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GREECE MACRO MONITOR

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Focus notes: Greece

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Greek Parliamentary vote opens the door to ratification of 2nd bailout package by Feb. 15th Eurogroup

Contents

Greek Parliament approves key conditionality underlying new bailout package

A two-day long parliamentary debate on a new EU/IMF rescue programme for Greece worth €130bn and its accompanying conditionality concluded in the early hours of Monday. The omnibus bill that contained all fiscal austerity measures and structural reforms comprising the conditionality of the new package was ratified by the 300-seat Parliament with 199 in-favor votes. On the other hand, 74 MPs cast a negative vote, 5 declared "present" *i.e.,* neither supported nor dismissed the package and 22 were absent from the voting procedure.

These developments open the door for the endorsement of the new rescue package by the next Eurogroup meeting on Wednesday February 15, 2012. As a reminder, the approval of the omnibus bill by the Greek Parliament was one of the three key prerequisites set by Eurogroup President Jean-Claude Juncker for an endorsement of the new rescue programme by the euro area finance ministers. Specification of additional spending cuts worth €325mn to be implemented in 2012 and written commitments by the leaders of the main political parties supporting Lukas Papademos's government were the other two preconditions.

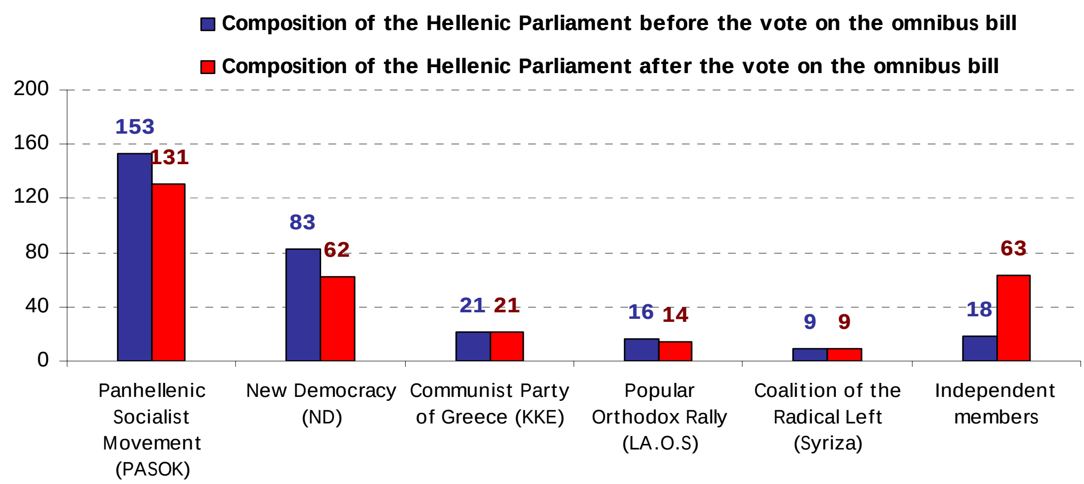
In a move to minimize the risk of dissenting voters within their parties, the leaders of PASOK and New Democracy - two of the three parties backing the present government - enforced party discipline *i.e.,* threatened to expel any of their MPs who would vote against the omnibus bill or decline to attend the parliamentary session. In a protest against the new austerity package 22 MPs from PASOK and 21 MPs from the New Democracy party cast a negative vote (or were absent from the voting session) and were immediately ousted from their parties' parliamentary groups. On the other hand, 2 parliamentary deputies from the right-wing Popular Orthodox Rally (LAOS) party were expelled from their party for voting in favor of the omnibus bill.

Giorgos Karantzaferis the leader of LAOS - the third party supporting the present government – announced during a news conference on Friday that he would not vote in favor of the new austerity program, arguing that the country faces the risk of losing "the last trace of national sovereignty". Yet, he pledged to continue backing the coalition government and called Mr. Papademos to reshuffle his cabinet, replacing a number of government ministers with technocrats. Press reports suggested over the weekend that the Prime Minister may announce a cabinet reshuffle as early as today (Monday February 13, 2012).

In a related issue, press wires suggested last week that, in a letter sent to the Prime Minister, PASOK leader and former Premier George Papandreou called for the interim government to remain in place until 2013, provided that a final agreement is reached on the measures underlying the new rescue program. The request was arguably made on the basis that an extension on the present government's tenure would boost confidence among official lenders that agreed pledges would be implemented. In the opposite camp, New Democracy leader Antonis Samaras insists that general elections should be called as soon as the new bailout program is secured, with the weekend before the Orthodox Easter (8 April) or, alternatively, the end of April being suggested as suitable dates for the ballot.

Following last night's parliamentary vote, the structure of the current Parliament have been changed in an unprecedented manner. The following graph shows the number of parliamentary seats controlled by political parties both before and after yesterday's ballot:

Table A – composition of Hellenic Parliament before yesterday's vote



Source: Greek Parliament, Eurobank EFG Research

What are the findings of recent opinion polls?

