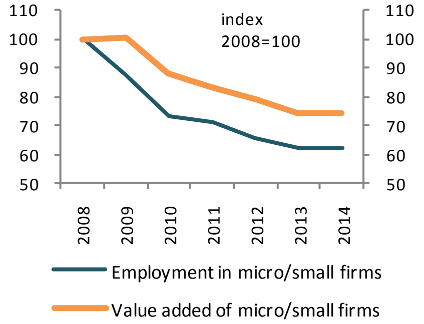
The sharp decline in the population of micro firms against a backdrop of rapidly falling demand explains two thirds of employment losses in the private sector

The improved employment outlook comes after an extremely protracted recession that comprised 22 consecutive quarters of large drops in employment. Total employment contracted by almost 24% or 1.1 million jobs cumulatively in the 5 years to 2013. About 70% of this decline corresponds to the reduction in positions for wage earners (780,000 persons), of which 250,000 are from the public sector (130,000 were temporary workers and the bulk of the remainder are retirees and thus have no material impact on the unemployment rate), about 150,000 were employers, 100,000 unpaid family employees, and only 65,000 were self-employed (freelancers). In percentage terms, employers were the hardest hit by the recession, down by 40% from their 2008 peak, followed by unpaid family workers and wage earners (-37% and -26%, respectively), while the self-employed registered only a marginal decline of 7%.

The economic crisis appears to have taken a disproportionately high toll on employment in micro firms. These firms have, in general, limited capacity to absorb adverse shocks on their turnover, simultaneously facing severe liquidity problems due to high uncertainty and rapidly falling collateral values. In this environment, the share of wage costs in the aggregate business cost structure of a typical micro firm is relatively small compared with other aspects of operating costs (e.g. energy, social security contributions, rental, real estate tax or financial costs). In this context, a significant number of micro-business owners have chosen to close their firms and become self-employed. This strategy could partially explain the relative stability in the number of self-employed.

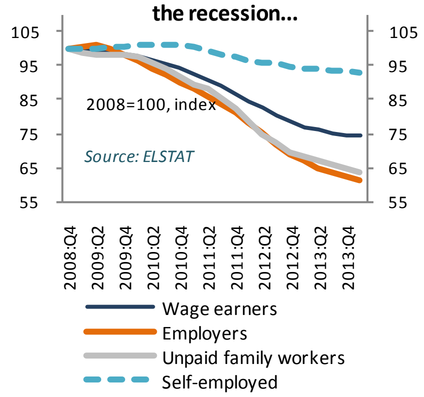
Combining EU Commission data on SMEs' demography with ELSTAT's LFS data for labor market trends by type of employment, NBG Research estimates that around 67% of jobs lost in the economy during the period 2009-2013 were from micro and small firms. Indeed, EC estimates for micro and small firms (SBA data) combined with LFS data for the number of employers, suggest that the micro & small firm population declined by about 30%, or 220,000 business units, over the period 2009-2013. Since the average micro/small firm in Greece employed 2.1 persons, on average in 2013, according to EC and NBG estimates, the reduction in the micro firm population is estimated to have led to a

...leading employment and value added in the small firms sector to multi-year lows

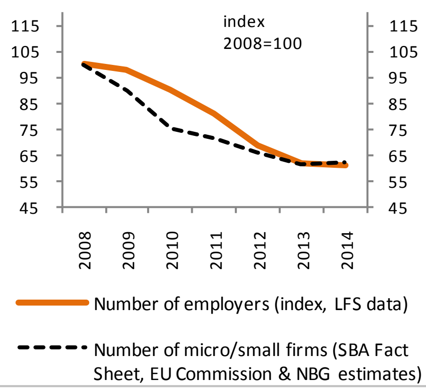


Sources: EU Commission SBA, ELSTAT & NBG estimates

In percentage terms, employers experienced the hardest hit by the recession...



... and the decline in the employers population closely tracks small business closures



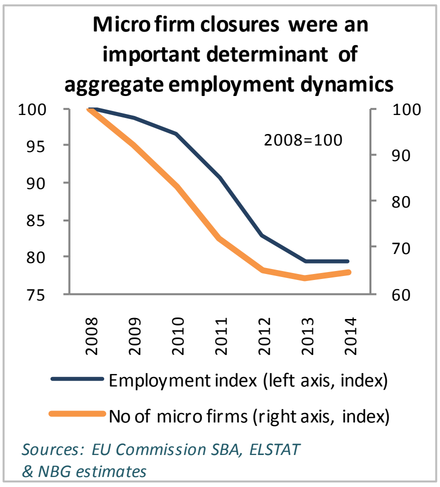
cumulative loss of more than 470,000 jobs during this period.

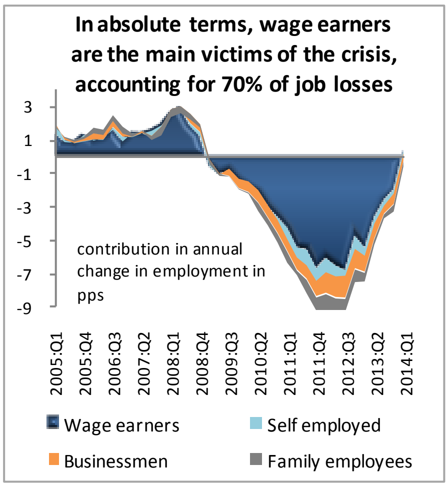
However, the total contribution of micro and small firms to the decline in employment is probably higher than what is suggested by firm closures, as many firms have also resorted to layoffs in their struggle to survive. Indeed, layoffs from remaining micro and small firms in this period are estimated at about 260,000, increasing the total contribution of micro/small firm segment in the job destruction in the economy to 730,000 jobs or 67% of the total employment contraction during 2009-2013.

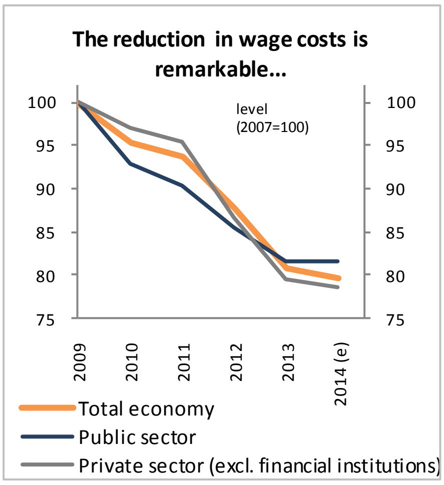
Accordingly, the share of micro & small firms has declined to below 70% of private sector employment in 2013 from almost 78% in 2008. The size of the employment destruction for micro and small firms is not surprising, as their population (as proxied by the number of employers in the economy) historically exhibited a high sensitivity to the economic cycle, with the Greek economy characterized by the highest rate of business creation and destruction in the euro area over the past 20 years. Nonetheless, since the average length of recession in Greece never exceeded 1½ years over the past 5 decades, new business creation in line with the ensuing economic recovery tended to swiftly offset the losses of the recessionary phase, with the economy usually returning to its pre-recession levels within 3 years. However, the current recession has now lasted 22 quarters, and the contraction of domestic demand amounts to a massive 32% in the period 2008-2013 (in constant prices), while the drop in activity in specific sectors reached 70% (e.g. construction). That said, in this environment, the micro firm closures during the crisis reflected not only cyclical pressures, but also structural aspects of adjustment such as the permanent downsizing of non-tradables producing sectors and a rationalization of demand in income-elastic domestic spending categories.

The sizeable wage adjustment leads to a material improvement in real unit labor costs, fully reversing the losses of the previous decade

Wage compression gained momentum in the period 2012-2013, when significant reforms in the private sector wage setting process took place. Indeed, during the first years of the crisis, wage adjustments were made mainly through the reduction in public sector wages, the decline in the compensation of the self-employed and the revision of personal employment contracts. As a result, economy-wide wages declined by only an estimated 6.7%





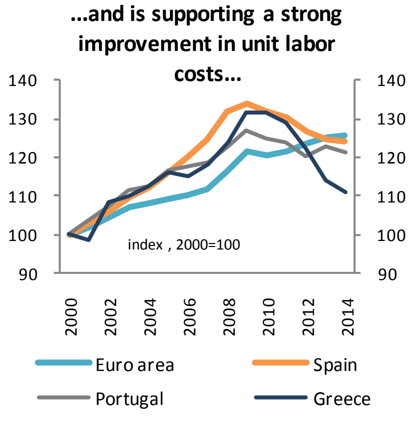


in the period 2010-2011. Wage adjustment accelerated in 2012-13, when several reforms undertaken in 2011 and 2012 led to a reduction of private sector wages by about -16%. The reforms that had the strongest bearing on wage costs are the following:

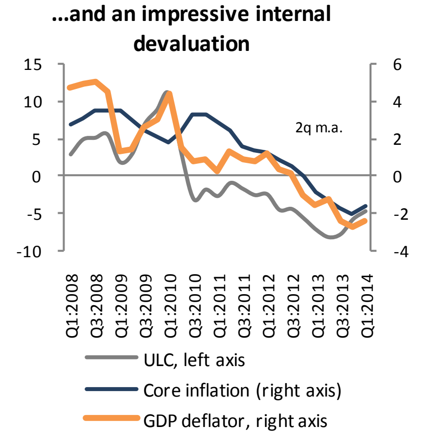
- Prioritization of firm-level wage agreements over sectoral or nationwide collective agreements and the enhancement of firms' ability to opt out from the provisions of collective sector agreements, as regards compensation and working hours, with a view to better aligning compensation and employment conditions with underlying productivity and demand trends and opting for the use of personal contracts.
- Elimination of the administrative extension of existing "occupational" and sectoral collective agreements and the reduction of the effective length/tenure of existing collective contracts by setting the maximum duration of collective agreements to 3 years. The former measure restricted the "after effects" of expiring collective agreements to a maximum period of 3 months, and necessitated the broad-based revision of existing contracts, thus accelerating wage adjustment.
- Reduction in the statutory minimum wage by 32% to EUR 511 for employees under 25 years of age, and by 22% to EUR 586 for those 25 and older. Minimum wages will remain stable until 2016, and the Government rather than the social partners will set the level of the minimum wage from 2017 onwards, taking into account domestic macroeconomic conditions and labor cost competitiveness trends.
- Freezing of "maturity" coefficients embedded in employment contracts that provide for "time in grade" salary increases, until unemployment falls to below 10%.

Overall, it is estimated that wage adjustment for about one third of all employees occurred through the signing of new personal employment contracts that contained wage cuts about 10-40% higher than the respective collective agreements.

