

Greek Banking and Financial Markets Within the Euro Area

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On 1 January 2001, Greece became the 12th member of the euro area after successful convergence of the economy and the satisfaction of the Maastricht Treaty criteria. Over the last decade, average annual inflation (on a harmonized basis) fell from almost 20% in 1990 to 2% in 1999 and the first half of 2000, the government budget deficit shrunk from 16% to 0.9% of GDP in 2000, while government debt, from a peak of 111% of GDP in 1996, declined to 104% last year. Since the mid-1990s, the exchange rate of the drachma against the ECU and later against the euro was characterized by a high degree of stability and from March 1998 the drachma participated without tensions in the ERM until the transition to the euro. Finally, long-term interest rates converged substantially to the corresponding euro area levels, reflecting the increased credibility of the policies conducted by the Bank of Greece over the last few years were instrumental in ensuring the success of the disinflation process. Since mid-2000, inflation has increased in Greece, as in the whole euro area, due to the effects of higher energy prices and the appreciation of the dollar. In May 2001, harmonized inflation stood at 3.9% compared with an average of 3.4% in the euro-area, but it is projected to decline to below 3% by the end of the year.

Nominal convergence was accompanied by real economic convergence. Strong growth of over 3% has been achieved since 1997 and it reached 4.3% in 2000, with around 5% projected for the coming years. High government and private sector investment growth are underpinning this achievement, which is a consequence of the prevailing climate of macroeconomic stability. Following entry into the euro area, a stable macroeconomic environment is further secured by a substantial reduction in foreign exchange risk.

Against the background of these developments, the Greek banking sector has been going through a rapid transformation, adopting itself to the new, more competitive environment generated by the completion of the single financial market and the adoption of the euro. Over the last few years, Greek banks have been improving the quality of their portfolios, restructuring their activities and enhancing their competitiveness. Central to this has been a consolidation process similar to that seen in other EU countries. Privatizations along with mergers and acquisitions have reduced the number of commercial banks and led to the emergence of 6 main banking groups whose market share in 2000 was 85.9% (on the basis of deposits) compared to only 66.5% in 1995. As a result, Greek banks are now better placed to take advantage of economies of scale and scope and to compete on an equal footing with other banks in the euro area. Moreover, their expansion over the last few years into neighbouring Balkan countries through the opening of branches and the acquisition of local banks gives them a competitive advantage in these potentially fast-growing markets.

Alongside consolidation, Greek banks have been changing the structure of their balance sheets and their income sources. Thus, the ratios of consumer and housing loans to total loans have increased considerably and banks have expanded into financial services beyond the traditional deposit-taking and lending operations. This has contributed to greater diversification of their sources of income and to a significant increase in the total value of their off-balance sheet items.

The capital base of Greek banks has improved substantially in the last few years, having benefited both from banks' increased profits and also from the buoyant conditions on the stock market in 1999, which allowed banks to raise significant amounts of new capital. At the end of 1996, the risk-adjusted capital adequacy ratio stood at just over 8%; since then, it has almost doubled to around 15%, giving banks a solid base on which to expand their business in the next few years. From the supervisory viewpoint, the changes in the operating environment of commercial banks imply the need for greater vigilance in the areas of credit and market risk and more attention to the adequacy of banks' risk management systems. Banks are responding to these changes by upgrading these systems and related controls, and the Bank of Greece is closely monitoring developments and calling for further improvements in banks' risk management systems, where necessary.

The functioning of the banking system has also benefited from substantial improvements in the infrastructure of money and financial markets. The Greek real-time gross settlement system HERMES, which is connected to TARGET (the European cross-border settlement system), has been operating exclusively in euro since 1 January 2001 this year. It enhances the safety of the electronic transfer of funds at both national and international levels. The Greek Electronic Secondary Securities Market, with an average monthly turnover of around 21 billion euro this year, has contributed decisively to the deepening of the bond market and this, together with the fact that ten major international banks operate alongside five Greek banks as primary dealers in the market, has facilitated the placement of Greek bonds in the international market.

Following the harmonization of the monetary policy operating framework as well as of payment, accounting and other related systems, the changeover to the euro was successfully completed on 1 January 2001. Since then, all transactions in money, bond and capital markets are in euro, and the Bank of Greece has been participating in the implementation of the single monetary policy. An important new challenge for Greek banks lies in the introduction of euro banknotes and coins to take place in Greece from 1 January 2002, at the same time as in the other 11 euro area countries. Preparations at the Bank of Greece for this huge logistical operation are already well under way and are described in the Bank's publication *The National Cash Changeover Plan*.

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