The publication of the results of a new opinion poll conducted by *Public Issue* early last week showed that public support for the right-wing Popular Orthodox Rally (LAOS), the third party in the tripartite coalition supporting Lukas Papademos's government, has slipped to 5% from 8% nearly a month earlier. The same poll showed that socialist party PASOK is steadily losing ground. It attracted the support of 8% of respondents, ranking in the fifth place, 1.5% lower compared to an earlier poll published in late December and well below the vote it scored (ca 44%) when it returned to power in late 2009. Furthermore, New Democracy continues to lead the polls with 30.5%, albeit remaining well short of levels around 40% needed for an outright majority in parliament. Specifically, the conservative party would gain about 130 seats in the 300-seat Parliament if elections were held today. PASOK would secure about 40 seats, compared to 160 seats it won at the parliamentary elections in November 2009. The Communist Party (KKE) garnered 12.5% and the Coalition of the Radical Left (SYRIZA) 12%. Democratic Left, the most moderate of the three leftist parties, saw its support rising to 18%, up 4.5% since last month. The poll also indicated that respondents were divided on PM Lukas Papademos with 48% expressing a negative opinion and 46% a positive one. A poll conducted in December had showed that the positive opinion on the PM was 60%. Regarding their opinion on the coalition government's performance so far, respondents were virtually unanimous, with 91% expressing disappointment.

Main parameters of the new lending program and implications for sovereign liquidity and solvency

In our *Feb. 9, 2012 Greece Macro Monitor* we provided a detailed list of the new fiscal austerity measures and structural reforms constituting the conditionality of a new bailout package for Greece agreed at last October's EU Summit. To recap, the new adjustment program includes, among others: **a)** measures to increase wage flexibility in the private sector *via* a 22% reduction in minimum-wages (an additional 10% cut will be apply for new entrants) and a gradual abolishment of sectoral wage agreements; **b)** measures to downsize the public sector and reduce payroll and pension costs *e.g.* immediate closure of a number of "unproductive" public entities, additional layoffs (some 15k employs will be fired immediately or will be transferred to a special labor reserve) and steep pension cuts in a number of public enterprises (DEKOs) ; **c)** measures to increase public sector flexibility and efficiency *e.g.* termination of life-time employment schemes in public sector enterprises and state-controlled banks; **d)** lower social security contributions and a 15% reduction in auxiliary pensions; **e)** higher VAT rates in a range of goods and services (pharmaceuticals, foodstuff, electricity bills and other); and **f)** immediate liberalization of a number of closed professions. In addition to the above, extra *spending-side* measures worth €3.2-3.3bn (1.5ppt-of-GDP) will need to be applied this year to facilitate fulfillment of the 2012 budget target. Furthermore, Greece will need to identify by June expenditure measures worth €11bn for the period 2013-2015 so as to bridge an equivalent financing gap implied by the troika's new fiscal projections.

In what follows we provide a preliminary assessment of the beneficial impact of the new bailout package for Greece for the country's sovereign liquidity and solvency position:

As per the October 26-27 EU Summit Statement, the new lending program will consist of €100bn in new official (EFSF/IMF) funding plus an additional amount of €30bn to run the PSI scheme *i.e.,* provide certain sweeteners to private investors participating in the debt exchange. Note that an additional amount of available funds (ca €34bn) still remains unutilized under the 1st EU/IMF assistance package. Moreover, a number of EU official sources including Greece's Deputy Premier and Evaggelos Venizelos revealed recently that euro area partners are considering an increase in the overall lending amount under the new bailout package by at least €15bn.

Presumably, the latter amount is required to provide coverage of the government's borrowing requirement for an additional year (until 2015) relative to what was envisioned earlier. It is not entirely clear to us at this stage whether this extra funding will be in the form of additional EFSF loans under the new bailout plan or take the form of a so-called *Official Sector Involvement* (OSI) scheme, materializing shortly before *or in parallel* with the PSI exchange.

According to recent press reports, the troika's new debt sustainability analysis for Greece (not published yet) will contain more downbeat baseline forecasts for the evolution of a range of key variables driving debt dynamics, including GDP growth, primary fiscal balances and privatization revenue for the period 2012-2020/2030. *See also our earlier analysis (Greece Macro Monitor, February 9, 2012) on an official report circulated in the local press late last week titled "Greece – Memorandum of Economic and Financial Policies". The report contains the general framework and conditionality of the new bailout program.*

As a result of the aforementioned developments, the new IMF/EC/ECB debt sustainability analysis (DSA) for Greece will arguably identify an incremental financing gap for the period 2012-2020 relative to that projected in the IMF's December 2011 DSA. According to some reports, this projected gap amounts to as much as 10ppt-of-GDP and needs to be covered so as to facilitate attainability of the 120%-of-GDP *terminal* target for the public debt ratio. One way to cover it could arguably involve having the ECB (as well as the national central banks in the euro area) give up implicit gains made on GGB holdings acquired via secondary market purchases.