Not surprisingly sectors of economic activity in which labor costs adjusted more rapidly, registered smaller employment losses and some of them are already showing signs of recovery. Services sub-sectors, such as transportation and storage, accommodation, health, education and business services registered the most pronounced and timely wage adjustments, and are currently providing encouraging signs as regards near-term employment trends. Most of these segments have also showed remarkable



Source: EU Commission



Source: Eurostat , ELSTAT

progress in the second stage of internal devaluation mechanism, i.e. the transmission of labor cost reductions to final prices. Indeed, deflationary trends in most of the above sectors were particularly strong and started relatively early compared with the rest of the economy. Evidently, in services sub-sectors where the favorable impact of labor cost adjustment was compounded by an increasing export orientation, new investment and structural reforms, employment outcomes are even stronger (e.g. sea-transportation, logistics and tourism related services). Moreover, despite the very challenging juncture for Greek manufacturing, there are some exporting sub-sectors which managed to transform labor cost reductions and successful strategies of business restructuring into recently improving production and employment outcomes, such as the food, beverages and tobacco producing sectors.

Domestically-oriented business sectors, as well as sectors characterized by less flexible labor market structures, experienced the largest employment losses

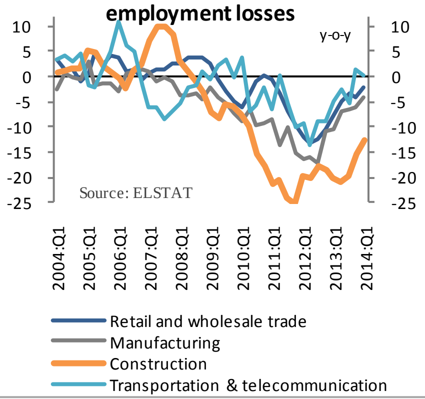
Employment losses were exceptionally high in the non-tradable sectors -- especially in construction, retail, and wholesale trade and in most segments of manufacturing. In fact, 664,000 jobs have been lost in these sectors since 2008. The job losses have been so high since -- in contrast to past experiences of labor market adjustment in Greece -- this time there has been little labor hoarding and employment smoothing, as many firms fought to survive, relying on permanent downsizing.

Construction: The bursting of the pre-crisis construction boom led to significant downsizing

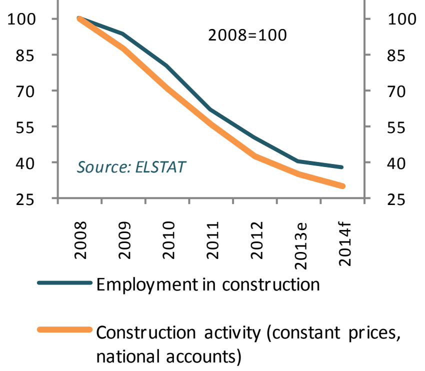
Almost 22% of the total employment contraction during the period 2009-2013 (or 235,000 jobs) occurred in the construction sector (a cumulative employment decline of 59% between 2008 and 2013) and reflected a broad-based collapse in residential construction, public works and business construction activity.

Indeed, residential construction activity (constant price terms, national accounts basis) declined by about 70%, cumulatively, in the 6 years to 2013, and its share in GDP dropped to a historical low of 2.3% from 8.2% in 2008 and a euro area average of 5% of GDP in 2013. Activity in business construction and public works was more resilient, declining by 27% cumulatively in the same period, and its share in GDP shrunk by only 0.2 pps to 3.6% in 2013 compared with 4.6% of GDP in the euro area.

Construction, manufacturing and retail trade account for most of employment losses



Construction: the bursting of the pre-crisis construction boom led to significant downsizing...

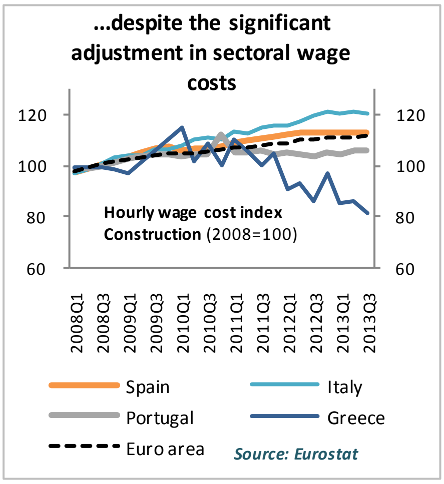


Taking into account the reduction in the number of employers and the average firm size in this sector, we estimate that employment in micro and small construction firms fell by almost 70%, broadly matching the decline in sectoral activity. Adjustment in this sector also occurred through wage adjustment. In fact, sectoral wages in construction declined by more than 25% in the 5 years to 2013 (including the estimated adjustment in compensation through personal contracts and the income of self-employed), bringing ULCs about 21% lower than their 2008 peak.

Evidently, flexible employment forms and a relatively fast adjustment in wages in this sector provided a limited respite to micro construction firms in view of the collapse in activity. Smaller firms are more vulnerable, as they tend to operate as subcontractors of larger firms on construction projects or operate exclusively in the residential contraction segment, which suffered the heaviest output losses. On the other hand, medium-to-large sized firms appear to have resorted to some type of labor hoarding, supported by an accelerating adjustment in labor compensation and working hours. In this respect, near and medium term activity trends are expected to be supportive of a permanent increase in the average size of firms in this sector as infrastructure and business construction projects will dominate the recovery phase, while the survivors of the crisis from the micro-small business segment will mainly operate in the slowly recovering residential segment.

Indeed, according to NBG estimates, non-residential construction activity is expected to grow by 8.5% per year, on average, in the period 2014-16 while residential construction will begin to recover only in 2016, following a further cumulative contraction of -13% in real terms in 2014-15. Accordingly, a further reduction in the number of micro construction firms is likely in 2014-15.

Some preliminary signs of a slowing in recessionary momentum in this sector are becoming evident in recent quarters. The pace of employment reduction in construction slowed to -12.5% y-o-y in Q1:2014 compared with -19.2% y-o-y in 2013. The notable recovery in sectoral employment expectations in construction (EC business survey covering mostly medium and large construction firms) mainly reflects improving trends in the non-residential segment. Currently, the restart of large infrastructure projects creates the foundation for a further slowing in the pace of employment contraction, although employment for the sector as a whole is unlikely to start expanding until 2015 as the weakness of



the residential segment will offset the improvement in business construction and public works.

Employment in the distributive trades sector declined by 25%, somewhat contained by the relatively high flexibility of wages and employment conditions

Employment in the domestic distributive trades sector (retail and wholesale trade) declined sharply -- by 25% or 210,000 jobs -- corresponding to the second largest source of employment reduction during the crisis after construction.

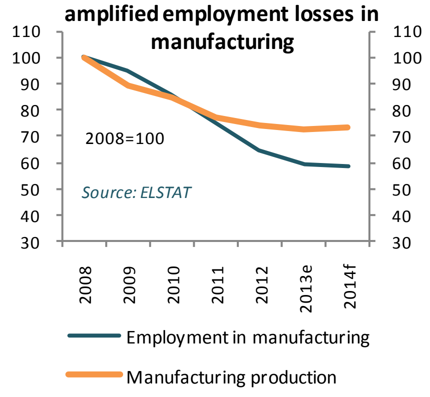
Although, in percentage terms, the decline in employment in this sector was slightly lower than the contraction in domestic demand (-25% compared with a -38% drop in domestic demand in constant prices) and the declines in manufacturing and construction employment (-40% and -59%, respectively), the large contribution of this sector in total employment (18.3% of total employment compared with 11.8% and 9.2%, respectively, for the manufacturing and construction sectors) magnified the final impact on aggregate employment.

Once again, micro and small firms bore the brunt of the adjustment. The number of micro firms operating in trade declined by 33% or about 90,000 units (in net terms, i.e., taking into account the creation of new enterprises during this period), leading to the loss of an estimated 190,000 employment positions. In percentage terms, the employment decline in the micro/small firms segment was broadly analogous to the fall in retail trade volume (-33% versus a cumulative drop in retail trade volume of -37.7%). Only medium-to-large sized firms managed to absorb part of the adverse demand shock without translating it directly into layoffs. Indeed, employment in medium-to-large sized firms declined by an estimated 10% compared with 33% for employment in micro and small firms.

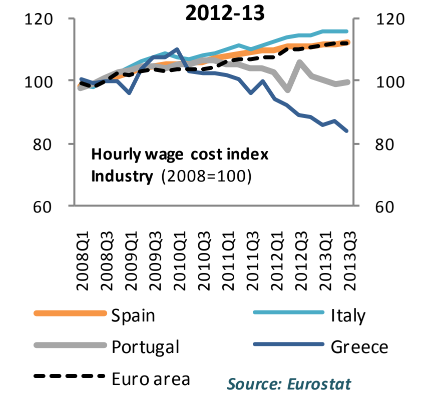
In this respect, the higher intrinsic flexibility of labor market arrangements in trade appear to have protected some jobs by permitting a faster adjustment of wages and working hours (-28% and -12%, respectively, in the period 2009-2013, compared with the respective economy totals of -23% and -8%) -- the most pronounced among all sectors of the economy.

Employment in the retail segment is also showing signs of stabilization since late 2013, while the latest data from the EC business survey suggest an expansion of employment in this segment from Q2:2014 onwards, supported by strong tourism

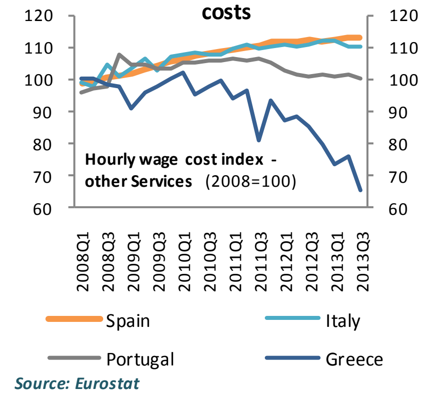
Low competitiveness and delayed labor cost adjustment amplified employment losses in manufacturing



Labor cost adjustment in industry gained traction in the period 2012-13



The services sector experienced the sharpest adjustment in labor costs



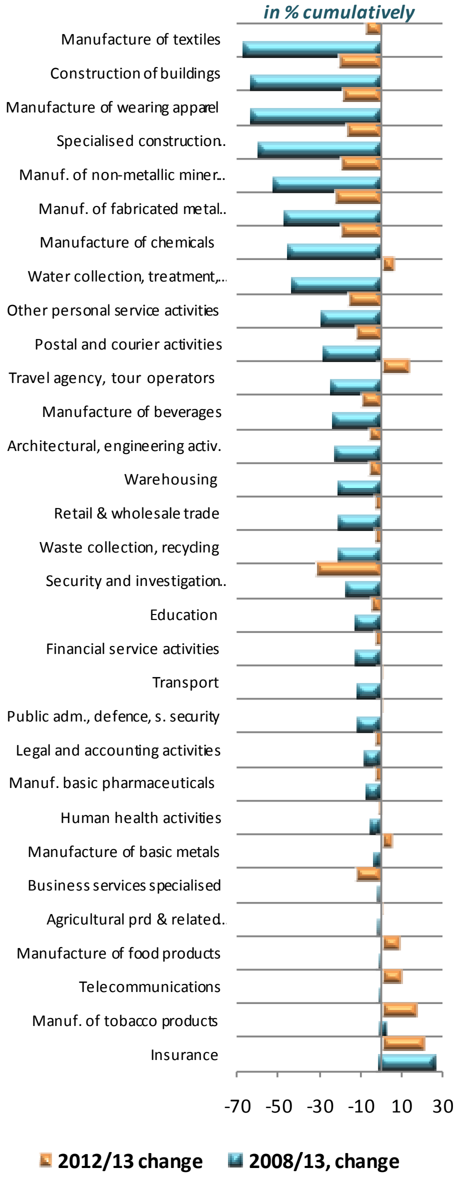
activity, which is becoming an increasingly important determinant of trade. This latter trend reflects an increase in tourist arrivals and revenue of 12.4% and 4.4%, respectively, between 2008 and 2013. Not surprisingly, new labor demand is estimated to come mainly from the medium and large-sized firms that are at an advanced stage of restructuring, have better access to liquidity, and have higher negotiating power with suppliers and a more streamlined marketing and distribution networks. On the other hand, most of the downsizing of the micro business segment is likely to be irreversible (especially in discretionary consumer spending).

