GREECE A NEW START OR A REPLAY?

AN ECONOMIC POLICY UPDATE

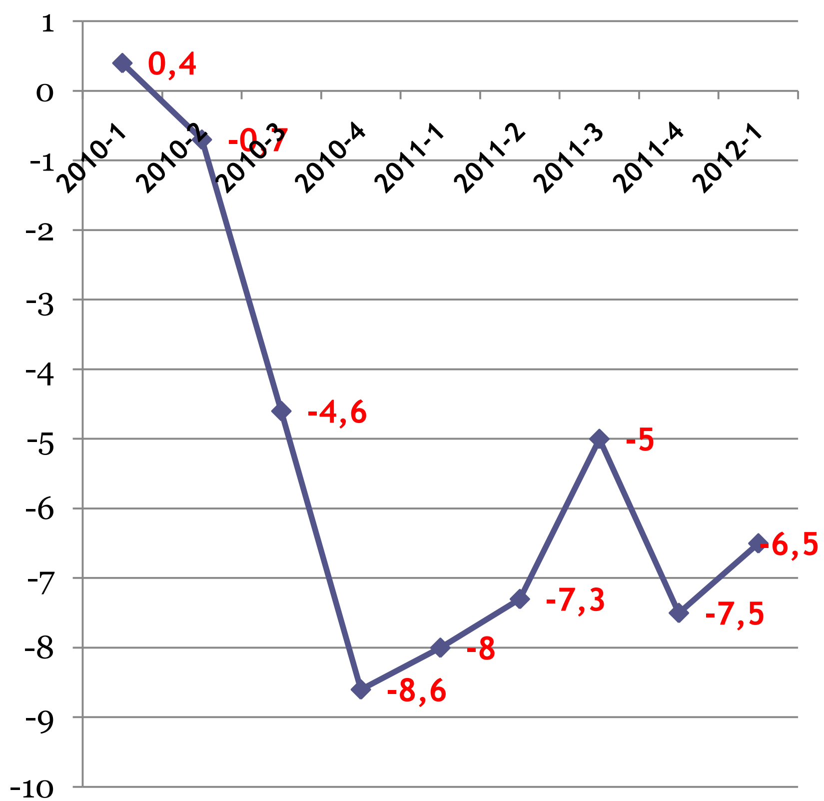
S. TRAVLOS

JUNE 2012

THE ECONOMIC ENVIRONMENT

- GDP is anticipated to decline by as much as 6,5% this year. Further political instability may lead to an even deeper depression this year and further delay in recovery.
- Manufacturing is down by 9,2% in the first quarter of 2012.
- Exports are still growing but not at a considerable pace to cover for the lost domestic demand.
- Unemployment has reached 22,6% in the first quarter of 2012.
- Stress factors are on the increase and accidents may happen.

GDP DECLINES FURTHER IN FIRST QUARTER 2012



STRESS FACTORS INCREASE – ACCIDENTS MAY STILL HAPPEN

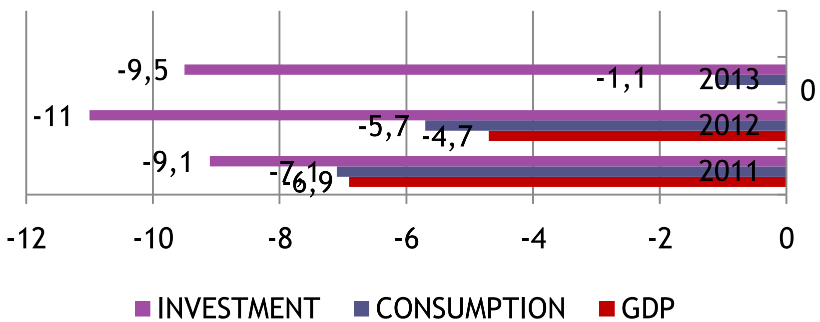
- 241 listed companies have declared losses for 2011 in the order of 7.36 billion euro (163 companies out of a total of 241 are loss making).
- Non-payment of electricity bills has dramatically increased over the last year. Retail consumers owe to the main operator 629 million euro by the end of April 2012 (as against 414 in 2011) while the total due is 1009 million euro.
- Retail activity in fuel has gone down by 25% in March 2012 compared to March 2011 in volume terms and 18.4% in value terms. Retail activity in car dealers has dramatically declined from 107.2 in 2008 to 86 in 2009 and down to 22.7 in the first quarter of 2012.

- The key **systemic risk continues to be** the draining of domestic depositor liquidity out of the Greek banking system with 9 billion euro of deposits evaporating in the pre-election period. Despite the **Recapitalisation** of the 4 larger banks, a bank run may still occur in anticipation of any adverse political developments or in case of failing to successfully re-negotiate the loan agreement.
- Major **public corporations in the energy sector** are at the brink of financial collapse as they are unable to refinance debts and demand for services is falling.
- **Pension funds** are at the brink and are unable to cover obligations in July requiring massive injections from the budget or new cuts in pensions or both.

