

EBS/83/20

CONFIDENTIAL

January 25, 1983

To: Members of the Executive Board
From: The Secretary
Subject: Greece - Change in the Exchange Rate

The attached paper on a change in the exchange rate of the Greek drachma is circulated for the information of the Executive Directors.

Att: (1)

INTERNATIONAL MONETARY FUND

GREECE

Change in the Exchange Rate

Prepared by the European Department

Approved by L. A. Whittome

January 24, 1983

On January 10, 1983, the Greek authorities communicated to the Fund their decision to devalue the drachma vis-à-vis the U.S. dollar by 15.5 per cent effective January 9 (EBD/83/11, 1/11/83). At the same time, the Greek authorities requested EC approval for restrictions on imports in nine categories of goods, including some textiles and footwear, agricultural machinery, certain household fittings and furniture, and alcoholic beverages and food items. In addition, new institutional arrangements for the promotion of exports were announced. The authorities expressed their belief that, with these measures, agricultural incomes would rise considerably, as would the growth rates of exports, industrial production, and employment. They also felt that the devaluation would not seriously affect the cost of living as they would exercise firm control over price increases.

A managed float of the drachma has been in operation since 1975. Although a member of the EC, Greece is at present not a member of the European Monetary System (EMS). However, when setting the drachma exchange rate, the authorities take into account movements in the ECU, in particular the deutsche mark. The drachma/U.S. dollar rate is fixed daily and official quotations for other currencies are determined daily on the basis of the official rates between the U.S. dollar and the currencies concerned. The intervention currency is the U.S. dollar.

Greece's current account deficit has risen over recent years, reaching US\$2.4 billion in 1981 or 6.4 per cent of GNP, compared with US\$1.0 billion or 3 per cent of GNP in 1978 (Table 1); this deterioration reflected a weakening in both the trade and invisibles accounts. A special factor in the worsening of the trade deficit was the substantial increase in many import categories from EC countries following the abolition of import duties in connection with the accession of Greece to the EC as of January 1, 1981. In 1982, the current account deficit amounted to an estimated US\$2.1 billion or 5.5 per cent of GNP.

The new Government which came to office in late 1981 has taken measures aimed at containing price and cost increases and improving the competitiveness of the Greek economy.

The drachma has depreciated steadily over recent periods so that, by the third quarter of 1982, the rate against the U.S. dollar (the intervention currency) was on average 44 per cent lower than during the first quarter of 1980, while the nominal effective rate (export-weighted) depreciated by 18 per cent over the same period (Table 2). The real effective rate for the drachma, however, has appreciated over this period, as the depreciation of the nominal effective exchange rate fell short of the differential between domestic and foreign price and cost developments over the same period. The actual magnitude of changes in effective rates depends a great deal on choices made regarding trade weights, base period, and (for real effective rates) relative price and cost indicators. However, calculations on the basis of bilateral 1980 export weights and relative unit labor costs in manufacturing indicate an average real effective appreciation of about 14 per cent from 1977 to 1981 and 10 per cent during 1981 alone; full information is not yet available enabling comparable calculations to be made for 1982, but preliminary estimates suggest that the real effective rate continued to appreciate on this basis. The real effective appreciation is somewhat less when calculated on the basis of trends in relative prices, partly due to governmental price controls and delays in transmitting higher costs into price increases.

Consultation discussions between the Greek authorities and a staff mission were held in Athens from November 30-December 15, 1982. The staff believes that there was a prima facie case for the recent devaluation of the drachma, and the staff report, which will take the most recent developments fully into account, will be issued shortly.

Table 1. Greece: Selected Economic Indicators

	1978	1979	1980	1981	1982 Estimated
<u>(Percentage change)</u>					
Domestic economy					
Real GDP	6.7	3.7	1.6	-0.7	...
Real domestic demand	6.1	4.2	-1.4	-1.5	...
Consumer prices (average)	12.6	19.0	24.9	24.5	21.0
Average earnings:					
Nonagricultural sector	21.8	18.8	20.6	24.0	27.7
Labor force	0.7	0.6	4.4	3.6	0.8
Unemployment rate (in per cent)	4.0	6.1
<u>(In billions of U.S. dollars)</u>					
Balance of payments					
Current account deficit	0.96	1.88	2.22	2.41	2.10
(In per cent of GNP)	(2.9)	(4.7)	(5.3)	(6.4)	(5.5)
External debt (at end of period)	4.49	4.90	6.40	7.47	8.56
Official reserves (at end of period)	1.17	1.52	1.52	1.18	1.22 <u>1/</u>
<u>(Percentage change, end of period)</u>					
Financial indicators					
M3 growth	26.0	18.4	24.7	34.7	30.0
Domestic credit	27.2	22.3	24.8	35.5	33.0
Credit to the public sector	38.2	31.3	35.6	55.1	44.0
Public sector gross borrowing requirement (in per cent of GNP)	6.6	7.5	11.5	19.0	15.0

Sources: Bank of Greece; IMF, International Financial Statistics; and staff estimates.

1/ At end-November.

Table 2. Greece: Nominal Exchange Rate Indicators^{1/}

		Index of ECU/drachma Rate (1979 = 100)	Index of U.S. dollar/drachma Rate	Export-Weighted Effective Rate 2/ (1975 = 100)	Trade-Weighted Effective Rate 2/
1977		...	87.2	94.0	91.2
1978		...	87.4	86.1	81.2
1979		100.0	86.8	80.8	77.1
1980		85.7	75.6	70.1	67.0
1981		82.0	58.3	66.4	60.9
1980	I	91.3	81.8	74.6	72.3
	II	85.2	74.8	69.3	66.5
	III	82.5	74.4	67.8	64.6
	IV	84.1	71.4	68.8	64.7
1981	I	82.1	64.4	67.1	62.0
	II	81.4	58.0	66.3	60.8
	III	82.5	54.0	66.0	60.3
	IV	82.3	56.7	66.5	60.6
1982	I	80.9	53.1	65.0	59.1
	II	78.4	49.7	62.8	57.1
	III	76.2	45.8	60.9	55.3

Sources: IMF, International Financial Statistics; and staff calculations.

^{1/} Foreign currencies/unit of account per drachma.

^{2/} Weights based on 1980 bilateral trade with 14 partner countries.