Manufacturing: declining consumption of non-tradables, weak external demand, and relatively inflexible employment arrangements took a heavy toll on manufacturing employment

Employment in the manufacturing sector declined by 40% (221,000 jobs) cumulatively in the period 2008-2013, broadly matching the respective decline in industrial production volumes. In fact, the drop in manufacturing employment started a year earlier than in the rest of the economy, together with the beginning of the international financial crisis and the sharp drop in external demand for key exporting sectors (e.g. basic metals, non-metallic minerals, and chemicals). The Greek crisis amplified the pace of job destruction in this sector. Although labor hoarding played a more prominent role for medium and large manufacturing firms, the relatively slow revision of sectoral and firm-level wage agreements and a limited role of adjustment in working hours in the period 2009-2011 (about 60% lower than in the services sector) delayed business restructuring and undermined the viability of more vulnerable firms.

Significant manufacturing sub-sectors, such as metals and non-metallic minerals, have faced additional difficulties due to their high exposure to the rapidly contracting construction activity, whereas activity in other important sub-sectors (e.g. pharmaceuticals) has been adversely affected by the sharp reduction in public sector health spending. Moreover, relatively subdued activity in important export-oriented sub-sectors of manufacturing – such as chemicals, textiles and machinery/equipment -- due to the weak demand conditions in the euro area and SE Europe outweighed the favorable trends in a limited number of exporting sectors, i.e., food, beverages and tobacco products. Again, the distribution of job losses by firm size was highly skewed towards micro/small firms -- especially those producing non-tradables -- which are estimated to account for

Employment trends have started to improve in export-oriented sectors and in sectors where business and cost restructuring is at an advanced stage



almost 80% of jobs lost in the sector (including the impact of closures and personnel cuts in existing firms).

Moreover, labor market reforms during the period 2011-13 contributed to a notable increase in wage responsiveness to demand and productivity trends and permitted a more efficient adjustment of employment patterns to current business conditions. Indeed, wage costs in manufacturing started to decline at an accelerating pace only from 2012 – down 16.3% since Q4:2011, due to the revision of existing sectoral and firm-level collective agreements, in conjunction with an increasing role of personal contracts. Accordingly, unit labor costs declined by about 15% in the 4 years to 2013 -- supported also by recovering productivity -- broadly reversing the accumulated losses in cost competitiveness during the period 2000-2009 (a cumulative deterioration of 17% in this period).

Latest data on capacity utilization in exporting sub-sectors of manufacturing, as well as business survey data on production and employment expectations in industry, suggest a stabilization of manufacturing employment.

A protracted period of severe business restructuring has led to, on average, larger and more efficient firms

Although Eurostat data on business demography and characteristics are available with a significant lag that exceeds 2 years, the underlying adjustment in the business sector described above, is suggestive of an increase in the average size of business units in Greece. Indeed, provided than employment in micro and small firms is estimated to have declined by more than 30% in the period 2008-2013 -- compared with an economy-wide decline in employment of 24%, a decline in the employment of freelancers of 6.7% and in public sector employment of 25% -- the implied reduction in employment in medium and large-sized firms is less than 17% in the same period. Accordingly, the share of micro & small firms in total employment has declined to below 70% of private sector employment in 2013 from 78% in 2008 and is expected to decline further to below 64% by end-2015 as employment in larger business units picks up.

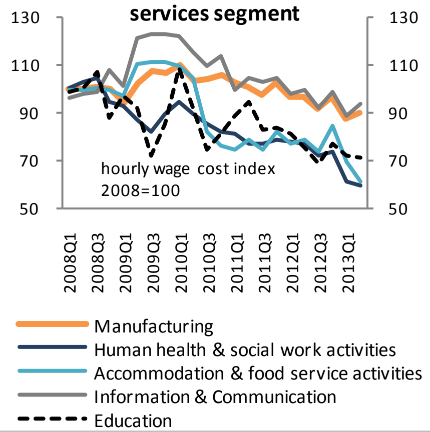
Similarly the economy wide gross operating surplus -- that tracks closely trends in corporates' operational profitability -- has declined by about 16% in the period 2008-2013 and has shown signs of stabilization since H2:2013, while mixed income, which tracks more closely profitability of mostly unincorporated micro

Greece: Adjustment in wages, employment, activity and sectoral structures during the crisis

	Share in total employment 2008	Cumul. Change in Employm.	Number of micro & small firms	Underlying change in sectoral economic activity*
	% total	Cumulative change in % (2008-13)		
Wholesale & retail trade	18,3	-24,9	-36,3	-37,7
Manufacturing	11,8	-40,4	-46,6	-28,0
Agriculture, forestry	11,1	-4,3	-39,0	-5,8
Construction	9,2	-59,0	-70,0	-72,2
Public administration, defence	8,3	-14,4	...	...
Education	7,1	-15,2	9,9	-22,0
Accommodation and food serv.	7,0	-19,5	-25,9	-35,0
Health	5,2	-9,8	-4,4	-12,0
Other sectors	31,8	-18,3	-24,0	-32,0

** on the basis of available national accounts data and/or or conjunctural indicators of activity,*

The adjustment in wage costs is remarkable, especially in the services segment



and small firms, dropped by 28% during the same period. These developments are also supportive of an increasing role of larger business units in the Greek economy.

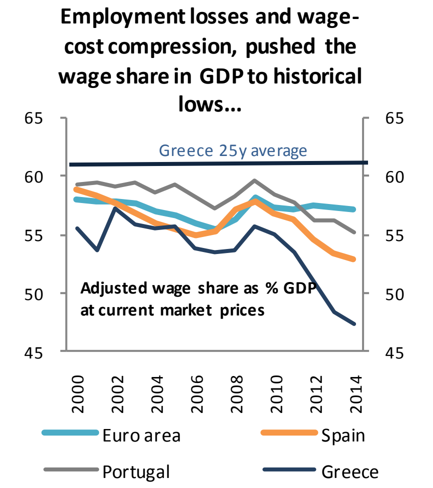
Rapidly advancing business restructuring in the corporate segment, in conjunction with falling labor costs, lay a solid foundation for a recovery in corporate profitability

Wage adjustment, compounded by a notable improvement in labor productivity in 2012-13, led to a reduction in nominal unit labor costs that exceeded 15% by end-2013. In relative terms, compared with the rest of the euro area, the cumulative improvement in unit labor costs exceeded 20% during this period, pushing them to below their 2000 level.

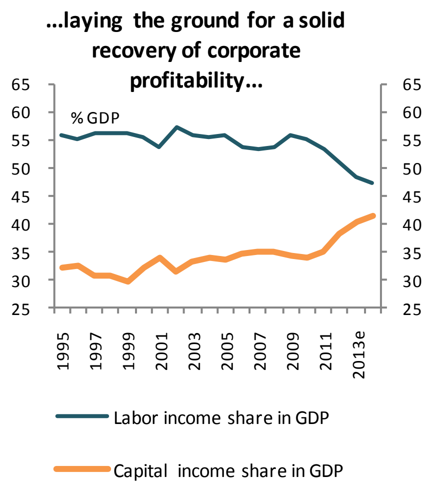
The above trends have accelerated the restructuring of the Greek corporate sector, and in conjunction with rising turnover from exporting activities, are reflected in the stabilization of operational profitability by end-2013 (as proxied by developments in the gross operating surplus for the non-financial business sector of the economy). Evidently, larger, more competitive firms will drive the next stage of business recovery, and will play an increasingly important role in activity and employment trends in the future. Indeed, the favorable impact of unit labor cost reduction and efficiency gains on operational profitability of Greek businesses are estimated to lead to an average annual increase in the operating surplus of the Greek non-financial business sector starting in 2014.

The combined impact of business restructuring and declining labor costs is reflected in the compression of the wage share in GDP to extreme lows, providing a strong signal of an imminent recovery in employment

The significant adjustment in wages, in conjunction with the sharp fall in employment and the increasing resilience of capital income, led the wage share in GDP to an all-time low. The wage share corresponds to the compensation of the total number of employed divided by the gross domestic product at current market prices. In this context, the wage bill of the self-employed is calculated (by Eurostat and EC databases) under the assumption that their wage rate is equal to the compensation of wage earners and thus, the wage share metric that includes the imputed income of the self-employed is referred to as “adjusted labor share”. In the 5 years to 2013, the adjusted wage share in Greece declined by 7.3 pps, to



Source: AMECO

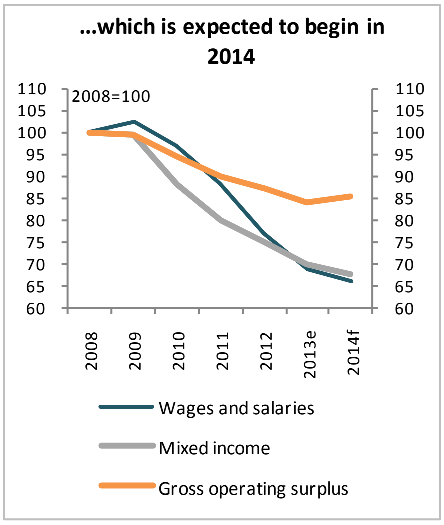


48% of GDP compared with 57% of GDP in the euro area. This ratio is now 9 pps of GDP below the euro area average and among the lowest in the euro area.

In contrast, capital income, mainly comprised of gross operating surplus of the business sector (i.e. the operational profitability generated from invested business capital), as well as other secondary sources of income (interest, pensions, agricultural income, etc.), has proved much more resilient during the crisis, declining by only 19.7% versus a decline of 44% for labor income in the 5 years to 2013. Adjusting for the share of capital income related to incorporated enterprises (corresponding to a part of mixed income with the estimate provided by the EU Commission), the share of capital income in GDP increased by 7.3 pps of GDP compared with 2 pps, on average, in the euro area. Indeed, there are increasing signs of a recovery in the gross operating surplus, by an estimated +2.8% y-o-y in FY:2014, following a reduction of 2.7% y-o-y in 2013.