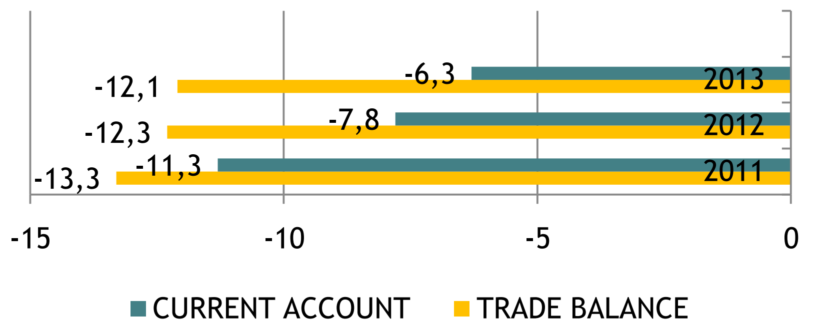
S. TRAVLOS JUNE 2012

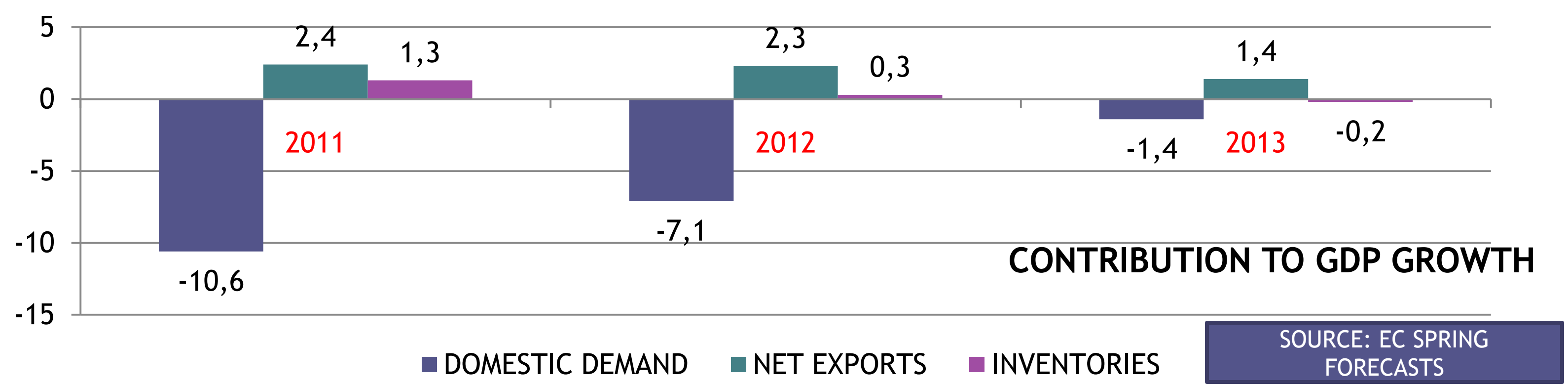
THE OUTLOOK REMAINS DIFFICULT

A MORE DIFFICULT THAN INITIALLY EXPECTED RECOVERY

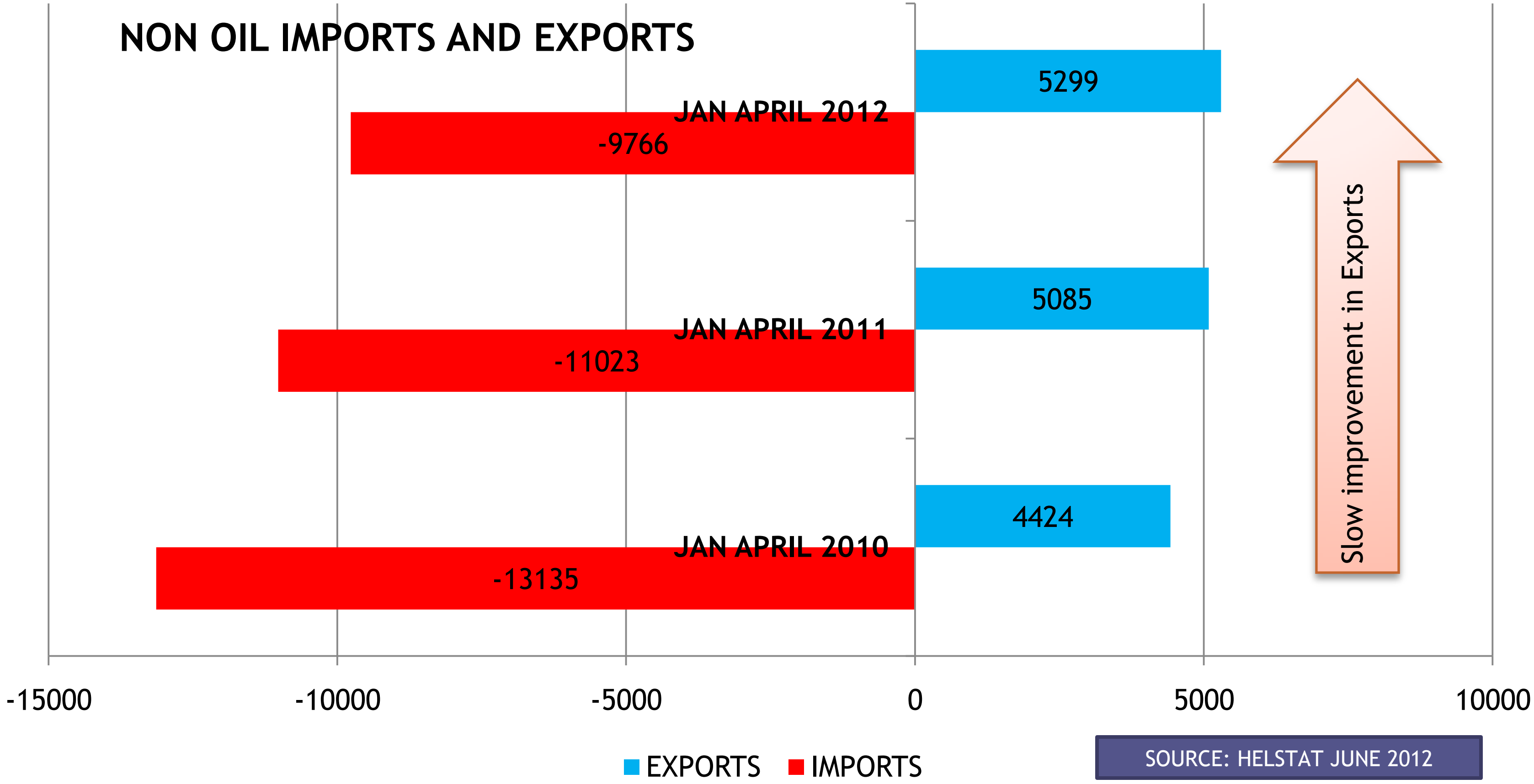


SLOW CORRECTION IN TRADE BALANCE AND CURRENT ACCOUNT (%GDP)