Reportedly, the overall notional amount of Greek government held by the ECB is ca €50bn and has an average purchase price of around 75. Moreover, national central banks in the euro area are understood to hold an additional €12-15bn in GGBs (notional terms). According to recent press reports and newswires, a way could potentially be found to allow Greece to repurchase these bonds - *e.g.* via the EFSF – at an average price close to the acquisition price. Such a repurchase scheme would, by itself, facilitate a significant upfront reduction in Greek public debt, *e.g.* by an estimated amount of €12bn only through the ECB holdings. In addition, it would make the coverage of the government's future borrowing requirement more manageable as a result of reduced interest payments and a lightened bond maturity schedule in coming years.

The implementation of such an OSI scheme ahead of the PSI debt exchange could also facilitate the activation of collective action clauses (CACs) in local law bonds, without risking future litigation by potential hold-outs on the basis of unequal treatment between privately-held and officially-held restructured debt. That is, of course, provided that: a) Greece unilaterally inserts such clauses in domestic law GGBs ahead of the private-sector debt exchange; and b) the PSI tender fails to generate satisfactory participation (not necessarily our baseline scenario).

It should be noted here the idea of having the ECB and the national central banks in the euro area participating in a buyback program of Greek government bonds has reportedly stimulated a heated debate within these institutions in recent weeks, not least because of worries that such an involvement would risk violating the so-called "non bailout clause" in the EU Treaty. To lessen such worries, ECB head Mario Draghi was quoted last week as saying "that the sale of ECB-owned Greek government bonds to the EFSF without a loss would not mean financing states with central bank money".

As a final comment to this section, it suffices to repeat that yesterday's parliamentary approval of the conditionality underlying the new bailout program is a key step towards the implementation of the PSI debt exchange and the timely release of new official loan that will allow Greece to avoid an outright sovereign default when the next major bond redemption comes due (*i.e.,* a 3-year bond maturing on March 20, 2012 for ca €14.5bn). All these could, in turn, go a long way towards stabilizing market perceptions over Greece's fiscal situation, at least in the short-term.

However, the expected endorsement at this week's Eurogroup of the new bailout package for Greece (and its eventual approval by national parliaments in the euro area) may not necessarily constitute a lasting, *silver-bullet* solution for the country's sovereign solvency and competitiveness problems. This is especially since the new austerity program will need to be implemented in an increasingly adverse domestic environment, characterized by a protracted recession and increased social hostility to the new measures.

From a longer-term perspective, the domestic economy's ability to return to a positive and sustainable growth path is considered to be the single most important prerequisite for stabilizing debt dynamics and improving investor perceptions over Greece's sovereign solvency. These, in turn, require a rigorous implementation of the structural measures included in the new programme and, crucially, the creation of an EU/IMF-supported national strategy emphasizing economic growth, competitiveness and a more extrovert orientation of the Greek economy.

The tables on page 5 provide a quantitative assessment of the potential benefits of the new bailout package for Greece's sovereign liquidity and solvency. The amounts shown in the tables (in euro billions and ppt-of-GDP terms) constitute Eurobank EFG Research estimates and are based on the latest available IMF baseline macro assumptions (December 2011 DSA). We will revise our estimates and publish new tables as soon as the new troika DSA analysis is published.

Table B –2nd bailout package for Greece: Benefits for sovereign liquidity and solvency

Benefits to Greece's *sovereign liquidity* position following implementation of 2nd bailout package	2012-2014	2015-2016
A. Gross borrowing need (€bn) (*deficit financing, amortizations, other*)	241.8	63.8
B. Gross financing source (€bn) (*privatization receipts, issuance of S-T debt, other*)	52.6	33.1
Financing gap (A-B)	189.3	30.6
Sources of funding:		
Remaining funds under 1st EU-IMF package	34.0	0.0
PSI financing	61.1	30.6
New official funding under 2nd bailout package	94.3	0.0
Total financing source	189.3	30.6
Projected issuance of MLT bonds	0.0	10.7

Benefits to Greece's *solvency* outlook following implementation of 2nd bailout package

		Before 2nd bailout plan (IMF July 2011 SDA assumptions)	After 2nd bailout plan (IMF Dec 2011 DSA assumptions)	Δ (change)
Interest rate expenditure Cummulative 2012-2020	EURbn	131.9	78.6	-53.3 (EUR bn)
	ppt-of-GDP_{2011}	59.9	35.7	-24.2 (ppt-of-GDP)
Public debt-to-GDP in 2020	ppt-of-GDP	156	120	-36 (ppt-of-GDP)

Source: IMF Dec 2011, Eurobank EFG Research

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