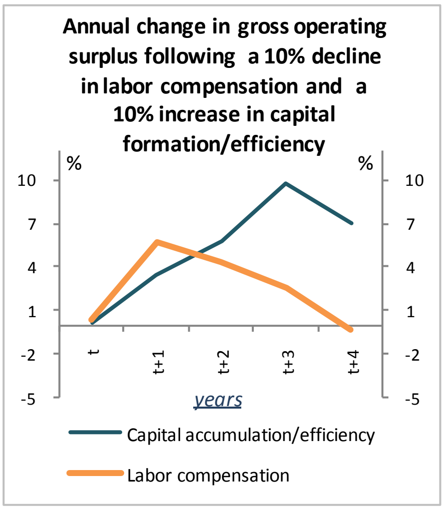
The collapse in the wage share in GDP in comparison with capital income in part reflects the low contribution in capital income of the relatively uncompetitive micro-businesses, which absorbed a sizeable part of the recessionary shock. In contrast, larger and more productive firms have proved far more resilient, as exemplified by the cumulative decline in gross operating surplus in the past 5 years by only -16% compared with a -28% fall in mixed income, with the latter largely reflecting revenue from unincorporated business activity. Larger firms took advantage of their wider range of adjustment options that included wage and personnel cuts, rationalization of production and distribution costs, liquidity hoarding, deleveraging and declining dependence on external financing and/or lower liquidity costs. The above factors lay the foundation for a recovery in business profitability as cyclical conditions improve.

This conjuncture is admittedly favorable for new hirings as wider profit margins should lead to higher investment and business expansion. NBG Research tries to estimate this upside to employment using a small VAR model that links corporate profitability trends (annual growth of gross operating surplus) with the growth in total compensation of employees and the part of GDP growth that is unrelated to labor, as obtained from the residual of the bivariate regression of potential GDP growth on employment. This latter variable is used as a proxy of the contribution of net capital accumulation and/or efficiency trends



on corporate profitability. The model is estimated on historical data for the Greek economy for the period 1994-2013. Although a VAR model, its theoretical foundations are that a profit-maximizing firm will hire labor until the real wage and labor's marginal product are equal. Thus, the contribution in gross operating surplus is no longer positive.

The model-based sensitivity (corresponding to the specific impulse response function from this model) of total labor compensation to annual changes in gross operating surplus, in conjunction with assumptions regarding the path of nominal wages and potential GDP growth, are used to project employment trends in the Greek economy over the period 2014-2020. In this context, we assume that wage growth will remain subdued following the economic recovery (constant real wage until 2016 and a cumulative increase of +4% in real terms for the period 2017-2020), while growth of real GDP is assumed to be lower than the latest Programme estimates (+2.3% per annum in 2014-2020 compared with 3.1%). These GDP growth forecasts are clearly dependent on the consistent implementation of the programme, including its growth-enhancing structural reform agenda. GDP deflator trends from the latest Programme DSA analysis are used to transform real GDP growth into nominal GDP levels and real wage into nominal compensation.

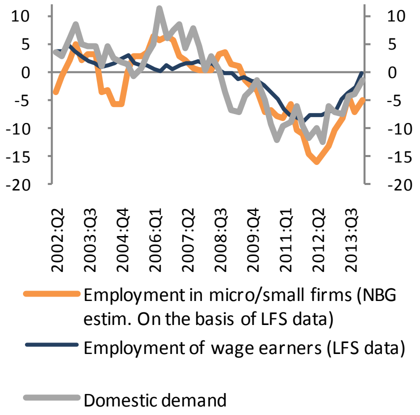


Using historical data for 2013 as a starting point and combining model-based estimates (impulse response functions and variance decompositions obtained from the system) with the assumptions for exogenous variables described above, we construct simulated paths of employment and gross operating surplus trends, consistent with the baseline scenario for real potential growth in the period 2014-2020 (assuming a constant elasticity of substitution between labor and capital).

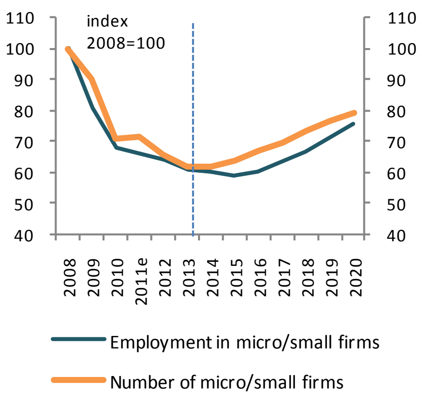
The model projects the average annual growth in capital income (GOS) of 3.5% (25% lower than its 30-year average, in real terms) in 2014-2020. The above estimates do not take into account the significant margins of further improvement in labor productivity and employment and the concomitant acceleration of capital returns through the renewal of existing capital stock on the basis of new investment in the following years.

Regarding employment, the results suggest that the improving momentum of capital income in Greece is estimated to greatly support hiring decisions. It is estimated that it will be profitable for Greek firms to increase their employment by an average pace of

Greece: Employment in micro enterprises is highly procyclical



A prospective upswing in new firm creation, in growing sectors, will support employment



2.5% per annum until 2020 or 18% cumulatively in 2015-2020, without facing a decline in their marginal returns on capital income. In this scenario, the wage share converges in 2022 to the euro area average. This corresponds to a cumulative increase in employment of almost 19.6% by end-2020 (720,000 employment positions), which could push the unemployment rate below 21% in 2016 and 12% by end-2020 on the basis of current demographic trends.

Overall, the empirical setting -- based on historical estimates of model elasticities -- and the conservative assumptions regarding the path of exogenous variables (potential GDP and real wages), as well as the extremely favorable starting point for employment creation in 2013 (historically low wage share, solid recovery in profitability), suggest that Greek firms have considerable scope to increase hiring as well as increase profitability in excess of the baseline scenario.

Upscaling of competitive business units and new micro/small firm creation in growth sectors will be the drivers of new employment creation

Though the transition to larger and more competitive production units will be -- as indicated above in the context of corporate hiring decisions -- the cornerstone of business adjustment and employment dynamics in the following years, the strong pro-cyclicality of the more dynamic and innovative micro/small business creation is also expected to play a significant role in employment trends. Specifically, an emerging round of new business creation through accelerating start-ups is expected to lay the foundation for a new generation of more efficient and export-oriented micro firms, which will support employment growth. Indeed, in H1:2014 there are increasing signs that the gap between business start-ups and closures declines for the first time in six years in early 2014 (according to latest estimates of Greek International Business Association SEVE, and retail SME business federation ESEE).

In this respect, the completion of remaining reforms in the business environment aiming at facilitating business creation, increasing inter-sectoral mobility of labor and capital, in conjunction with improving liquidity conditions, will be highly supportive of employment growth in view of the traditionally high job intensity of micro business creation. In this context, and using the historical elasticity of employment sensitivity to micro firm demographics, we estimate that even a reasonably moderate pace of net annual business creation of about 3.6% of existing micro/small firms stock (compared with an 18-year average of 4.5%) would translate in 75,000 new job positions until 2016 and about 200,000 by end 2020 corresponding to almost ¼ of the estimated total employment creation in the economy in this period, while the rest is expected to come from new hiring and upscaling of activities by existing firms.

GREECE

Macro View - Economic Outlook

Increasing signs of an imminent recovery in economic activity with consumer spending and services exports trends exceeding initial estimates