PRODUCTIVE CAPACITY A CONSTRAINT FOR EXPORT RECOVERY

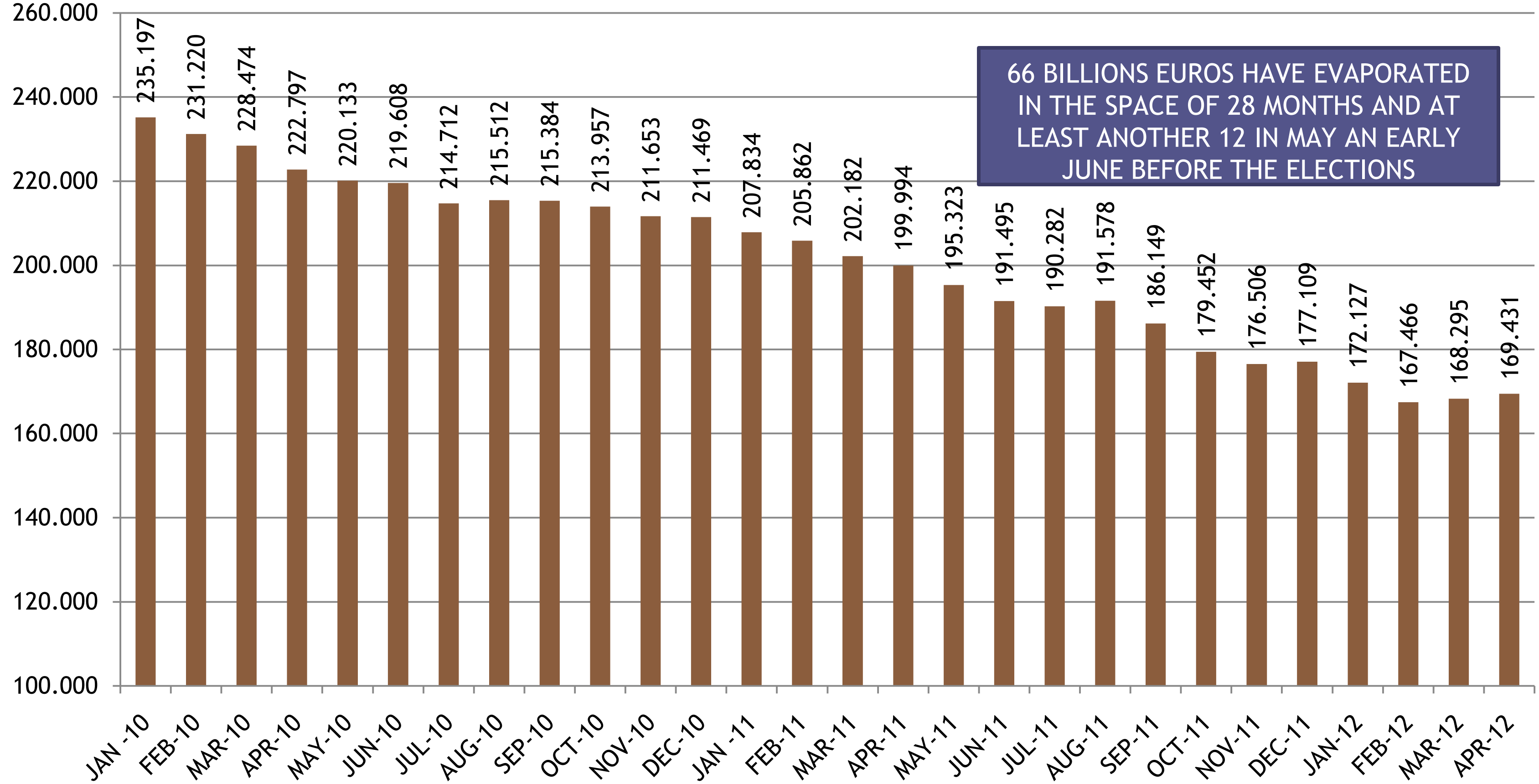


SOURCE: HELSTAT JUNE 2012

FINANCIAL FRAGILITY PERSISTS

- The Blackrock exercise has shown that the capital shortfall of the major banks is considerable estimated at 40 billion euro on the basis of macroeconomic assumptions of 2011.
- The deepening of the recession in 2012 is likely to lead to a requirement of 45 to 60 billion euro for recapitalisation.
- The HFSF has already provided 18 billion euro for the bridge recapitalisation.
- Authorities and bank managements must provide private investors with the right set of incentives so that participation in capital increases is high assuming that the overall economic and market sentiment improves.

