

X The Simitis government is likely to achieve Greece's economic convergence with the rest of the European Union earlier than expected, and go to the polls in September 2000 on the strength of its resulting bolstered credibility, the Bank of America has said in its latest report on the Greek economy.

"With the forthcoming de-escalation of inflation in the next few months, we believe that the positive dynamics of the market will lead Greece to convergence much earlier [than originally expected], that is, in the middle of 2000," it says, forecasting that the spreads between Greek and German 10-year bonds will have been reduced to 50 basis points (0.5 percent) early in 2000.

"It is rather unlikely that the present government will distance itself from the target of convergence without jeopardizing its political future, as convergence has become its strong card for reelection," the report says.

It notes, further, that the European Commission and the European Central Bank (ECB) will also be likely to welcome Greece's entry to EMU on January 1, 2001, if only because it would have a catalytic influence on the other countries with a pre-entry status, reducing political obstacles and encouraging them to follow suit.

Although the question remains open whether Greece will meet the Maastricht criteria for convergence on the basis of the funda-

## Convergence with the EU to be achieved by 2000

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Report says hard drachma will make government's task easier

mental indicators of its economy, the report continues, the nominal criteria, including the "sticky" inflation rate, should be achieved with some ease.

The fiscal deficit will hover in the 2 percent area, with public debt on a downward course, and an inflation rate below 3 percent in the spring of 2000. The attainment of this latter target requires a reduction in utility rates and a strict monetary and currency policy, on condition that international inflation trends also remain on a downward course, the Bank of America recommends.

The perception of the markets regarding monetary policy, the drachma and international liquidity will play an important role in the effort, it says.

The pursuit of structural changes in the public sector, the labor market and the social security system are expected to be achieved in

part, it forecasts, but must continue, gathering sufficient pace for the next 10 years, in line with Commission and ECB decisions, but also led by financial markets. Market perceptions will play a leading and very significant role in the next two years, the report adds, with positive expectations being maintained as long as the "game" of the Greek economy's convergence remains profitable. It urges the government to control the main bulk of market expectations at the same time as pushing forward with structural reforms. Unpredictable changes in the tax framework, surprises in the management of the public debt regarding the issuance of securities, upheavals in the operation of the system of primary dealers or in the secondary market system, could seriously jeopardize the fragile expectations of the market, it warns. Monetary policy will have to bear the whole burden of convergence, with a gradual

but steady fall in interest rates and a strong drachma constituting the main armory of the Bank of Greece in coming months. The worldwide de-escalation of interest rates and a relatively strong euro should provide strong support. The stability of the drachma is of crucial importance. Given the course of inflation and the continuing rising trend in building activity, a mild appreciation of the drachma when its final parity in the framework of EMU is determined cannot be ruled out, it notes.

It also warns that relative success in the field of macro-economic indicators is not a guarantee against domestic or international upheavals. Greece's entry to the European exchange-rate mechanism in March may have so far protected the Greek market from the economic instability of the region, but its strength against a wave of generalized pressure from international liquidity remains to be seen, the report cautions. A credit risk, due to instability in the Balkans or the possibility of a flare-up in the Aegean, remains small but not negligible, as incidents of even a small scale could create serious turbulence in the market.

Finally, the report draws attention to the danger of the attainment of a nominal convergence providing an illusion of complete success, leading to complacency vis-a-vis the other important requirements and challenges of EMU.