Greece: Tracking the economy's cyclical position

	Feb-12	Mar-12	Apr-12	May-12	Jun-12	Jul-12	Aug-12	Sep-12	Oct-12	Nov-12	Dec-12	Jan-13	Feb-13	Mar-13	Apr-13	May-13	Jun-13	Jul-13	Aug-13	Sep-13	Oct-13	Nov-13	Dec-13	Jan-14	Feb-14	Mar-14	Apr-14	May-14	Jun-14
PMI (index level)	37,7	41,3	40,7	43,1	40,1	41,9	42,1	42,2	41	41,8	41,4	41,7	43	42,1	45	45,3	45,4	47	48,7	47,5	47,3	49,2	49,6	51,2	51,3	49,7	51	51	
Industrial confidence (index level)	-23,6	-21,6	-19,3	-21,9	-24,9	-25,5	-25,4	-21,8	-20,1	-17,6	-11,7	-13,7	-12,5	-11,6	-11,1	-6,7	-8,8	-10,6	-10,7	-5,3	-9,9	-11	-10,6	-11,2	-7,1	-4,1	-8,9	-4,9	1,3
Manufacturing production (yoy)	-11,1	-8,8	-3,2	-3,4	-4,9	-6,1	2,5	-6,5	3,9	-0,2	1,4	-2,0	-1,4	0,1	2,4	-3,1	4,7	-4,4	-4,8	-3,4	-5,7	-5,0	-1,6	0,7	3,6	-1,0	-3,0		
Industrial production (yoy)	-8,9	-8,4	-2,9	-3,0	0,0	-4,0	2,9	-7,2	3,9	-3,4	-1,5	-4,7	-4,6	-1,5	0,4	-5,6	0,7	-8,1	-7,8	-1,6	-5,1	-5,4	0,5	0,9	2,9	-2,7	-2,1		
Services confidence (index level)	-30,6	-32,2	-31,3	-31,1	-43,2	-42,8	-41,8	-40,9	-46	-38,4	-31,4	-28,6	-22,5	-22,4	-22,7	-13,1	-2,5	-4,6	-7	-9,7	-7,1	-8,1	-4,9	2,5	4,5	4,9	6	6,5	18,4
Consumer confidence (index level)	-83,5	-79,3	-78,7	-75,8	-70,4	-64,7	-65,2	-75,6	-77,5	-74,1	-72,1	-71,9	-71,4	-71,2	-71,8	-63,4	-66,5	-70,9	-76,6	-72,2	-66,2	-66,7	-63,3	-64,5	-65,2	-59,7	-55	-53	-49,8
Retail confidence (index level)	-38,7	-35,8	-37,6	-34,9	-35,2	-31	-26,6	-37	-48,4	-40,1	-33,5	-30,5	-33,1	-25,9	-26,7	-15,2	-19,1	-21	-21,3	-22,5	-22,8	-18,1	-15	-11,6	-8,4	-10	-9,7	-7,4	2,5
Retail trade volume (yoy)	-13	-16	-13	-10	-11	-9	-9	-12	-18	-17	-8	-17	-14	-6	-14	-2	-8	-14	-8	-5	-1	3	-6	-0,3	0,9	-0,8	7,1		
Building Permits (yoy)	-5	1	-32	-8	-40	-49	-29	-47	-31	-66	-33	-28	-45	-56	-16	-51	-15	-4	-30	-37	9	89	-44	-41	-5	4			
House prices (yoy, quarterly series)	-11	-11	-11	-11	-11	-13	-13	-13	-13	-13	-13	-11	-11	-11	-12	-12	-12	-9	-9	-9	-9	-9	-9	-8	-8	-8			
Construction confidence (index level)	-56	-61	-59	-61	-62	-56	-53	-58	-53	-57	-63	-59	-47	-46	-39	-35	-34	-32	-30	-18	-37	-33	-39	-23	-23	-14	-20	-20	-19
Employment (y-o-y)	-9,7	-9,1	-8,9	-8,9	-10,5	-9,4	-8,9	-8,7	-7,8	-7,6	-6,9	-7,5	-7,0	-7,0	-6,2	-5,9	-4,2	-4,9	-3,9	-3,4	-3,4	-2,9	-2,5	-1,1	-0,8	-0,3			
Employment Net creation of positions | wage earners | ERGANI	-10,5	-10,5	-10,8	-11,7	-11,4	-10,3	-9,8	-8,6	-8,2	-6,4	-6,0	-5,2	-4,2	-2,8	-1,6	-0,4	-0,1	-1,1	0,0	0,7	2,0	3,4	6,8	8,8	10,5	11,0	13,6	13,9	
Interest rate on new business loans (CPI deflated)	4,4	4,7	4,4	4,8	5,0	4,6	4,1	4,9	4,1	4,7	5,0	5,7	5,7	6,0	6,3	6,0	5,9	6,2	6,8	6,7	7,6	8,4	6,8	7,1	6,5	6,8	7,2		
Credit to private sector (y-o-y)	-3,9	-4,0	-4,3	-4,4	-5,3	-7,8	-7,7	-8,4	-8,2	-8,1	-8,4	-9,5	-8,9	-6,8	-6,8	-7,4	-6,8	-5,1	-4,8	-4,7	-4,8	-4,7	-4,3	-3,5	-3,7	-5,5	-4,9		
Private sector deposits (y-o-y)	-19,2	-18,8	-16,9	-18,4	-19,9	-17,8	-18,6	-16,2	-12,6	-10,5	-7,4	-6,2	-2,3	-2,3	-3,9	1,6	4,9	2,4	2,5	1,7	0,5	0,4	-1,5	-2,4	-3,9	-3,0	-1,6		
Interest rate on new time deposits (households, CPI deflated)	2,8	3,3	3,1	3,5	3,7	3,5	2,8	3,7	3,0	3,6	3,9	4,4	4,4	4,6	4,8	4,5	4,3	4,2	4,6	4,2	5,0	5,7	4,5	4,3	3,9	4,2	4,1		
Economic sentiment index (EU Commision, NBG weights, Greece)	79	79	81	80	78	80	80	80	80	82	87	86	87	89	90	94	94	92	90	94	92	92	91	93	95	98	95	99	104
Economic sentiment index (EU Commision, Euro area)	96	96	94	92	92	89	88	86	86	87	88	90	91	91	89	90	92	93	96	97	98	99	100	101	101	102	102	103	102
Exports (other (excl.oil&shipping) y-o-y 6m mov.avg	15,5	11,1	7,6	6,2	6,9	4,0	2,9	-0,9	0,9	-1,2	2,0	3,2	5,2	7,3	8,3	7,2	2,9	3,0	2,4	3,4	0,7	0,9	1,4	-1,0	-1,5	-1,3			
Imports (other (excl.oil&shipping) y-o-y 6m mov.avg	-4	-9	-11	-12	-13	-16	-15	-17	-16	-17	-17	-16	-14	-9	-6	-6	-4	-1	-2	0	-3	0	4	2	4	2			
NBG Composite Index of cyclical conditions ► ► ► ►	-49,3	-42,7	-37,6	-32,8	-34,6	-32	-27,1	-37,6	-29,4	-31,4	-25,8	-27,8	-24,4	-21,9	-17,8	-17,1	-9,31	-16,9	-13,7	-7,01	-12,1	-9	-3,97	-0,8	-1,2	-0,2	0,5	1,3	4,9

Color map scale

Rapid contraction — *Moderate contraction* — *Slow contraction* — *Stabilization* — *Slow expansion* — *Moderate expansion* — *Rapid expansion*

Sources: NBG, BoG, ELSTAT, EU Commission, IOBE

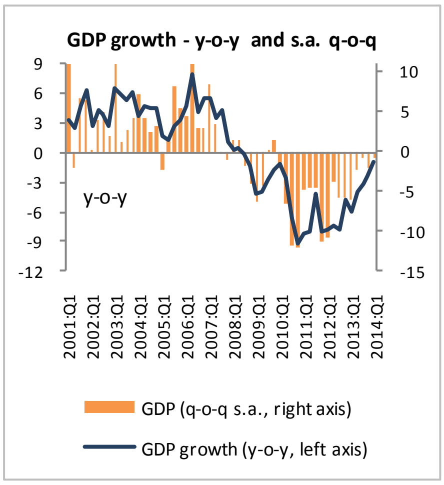
Greece: Growth Outlook

	2011	2012	2013	2014f	2012		2013f				2014f			
					Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2f	Q3f	Q4f
GDP (% yoy, non-seas & w.days adj.)	**-7,1**	**-7,0**	**-3,9**	**0,8**	**-7,7**	**-4,9**	**-6,0**	**-4,0**	**-3,2**	**-2,3**	**-0,9**	**0,2**	**1,6**	**2,0**
GDP (% q-o-q, NBG s.a.)	…	…	…	…	*-1,6*	***-1,5***	***-1,2***	***-0,1***	***-0,7***	***-1,2***	*-0,1*	*0,3*	*0,7*	*0,3*
Domestic Demand (y-o-y)	**-8,7**	**-10,1**	**-5,7**	**-0,2**	-12,4	-6,0	-7,1	-7,4	-4,3	-3,8	-1,4	-0,8	0,0	1,3
Final Consumption (y-o-y)	**-7,2**	**-8,9**	**-5,6**	**0,2**	-10,7	-8,5	-8,9	-6,4	-6,1	-0,8	0,8	0,1	0,2	-0,2
Private Consumption (y-o-y)	-7,7	-9,3	-6,0	1,1	-9,2	-9,6	-8,7	-6,6	-7,8	-0,2	0,7	1,5	1,9	0,3
Public Consumption (y-o-y)	-5,2	-6,9	-4,1	-3,5	-17,4	-3,3	-9,7	-5,5	1,7	-2,6	1,2	-5,1	-6,0	-4,0
Fixed Capital Formation (y-o-y)	**-19,6**	**-19,2**	**-12,8**	**-1,2**	-21,5	-10,3	-11,4	-11,5	-12,9	-15,3	-7,9	-6,8	-2,8	12,8
Residential construction	*-18,0*	*-32,9*	*-37,8*	*-23,8*	…	…	…	…	…	…	…	…	…	…
Total GFCF excluding residential	*-20,3*	*-13,1*	*-4,1*	*3,9*	…	…	…	…	…	…	…	…	…	…
Inventories* (contribution to GDP)	**0,7**	**0,2**	**0,9**	**-0,3**	-0,1	2,8	2,5	-0,3	2,6	-1,2	-1,2	-0,1	0,1	0,0
Net exports (contribution to GDP)	**2,4**	**3,9**	**2,0**	**1,0**	4,7	1,6	1,7	3,6	0,9	1,8	0,6	1,1	1,7	0,6
Exports (y-o-y)	**0,3**	**-1,7**	**1,8**	**5,6**	-3,1	-4,0	-2,2	1,6	5,2	0,5	5,4	4,0	7,2	5,2
Imports (y-o-y)	**-7,3**	**-13,8**	**-5,3**	**1,8**	-18,7	-8,1	-7,0	-11,1	2,7	-5,6	2,2	-0,1	2,7	2,2

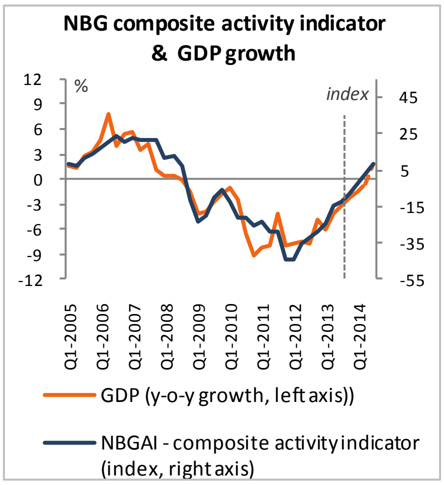
*also including other statistical discrepancies

Source: EL.STAT. and NBG Research Estimates

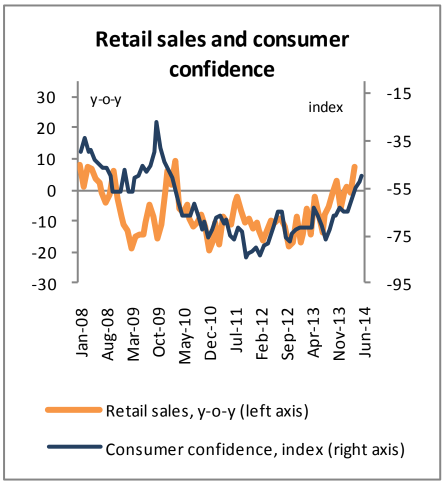
GDP stabilized on a qoq basis in Q1:2014 and forward-looking indicators point to a further improvement in macroeconomic conditions in Q2:2014



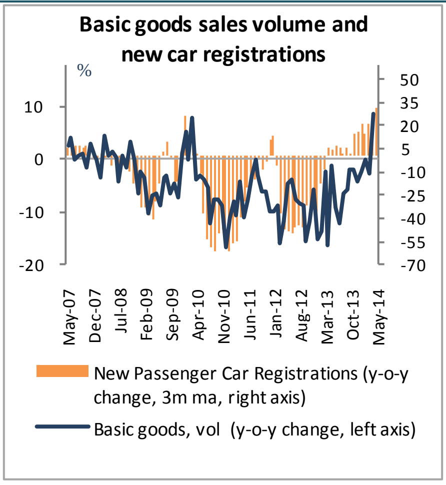
NBG's composite leading indicator suggests that the economy has started to expand in Q2:2014 following 22 consecutive quarters of contraction



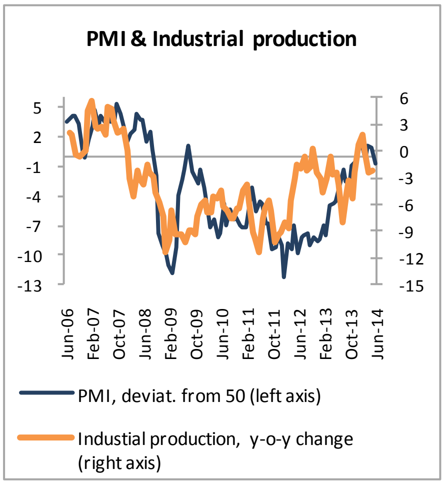
Private consumption has shown a notable improvement, increasing marginally in Q1:2014, on the back of favorable base effects and disinflation…