A DECREASING POOL OF DEPOSITS



FISCAL CONSOLIDATION

TAX INCOME DECLINES

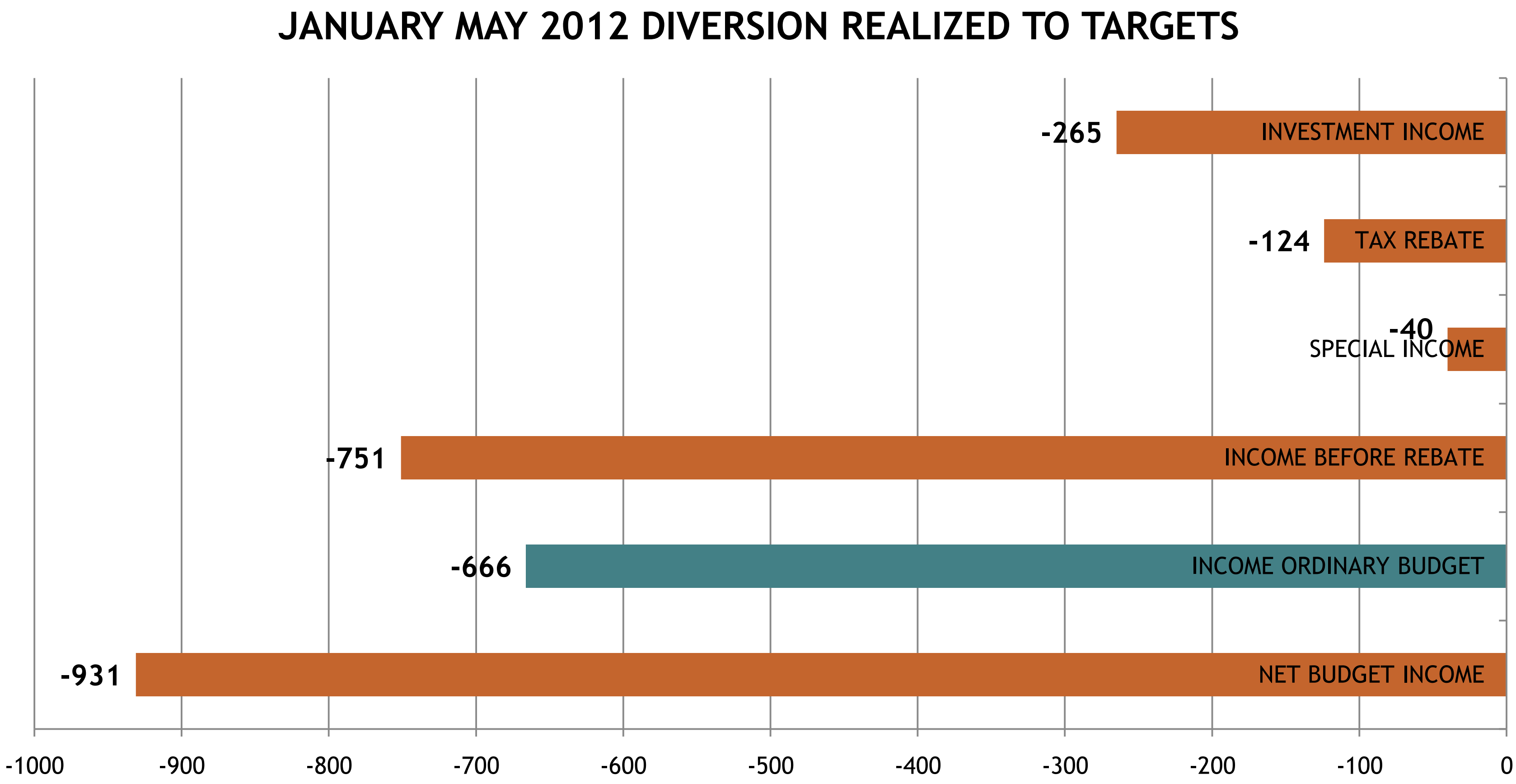
- There was a shortfall in tax receipts in May of 666 million euro or 10% compared to May 2011. On an annual basis the shortfall may reach 1 billion euro if trends continue.
- The main reasons are:
- The shortfall in income tax by 251 million euro.
- The shortfall in VAT and other indirect taxes due to the deepening recession.
- In general there is an increasing tax exhaustion tendency in the economy especially among the middle classes.

EXPENDITURE CONTAINED

- Public expenditure has been contained by 2945 million compared to the target for 2012 but debts to the private sector have exploded to around 6.5 billion euro.
- Operational budget expenditure has declined by 1508 million euro.
- Investment budget expenditure has declined by 1437 million euro.

PRIMARY BUDGET DEFICIT BETER THAN EXPECTED AT -2.356 MILLION AS AGAINST A TARGET OF -4.234 BUT ARREARS HAVE EXPLODED TO 9.251 MILLION EURO