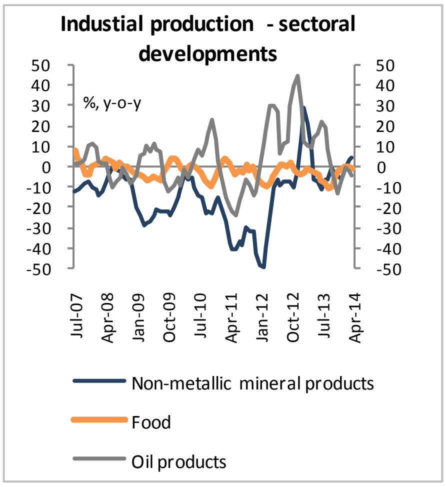
…while the latest readings of coincident and forward - looking indicators for consumption entered expansionary territory in Q2:2014, supported by buoyant tourism activity



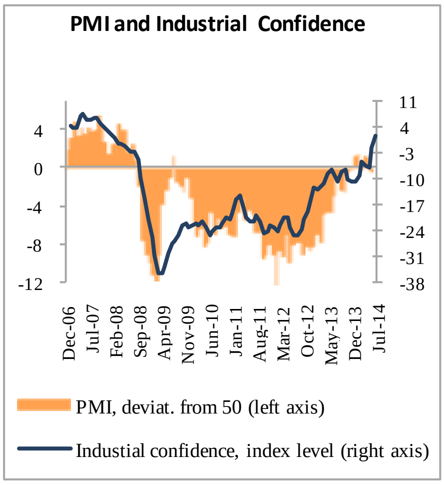
Industrial activity approaches an inflection point…



…although production in key sectors remains weak

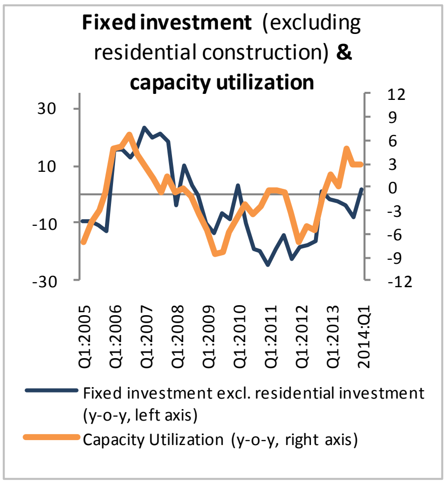


Forward-looking indicators are pointing to an imminent expansion of business activity starting from Q2:2014



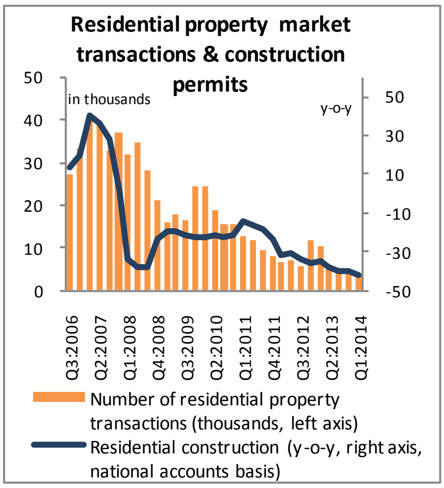
PMI and Industrial Confidence

Fixed investment declined at a slower pace in Q1:2014, as investment in equipment and infrastructure suggests that construction is gaining traction



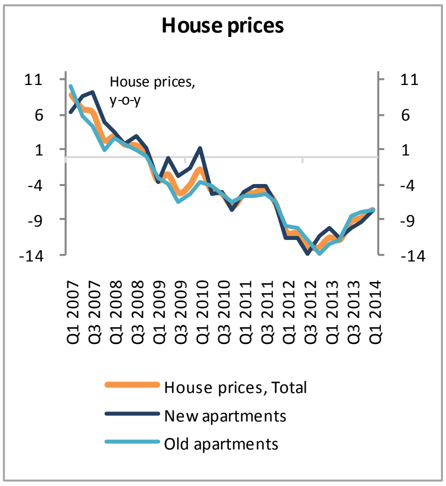
Fixed investment (excluding residential construction) **& capacity utilization**

The adjustment in the residential segment -- building activity and housing transactions -- continues unabated



Residential property market transactions & construction permits

The decline in house prices was slower in Q1:2014, with the peak-to-Q1:2014 adjustment reaching -34.7%



House prices

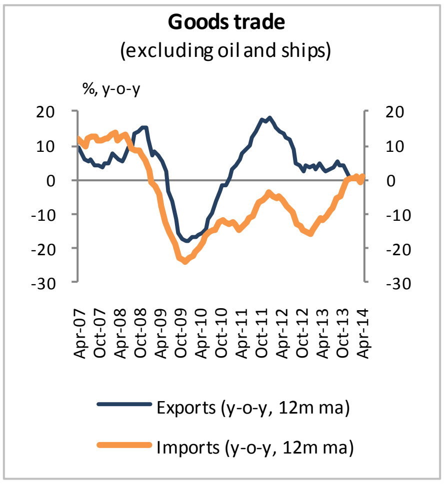
The current account is heading towards the 2nd consecutive annual surplus in 60 years...

Balance of Payments (as % GDP)

	2012	2013	2014f	2013 Q1	2013 Q2	2013 Q3	2013 Q4	2014 Q1
Current Account	-2,4	0,8	1,2	-1,2	-0,1	2,8	-0,7	-0,6
Non-oil Trade Balance	-4,9	-5,2	-5,4	-1,2	-1,3	-1,2	-1,5	-1,3
Non-oil Exports	7,5	8,0	8,2	1,9	2,0	2,0	2,1	1,9
Non-oil Imports	12,4	13,3	13,6	3,2	3,3	3,2	3,6	3,2
Oil Balance	-5,3	-4,2	-4,1	-1,3	-0,7	-1,3	-0,9	-1,2
Services Balance	7,8	9,3	11,4	0,8	2,3	4,8	1,5	1,1
Income Balance	-0,8	-1,5	-1,2	-0,5	-0,5	-0,4	-0,2	-0,4
Current Transfers, net	0,7	2,5	0,6	0,9	0,2	0,9	0,5	1,2
Capital transfers	1,2	1,7	2,0	0,6	0,0	0,9	0,1	0,8

Source: Bank of Greece

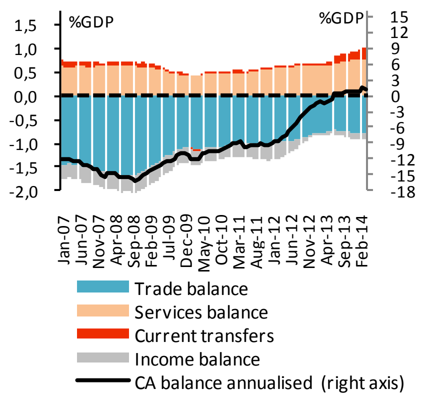
...as the trade deficit stabilizes at 17-year lows



Goods trade
(excluding oil and ships)

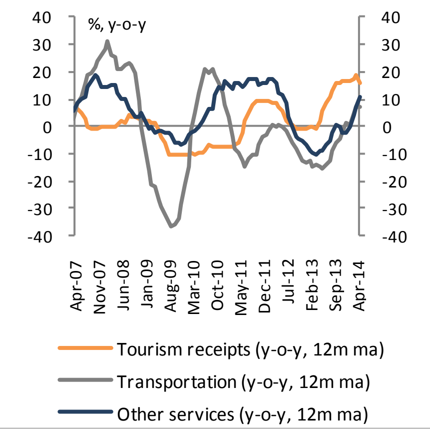
Current account components' trends in 5M:2014 are supportive of an additional improvement in 2014

Decomposition of Current account balance (nsa, 12-month m.a.)



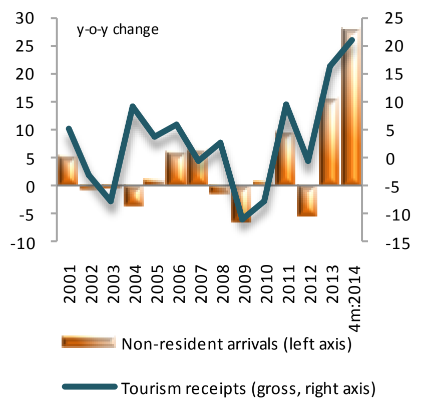
Services exports register strong increases…

Services receipts, gross



…driven by buoyant tourism activity: +10.6% y-o-y in revenue and +17.0% y-o-y in arrivals in 5M:2014. and a rebound in net shipping revenue (+24% y-o-y)

Tourism receipts and arrivals



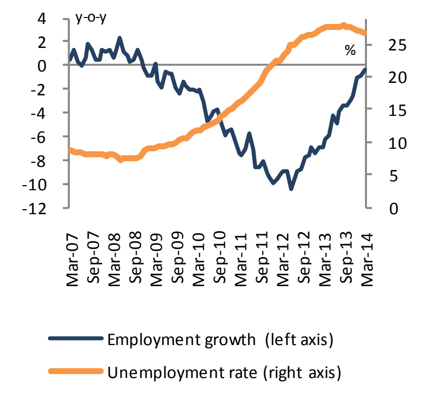
Private capital inflows to the Greek economy are increasing supporting the recovery process

Greece: Private capital inlows 2013-H1:2014	euro bn	% GDP
Financial/equity investment to listed firms	5,0	2,7%
Foreign direct investment	3,3	1,8%
Greek banks recapitalization	8,9	4,9%
Greek sovereign and coprorate bonds	8,0	4,4%
Total	**25,2**	**13,8%**

Source: BoG, HELEX, Unctad, NBG estimates

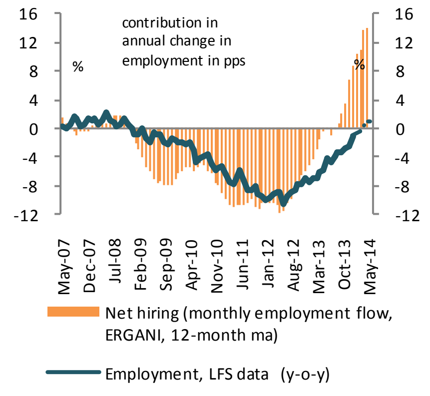
Labor market conditions improved in Q1:2014, with employment declining by 0.7% y-o-y compared with 2.9% in Q4:2014, and the unemployment rate falling to 26.9% from 27.6% in Q4:2013

Employment - Unemployment

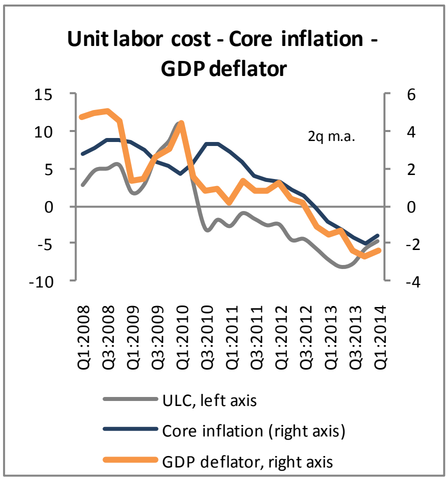


Coincident and forward-looking indicators suggest that employment will start increasing in Q3:2014