TAX INCOME


JANUARY MAY 2012 DIVERSION REALIZED TO TARGETS
-265
INVESTMENT INCOME
-124
TAX REBATE
-40
SPECIAL INCOME
-751
INCOME BEFORE REBATE
-666
INCOME ORDINARY BUDGET
-931
NET BUDGET INCOME
-1000
-900
-800
-700
-600
-500
-400
-300
-200
-100
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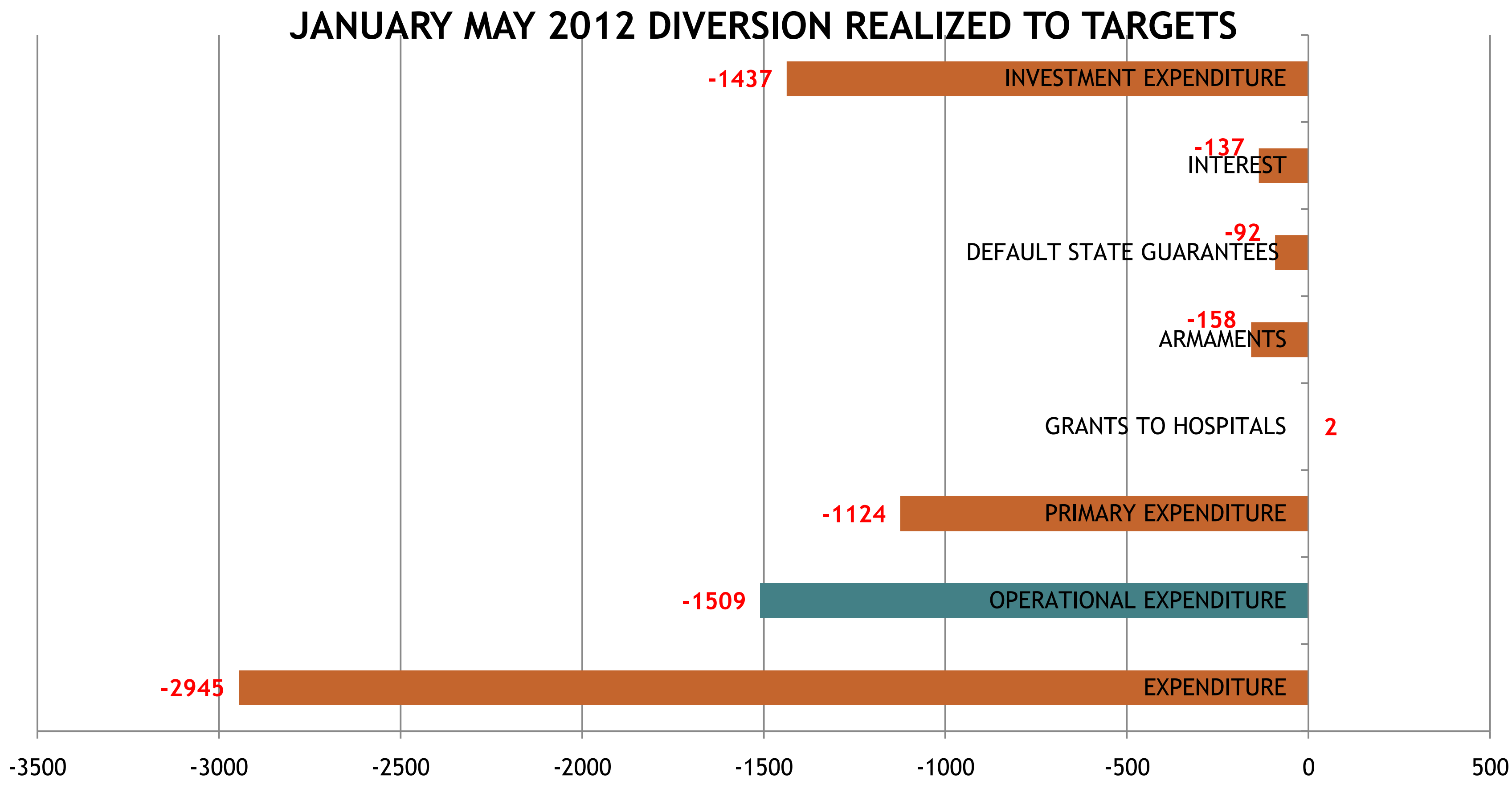
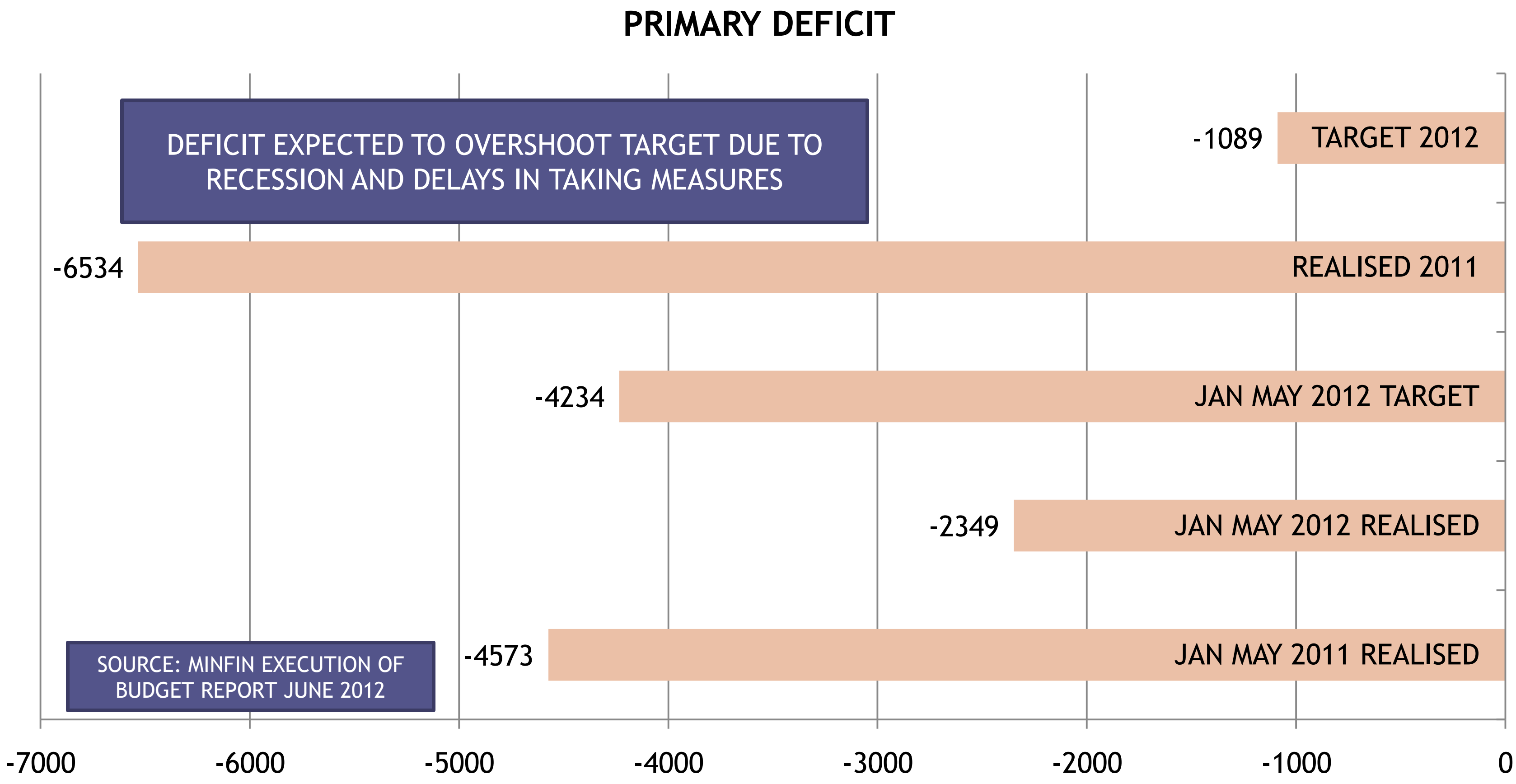
PUBLIC EXPENDITURE



PRIMARY BUDGET DEFICIT IMPROVING?



DEFICIT TARGET EXPECTED TO BE MISSED IN 2012

- The supplementary budget enacted in February 2012 sets a target for deficit at -14.139 million euro or 6.7% of the GDP.
- Following a five month implementation we expect the deficit to close at about -17.000 million euro or above 8% of the GDP by year end.
- In case the recession is deeper than expected the deviation from the target will be considerably larger. If GDP declines by 7% in 2012 we expect the deficit to be closer to 8.5%.