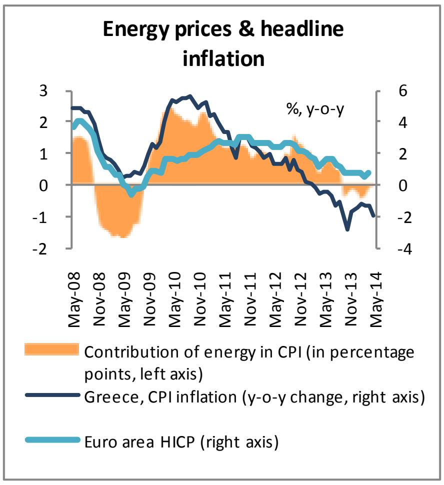
Net hiring of wage earners (ERGANI) & employment (LFS data)



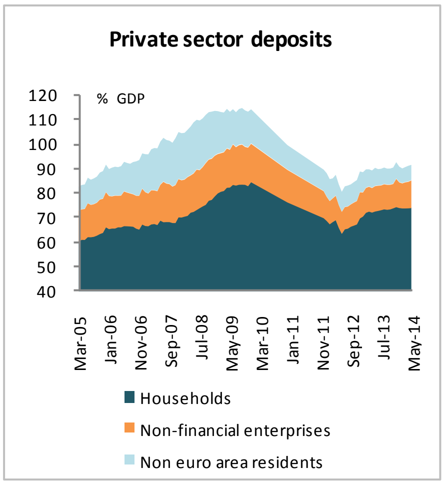
Disinflation continues at a slowing, though still rapid, pace …



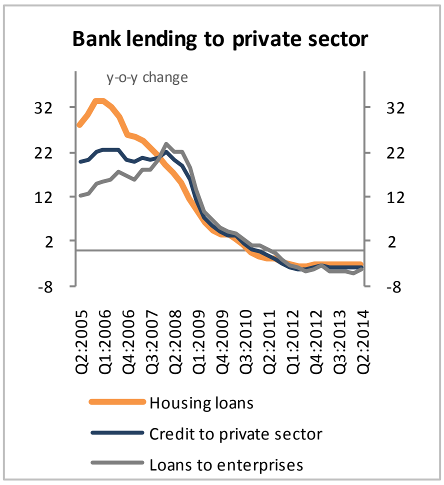
…as lower imported inflation amplifies the impact of low demand and declining labor costs



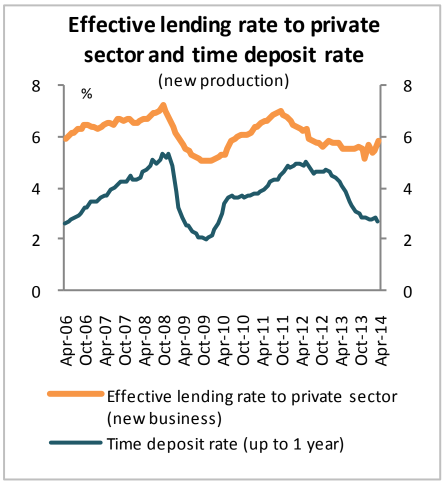
Private sector deposits have increased in May for a 4th consecutive month (+€1.1 bn compared with January 2014)



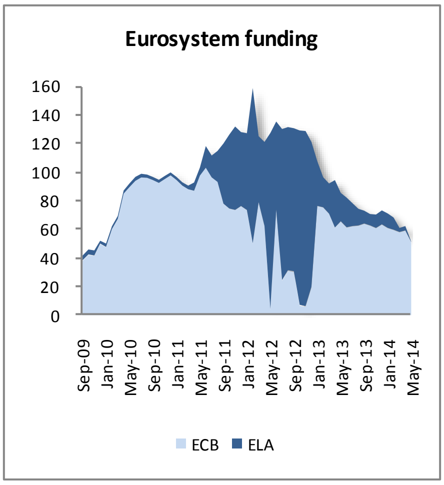
…whereas bank credit continues to contract, albeit at a slower pace compared with Q1:2014 (-3.5% y-o-y in May compared with -4.1% y-o-y in March 2014)



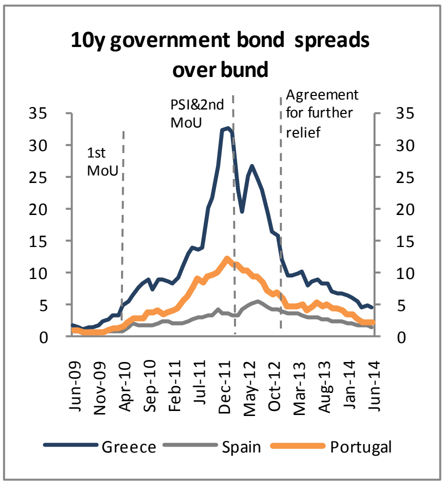
Deposit rates are declining, but the transmission to lending rates is more gradual, reflecting, *inter alia*, credit risk and liquidity concerns as well as credit composition effects



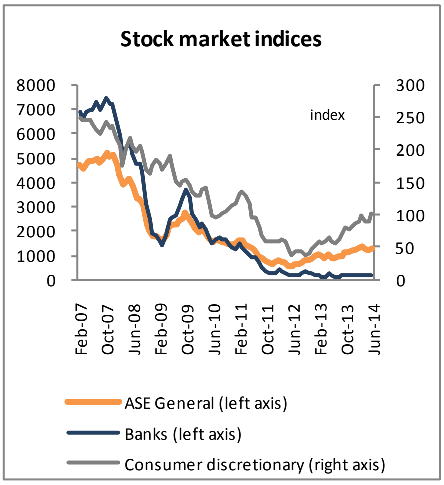
The dependence of Greek banks on Eurosystem funding decreased further in June (to €45bn or 11.4% of total liabilities) from €135bn in Q2:2012



Greek government bond yields fell to a 4.5-year low on the back of a solid improvement in fundamentals and a supportive international environment



Greek stock market valuations (ASE General) have increased by 131% from their mid-2012 trough, while y-t-d change reached 7.9%



Fiscal Outlook

Greece remains on course to overperform for a second consecutive year compared with its annual fiscal targets

Budgetary developments in 5M:2014 confirm solid budget execution on the back of improving revenue trends which supplement a continuing overperformance on the spending side.

More specifically, State Budget implementation trends in 5M:2014 (modified cash basis) reveal an improved tax revenue performance in May, offsetting most of the shortfall during the period January-April. In fact, total tax revenue exceeded the respective target (on the basis of new MTFS 2015-18) by €0.15 bn in 5M:2014 (-0.9% y-o-y) compared with a shortfall of €0.4 bn in 4M:2014. This improvement mainly reflects an overperformance in revenue from corporate income tax (€0.3 bn above the 5M target and +590% y-o-y) and increasing VAT revenue (in line with the 5M target, -0.7% y-o-y, compared with slippage of €0.27 bn in 4M:2014) as recessionary pressures ease. Revenue trends are expected to improve further in the following quarters in conjunction with the prospective recovery in demand, though disinflationary trends remain – supported by strong tourism activity – and the implementation of a higher effective burden on the income of professionals and small businesses arising from a new Income Tax Code, together with the abolition of most of the remaining tax deductions on personal income. Recall that the seasonality of tax payments is heavily skewed to H2, reflecting the period when taxes are due.

Continued spending restraint remains a key factor of adjustment, with primary government spending declining by -8.4% y-o-y in 5M:2014 (€0.5bn lower than in 5M:2014 and €1.5 bn down compared with the same period in 2013). The main drivers of the improvement are further reductions in social security financing (-€1.1 bn compared with 5M:2013), operational spending (-21% or €0.25 bn), as well as savings from lower spending on allowances for public servants and social protection.

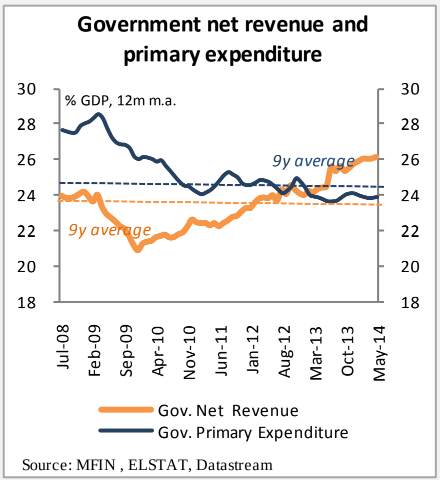
However, financing demands of the social security funds remain a problem against a target of lower budget transfers, and a high level of social security contribution evasion. It is notable that the public investment program execution, as well as planned tax refunds -- traditional sources of budgetary savings -- fully met their 5M:2014 targets set by the MTFS 2015-18.

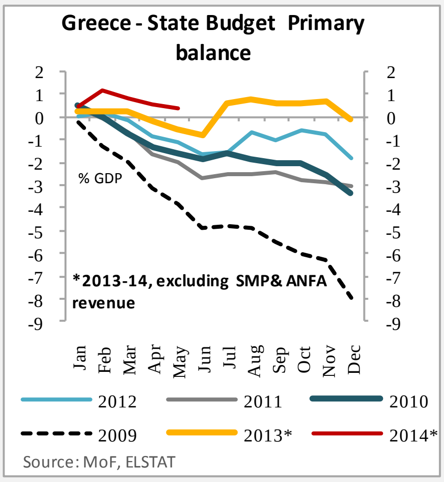
Overall, the **primary surplus in the State Budget** in 5M:2014 reached 0.4% of GDP, exceeding by 0.3% of GDP the respective 5M MTFS target. The programme definition for the **general government primary balance** includes the surplus of the entities forming the rest of General government (extra budgetary funds, local governments, social security funds, state owned enterprises) -- an estimated 1.4% of GDP in FY 2014 according to the MTFS 2014-18 -- which is largely financed by transfers from the state budget. Not surprisingly, the financial position of social security funds shows a net deterioration of about 0.3% of GDP in 4M:2014 compared with the same period in 2013 that mainly reflects lower budget transfers (-0.4% of GDP lower compared with the same period in 2013). Overall, the general government budget implementation data (on a modified cash-basis) for 4M:2014 suggest that the above surplus remains significant (c. 0.6% of GDP). The H1:2014 programme target is 0.2% of GDP and the outcome needs to be adjusted for the accumulation of new arrears (see below).

Continuing pressures in the financial position of the health fund and in the social security system remain the main sources of new arrears formation

It is estimated that new government arrears of €0.8 bn have been accumulated in 4M:2014 in addition to the €1.3 bn accumulated in 2013. This formation mainly reflects overruns in the main health care fund EOPYY where the full returns from corrective actions in the form of clawback mechanisms and further spending cuts have not yet been achieved -- as well as continuing delays in payments by social security funds, hospitals and local governments. A new amount of about €2 bn euros is earmarked, according to the MTFS, for the clearance of these arrears in the period 2014-15 (this amount is additional to the €8 bn earmarked under the 2nd Program of which €6.6 bn has been disbursed by April 2014). Nonetheless, the overperformance in general government budget implementation in 5M:2014 broadly compensates for the underlying formation of new arrears. With a view to coping with the above problems, EOPYY has launched external audits on claims of private entities (hospitals, clinics, diagnostic centers, etc.), while new KPIs have been established related to the timely payment of invoices, the timeliness of the health insurance premium transfer from the social security fund IKA to EOPYY and the submission of public hospital claims to EOPYY.

The main risks relate to the degree of revenue responsiveness to the prospective pick-up in activity and the slowing of the disinflation process in conjunction with the effective level of tax compliance in H2:2014, when a significant share of household tax payment obligations is concentrated (about 6% of GDP of tax payments). Additional downside risks involve the impact of adverse court rulings on past wage cuts and property levies, which could increase spending of the 2014 budget by about 0.3% of GDP.





Government Budget Implementation 5m.2013 (modified cash basis)	5m.2013	5m.2014			5m.2014/13 y-o-y change	MTFS 2015-2018 Estimates/3
		Outcome	5m.Target	*Deviation from target*	Outcome 5m	Target
			as % of GDP		*y-o-y*	*as % GDP*
I. State Budget Net Revenue (1+2)	**10,2**	**10,4**	**10,4**	**0,0**	***2,3***	**30,8**
1. Ordinary Budget Net Revenue (a+b)	**9,2**	**9,2**	**9,2**	**0,0**	***-1***	**28,0**
a. Revenue before Tax Refunds	9,5	9,9	9,8	0,1	*4*	29,6
b. Tax refunds	0,3	0,7	0,6	0,0	*163*	1,7
2. Public Investment Budget Net Revenue:	0,9	1,2	1,2	0,0	*34*	2,8
II. State Budget Expenditure (3+4)	**12,2**	**11,5**	**11,8**	**-0,3**	***-6***	**31,2**
3. Ordinary Budget Expenditure	**11,6**	**10,5**	**10,9**	**-0,3**	***-9***	**27,4**
of which 3.1 **Primary expenditure**	9,6	8,9	9,1	-0,2	*-8*	23,5
3.2 **Net interest payments**	1,5	1,4	1,5	0,0	*-6*	3,3
4. Public Investment Budget Expenditure	0,6	0,9	0,9	0,1	*56*	3,7
State Budget Primary Balance (I-II+3.2)	**-0,5**	**0,4**	**0,1**	**0,3**	**...**	**2,9**
State Budget Balance (I-II)	**-2,0**	**-1,1**	**-1,4**	**0,3**	***-48***	**-0,3**

Source: MoF monthly release on Budget implementation and Government Budget 2013

Greece: Dates to Watch

August		
1	7	13
Moody's credit rating review for Greece	ECB Governing Council meeting in Frankfurt	EL.STAT release: Quarterly National Accounts (Q2:2014)

September		
August-September	12	12/13
Greece – Review of the Economic Adjustment Programme by Troika	S&P credit rating review for Greece	Eurogroup/ECOFIN finance ministers' meeting

October			
2	10	13	23-24
ECB Governing Council meeting in Rome	EL.STAT release: Annual National Accounts (2013) – Revision according to ESA 2010	EL.STAT release: General government deficit and debt 2013	European Council – EU leaders' summit

November			
October-November	6	21	28
ECB comprehensive bank assessment results	ECB Governing Council meeting in Frankfurt	Fitch's credit rating review for Greece	Moody's credit rating review for Greece

Greek Economy: Selected Indicators

	2012			2013					2014		Most recent		2014f
	Q3	Q4	year aver.	Q1	Q2	Q3	Q4	year aver.	Q1	Q2			
Real sector (y-o-y period average, constant prices)													
GDP	-7,7	-4,9	-7,0	-6,0	-4,0	-3,2	-2,3	-3,9	-0,9	…	Q1:14	-0,9	0,8
Domestic demand	-12,4	-6,0	-10,1	-7,1	-7,4	-4,3	-3,8	-5,7	-1,4	…	Q1:14	-1,4	-0,2
Final Consumption	-10,7	-8,5	-8,9	-8,9	-6,4	-6,1	-0,8	-5,6	0,8	…	Q1:14	0,8	0,2
Gross fixed capital formation	-21,5	-10,3	-19,2	-11,4	-11,5	-12,9	-15,3	-12,8	-7,9	…	Q1:14	-7,9	-1,2
Exports of goods and services	-3,1	-4,0	-1,7	-2,2	1,6	5,2	0,5	1,8	5,4	…	Q1:14	5,4	5,6
Imports of goods and services	-18,7	-8,1	-13,8	-7,0	-11,1	2,7	-5,6	-5,3	2,2	…	Q1:14	2,2	1,8
Coincident and leading indicators (period average)													
Retail sales volume (y-o-y)	-10,1	-14,1	-12,2	-12,5	-8,4	-9,1	-1,8	-8,1	-0,2	…	Apr	7,3	
Retail confidence (15-yr. average: -1,5)	-31,5	-40,7	-36,1	-29,8	-20,3	-21,6	-18,6	-22,6	-10,0	-4,9	Jun	2,5	
Car registrations (y-o-y)	-45,7	-30,9	-41,7	-12,5	7,0	6,4	15,2	3,1	21,3	…	May	49,1	
Consumer confidence (15-yr. average: -42,9)	-68,5	-74,6	-74,8	-71,5	-67,2	-73,2	-65,4	-69,3	-63,1	-52,4	Jun	-49,8	
Industrial production (y-o-y)	-3,0	-0,4	-3,4	-3,5	-1,5	-5,9	-3,4	-3,6	0,5	…	May	1,8	
Manufacturing production (y-o-y)	-4,0	1,3	-4,2	-1,0	1,3	-4,2	-4,2	-2,0	1,1	…	May	1,2	
Capacity Utilization (15-yr. average: 73)	63,7	65,5	64,3	64,5	64,7	66,9	67,3	65,9	66,3	68,5	Jun	68,9	
Industrial confidence (15-yr. average: -6,1)	-24,2	-16,5	-21,5	-12,6	-8,9	-8,9	-10,5	-10,2	-7,5	-4,2	Jun	1,3	
PMI Manufacturing (base=50)	42,1	41,4	41,2	42,3	45,2	47,7	48,7	46,0	50,7	50,5	Jun	49,4	
Construction permits (y-o-y)	-43,7	-44,1	-30,6	-43,5	-30,7	-22,2	2,2	-20,6	-17,0	…	Apr	-7,7	
Construction confidence (15-yr. average: -21,2)	-55,7	-57,7	-58,3	-50,6	-36,2	-26,7	-36,6	-37,5	-20,0	-19,8	Jun	-19,1	
PIP Disbursements (y-o-y)	-46,4	2,2	-10,6	-1,9	-16,3	32,5	28,5	14,5	91,7	…	May	25,1	
Stock of finished goods (15-yr. average: 12,4)	9,4	5,0	10,7	4,9	-0,5	3,4	7,0	3,7	6,7	3,2	Jun	-0,1	
External sector (period average)													
Current account balance (% of GDP)	1,7	-0,9	-2,4	-1,2	-0,1	2,8	-0,7	0,8	-0,6	…	Q1:14	-0,6	1,1
Current account balance (EUR mn)	3219	-1809	-4615	-2239	-184	5056	-1236	1397	-1049	…	Q1:14	-1049	1682
Services balance, net (EUR mn)	7800	2218	15139	1477	4129	8709	2664	16979	1941	…	Q1:14	1941	…
Current Transfers, net (EUR mn)	24	-131	1432	1691	302	1652	821	4466	2209	…	Q1:14	2209	…
Merchandise exports-- non-oil (y-o-y cum.)	1,4	3,9	3,9	1,9	1,3	1,1	0,0	0,0	-1,4	…	Q1:14	-1,4	…
Merchandise imports-- non-oil (y-o-y cum.)	-21,4	-20,4	-20,4	-7,1	-5,4	-2,8	0,6	0,6	1,7	…	Q1:14	1,7	…
Employment													
Unemployment rate	25,5	26,3	24,6	27,0	27,6	27,8	27,6	27,5	27,3	…	Apr	27,3	26,3
Employment growth (y-o-y)	-9	-7,4	-8,9	-7,1	-5,5	-4,1	-2,9	-4,9	-0,9	…	Apr	-1,1	0,3
Prices (y-o-y period average)													
Headline inflation	1,3	1,1	1,5	0,0	-0,5	-1,0	-2,2	-0,9	-1,3	-1,5	Jun	-1,1	-1,0
Core inflation	0,3	-0,4	0,4	-1,2	-1,4	-2,0	-2,1	-1,7	-1,0	-1,2	Jun	-0,7	-0,7
Producer prices excl.energy	0,7	0,6	0,8	0,3	0,3	0,0	-0,5	0,0	-0,7	…	May	-0,7	…
Fiscal policy													
Government deficit/GDP (ESA95 & Progr. adj.)			-6,4					-3,2		…	…	…	-2,7
Gen.Gov.primary balance/GDP (ESA95 & Progr.adj.)			-1,3					0,8		…	…	…	1,7
Government debt/GDP	152,4	157,2	157,2	160,6	169,1	172,1	175,1	175,1		…	Q4:13	175,1	174,6
Revenues--Ordinary budget (cum. % change)	-5,8	-5,2	-5,2	-9,1	-8,9	-1,5	-0,1	-0,1	4,7	3,9	Q1:14	4,7	
Expenditure--Ordinary budget (cum. % change)	-12,7	-12,3	-12,3	-32,7	-23,3	-17,2	-15,8	-15,8	-7,3	-8,2	Q1:14	-7,3	
Monetary sector (y-o-y, end of period)													
Total deposits	-15,2	-5,4	-5,4	2,0	7,6	6,3	-0,4	-0,4	-3,4	…	May	-2,1	
Loans to private sector (incl. sec. & bond loans)	-4,5	-4,0	-4,0	-3,5	-4,1	-3,9	-3,9	-3,9	-4,1	…	May	-3,5	
Mortgage loans (including securitized loans)	-3,7	-3,4	-3,4	-3,2	-3,2	-3,2	-3,3	-3,3	-3,4	…	May	-3,2	
Consumer credit (including securitized loans)	-5,3	-5,1	-5,1	-5,3	-5,2	-4,8	-3,9	-3,9	-3,4	…	May	-2,8	
Interest rates (period average)													
10-year government bond yield	23,8	16,4	24,2	11,1	10,3	10,2	8,6	10,0	7,6	6,2	Jun	5,9	
Spread between 10 year and bunds (bps)	2239	1495	2266	960	887	845	682	841	586	473	Jun	458	
Exchange rates (period average)													
USD/euro	1,25	1,30	1,29	1,32	1,31	1,33	1,36	1,33	1,37	1,37	Jun	1,36	

Sources: BoG, NSSG, MoF, ASE, NBG, Bloomberg

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Macro View

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Note: The Bulletin analysis is based on data up to July 18, 2014, unless otherwise indicated