TAX AND EXPENDITURE ALREADY AGREED MEASURES

- Introduce a broad tax reform which will be adopted by **June 2012.**
- Revise the legal values of real estate to better align them with market prices by **June 2012.**
- The Code of Books and Records is repealed in its entirety and replaced by simpler legislation **not later than June 2012.**
- 15 000 redundant staff will be transferred to the labour reserve in the course of **2012**, in connection with the identification of entities or units that are closed or downsized.
- A plan for the clearance of arrears owed to suppliers by public entities is published by **June 2012** and the Government ensures that the stock of arrears steadily declines.
- By **June 2012**, the Government will legislate an average reduction by 10% in the so-called 'special wages' of the public sector .
- Establish a stable structure for Inter-Ministerial Coordination; **[May 2012].**
- The Government presents a pilot version of the e-procurement system **[Q2-2012].**
- EOPYY rationalises the number of contracts with private doctors so as to bring down the doctor-to-patients ratio close to the much lower EU average. **[Q2-2012]**

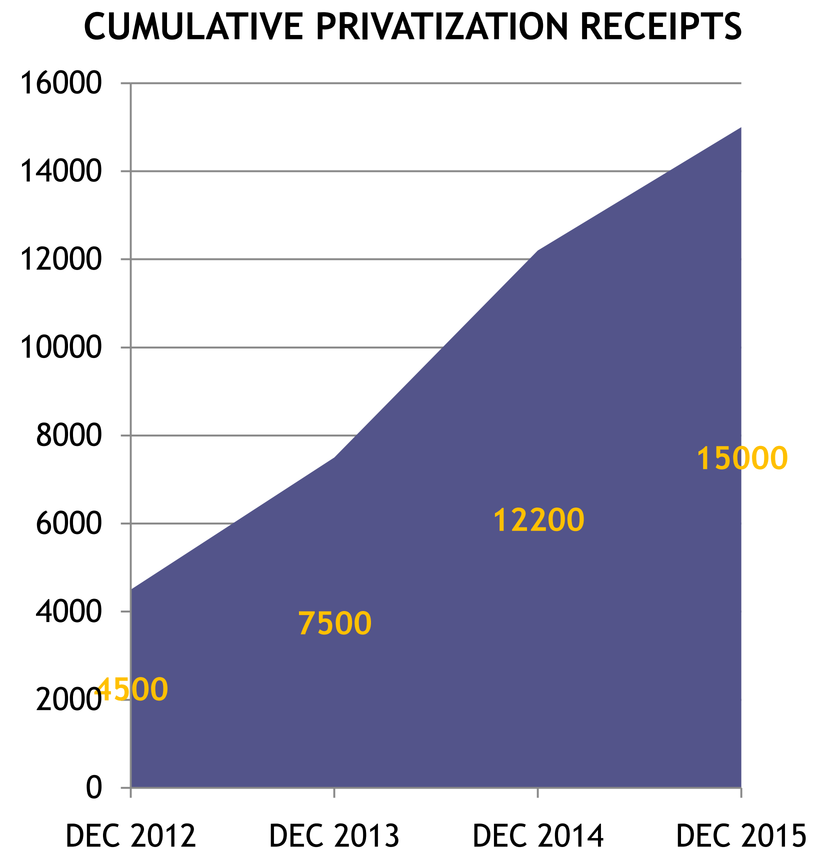
A spending review will be completed by June 2012 to assess areas of further savings in pensions, defense and local authorities.

STRUCTURAL REFORMS COMMITMENTS

- A timetable for an overhaul of the national general collective agreement will be prepared by **end-July 2012**.
- A fully articulated plan for the collection of social contribution will be developed by **end-September 2012**.
- The Government also adopts legislation **by Q2-2012**, to reinforce transparency in the functioning of professional bodies.
- Legislation on fixed fees applied by the main regulated professions by **Q2-2012**.
- Reform of the Code of Lawyers by **Q2-2012**.

A REVISED TARGET FOR PRIVATISATIONS

- Greece must raise 15 billion euro from asset sales until 2015.
- About 3 billion euro of assets will have to be sold by the year end of 2012.
- Top priorities in 2012 include:
  - National Lottery
  - Football Prognostics Organization
  - Hellenic Post
  - Public Gas Corporation
  - Hellenic Gas Transmission System Operator
  - Hellenic Petroleum
  - Hellinikon real estate
  - Athens International Airport



TOO MUCH WORK IN PROGRESS BUT FEW COMPLETE PROJECTS

- Major privatizations are in progress with at least two in a more advanced stage of implementation:
  - Gas Corporation
  - National Lottery
- But few success stories so far:
  - Telecom Organization (392 million euro)
  - Marina Vouliagmenis (43 million euro).
  - VLT licenses (474 million euro).
- The privatization work has been frozen during the current election process.
- The post election environment will be difficult for privatisations:
  - Government may opt to change executives at the Hellenic Assets Fund, and
  - Changes in the procedures may take some time to implement.
  - Market conditions remain difficult or even worsen.

- Major design flows in privatisations have occurred:
  - The most prominent real estate project Hellinikon Airport has been offered without planning studies and development guidelines requiring each participant to invest on these studies and business plan with uncertain outcome.
  - Legislation for regulators in various markets is nit yet ready and it will take time to enact and make the regulators operational before privatisation.
- Lack of preparation in 2010-2011 has resulted in major delays:
  - Advisors have been selected but contracting took several months to complete and as a result preparatory work has been at best patchy.
- Conflicting announcements as to the treatment of privatised sectors have unsettled prospective investors:
  - A major issue concerns the tax treatment of betting profits as it will affect future business activity.

THE NEW GOVERNMENT PLATFORM IS AMBITIOUS

- Renegotiation will be based on:
  - Two year extension of loan agreement until 2016.
  - Free collective agreements to be reinstated including the ability to set minimum wage.
  - New tax arrears arrangement so that payments do not exceed the 25% of 2012 income.
  - Reduction in VAT for restaurants and agricultural inputs.
  - No redundancies in the public sector.
  - Recapitalization of the Agricultural Bank.
  - Extension of unemployment benefit to two years.
- Structural reforms are vague and downplayed:
  - No clear privatization program agreed.
  - Abolition of state entities without redundancies.

A SYRIZA type of program without SYRIZA?

TROIKA SYMPATHETIC BUT NOT LIKELY TO MAKE MAJOR CONCESSIONS

- Troika is likely to accept an extension implementation of the loan agreement and an adjustment on a more gradual achievement of fiscal targets on the basis of a deeper than expected recession.
- Troika is unlikely to accept a general relaxation of the austerity measures as they do not wish a recovery based on domestic demand.
- Troika will not accept any loosening of the structural reforms program.
- European governments reluctant to make any more funding commitments for Greece at this stage as debt outlook worsens in the Eurozone. The extension will require an additional funding for Greece of 16 to 20 billion euro.

Greece has made too many commitments in the past on the structural front and has not delivered.

THE SEQUENCE OF EVENTS TO FOLLOW

- Review of the situation in early July and submission of troika report.
- Preliminary discussions on possible amendments and updating of the Medium Term start during July and concluded by 20th of July.
- A SPECIAL European Council meeting is convened in July in order to discuss the Greek case and ratify any mutually agreed new framework.
- Additional measures are legislated by August and a new memorandum possibly concluded by September.

MAJOR RISKS PERSIST

- Troika not willing to grant major concessions and Government has to take immediate fiscal and reform measures but is unable to legislate leading to increased instability.
- Government reaches agreement with Troika but again fails to implement reforms and disbursement of funds is discontinued by the year-end.
- Major crisis in Spain and/or Italy destabilises the Eurozone and leads to the abandonment of Greece to its fate.

CONTAIN RISKS BY SPEEDING UP STRUCTURAL REFORM IMPLEMENTATION

A LOT TO PROVE

- “The most important task facing new prime minister Samaras is to enact the programme agreed upon quickly and without further delay instead of asking how much more others can do for Greece" – Schauble 24.6.2012.
- “We consider it highly unlikely that Greece will comply sufficiently with even “lite” fiscal austerity conditionality, let alone with structural reform conditionality, including privatisation targets, which are unlikely to be relaxed… The troika – the European Commission, European Central Bank and the International Monetary Fund – may forgive a Greek failure in the September progress assessment, but is unlikely to tolerate another failure to comply on all fronts by the December assessment”- W. Buiter Citigroup, FT. 22.6.2012.

EUROPEAN ENVIRONMENT CHANGES BUT WILL GREECE BENEFIT?

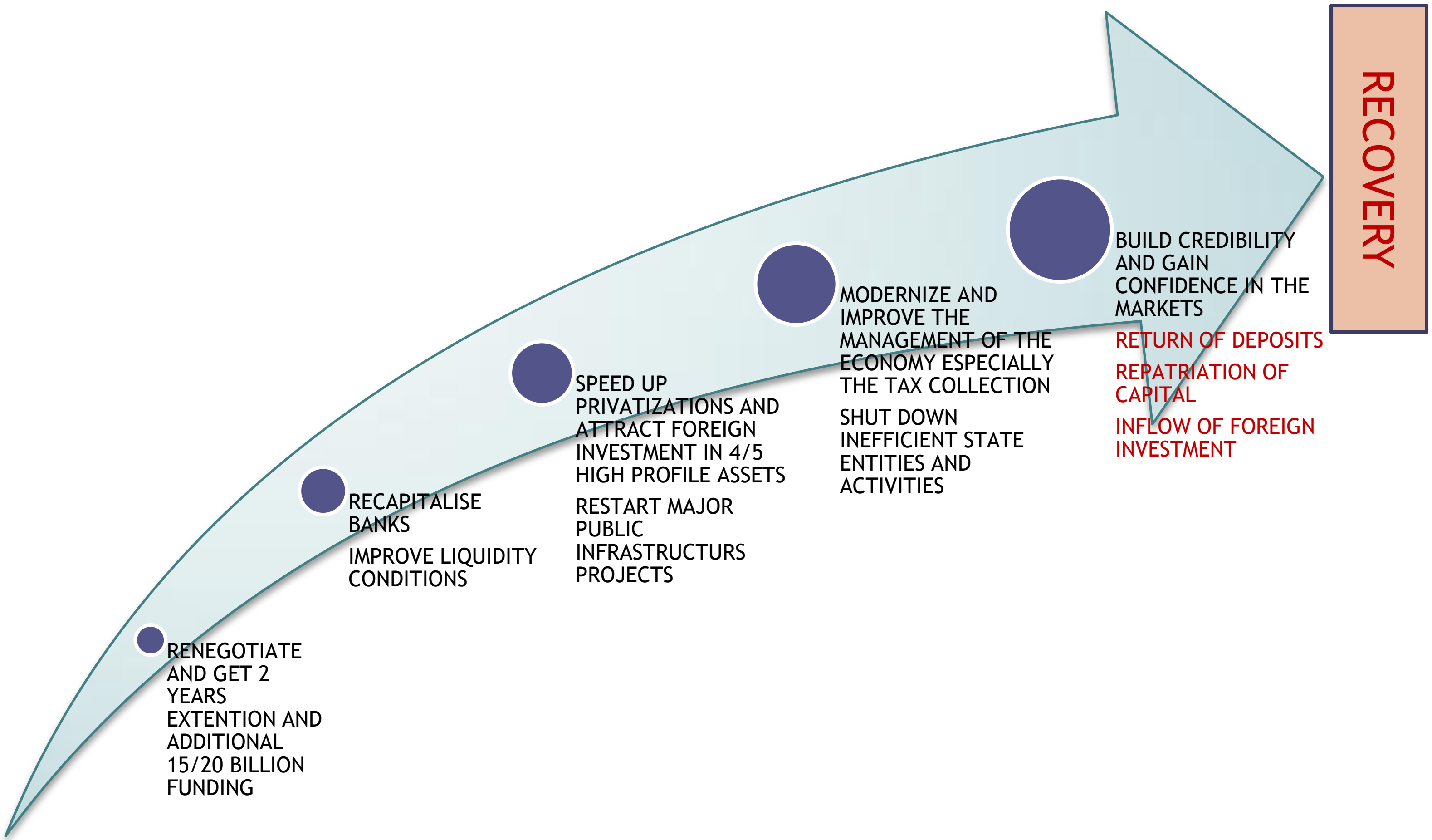
- A banking union is discussed but requires major preparation and Germany resists any pooling of liability while the role of ECB is hotly disputed.
- A growth initiative of 120 billion euro has been agreed but may be too modest.
- Debt management remains the key issue and Germany is reluctant to adopt new initiatives as increasingly the final solution rests with **mutualising** Europe's debts rather than imposing ever tougher austerity on debtors.

"Steps towards the introduction of joint and several sovereign liabilities (eurobonds) could be considered as long as a robust framework for budgetary discipline and competitiveness is in place to avoid moral hazard and foster responsibility and compliance". (H.V. ROMPUY REPORT TO THE COUNCIL 26.6.2012)

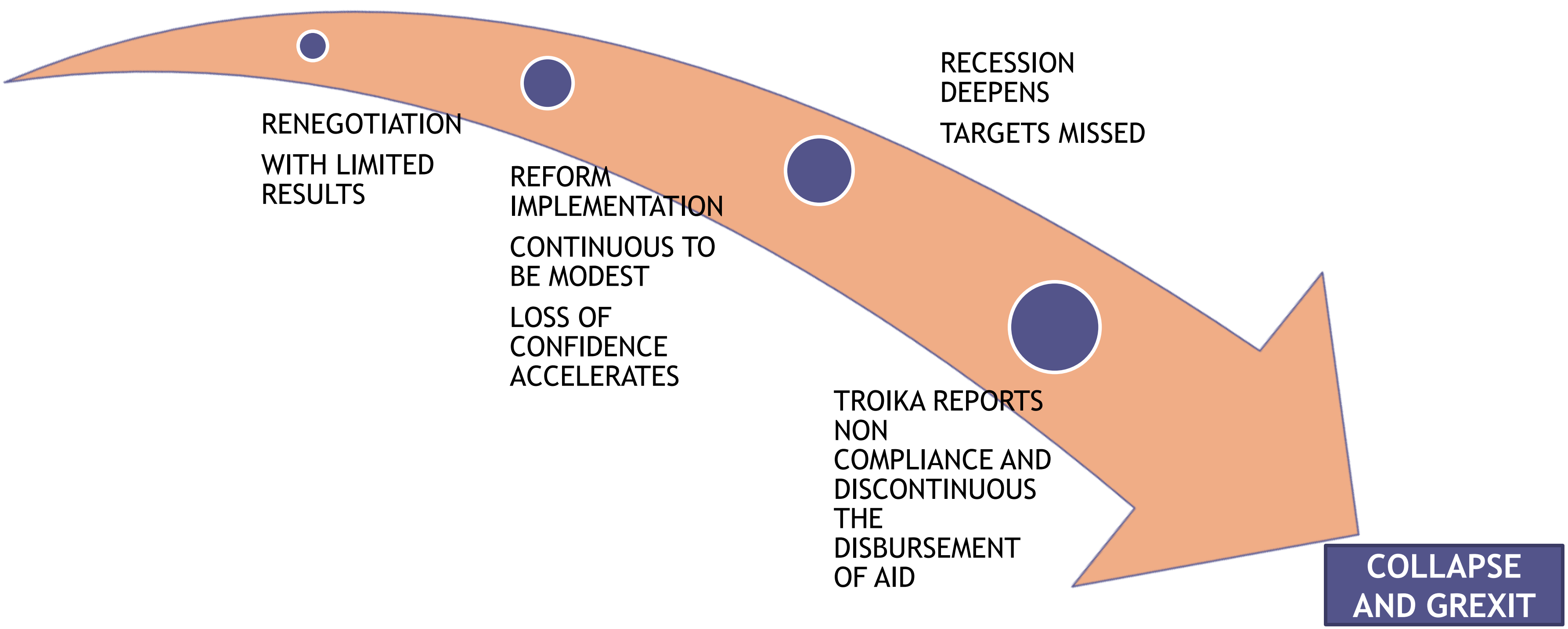
EUROPEAN INITIATIVES IMPROVE RESPONSE TO CRISIS

- An integrated financial framework to ensure financial stability in particular in the euro area and minimise the cost of bank failures to European citizens.
- An integrated budgetary framework to ensure sound fiscal policy making at the national and European levels, encompassing coordination, joint decision-making, greater enforcement and commensurate steps towards common debt issuance.
- An integrated economic policy framework which has sufficient mechanisms to ensure that national and European policies are in place that promote sustainable growth, employment and competitiveness.
- Ensuring the necessary democratic legitimacy and accountability of decision-making within the EMU.

THE BENIGN SCENARIO: SURPISE THE MARKETS AND RESTART THE ECONOMY



THE BAD SCENARIO: GOOD INTENTIONS BUT CONTINUOUS POLICY SLIPPAGE



SYNOPSIS

- Another year of recession makes achievement of targets difficult.
- Fiscal consolidation will continue to rely heavily on expenditure cuts as tax collection has been delayed and tax payers obligations are concentrated in the second semester of 2012.
- Cutbacks in the investment budget will lead to even deeper recession.
- Re-negotiation will not be easy and Government should be prepared for contingencies.
- Europe is changing but only gradually and assistance to Greece will continue to be conditional on achieving fiscal targets and reaching structural reforms milestones.
- Recovery may still occur through speeding up of structural reforms especially privatisations and the kick start of major infrastructure projects.
- The overall outlook has marginally improved but continues to be difficult until the government proves its ability to implement agreed policies.