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Focus notes: Greece

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Successful debt buyback opens the way for the unlocking of official funding to Greece, implementation of new package of debt relief measures

Key points

- In view of the apparent Greek bond buyback success, we expect the Eurogroup on 13 December 2012 to reach an agreement on how to cover the incremental financing (ca €1.29bn) required for the purchase of the *full* amount of bonds *validly* tendered in the exchange (€31.9bn). A decision is also likely on some additional relief measures to facilitate fulfillment of the 124%-of-GDP debt target in FY-2020.

- Our understanding is that the required financing initially earmarked for the implementation of the buyback (up to €10bn) constitutes part of the 2nd bailout package for Greece agreed with official lenders earlier this year (i.e., it does not represent *new* official-sector funding *per se*). In our view, the same treatment will apply to any incremental amount needed to finance the buyback operation.

- The upcoming Eurogroup is also expected to formally approve the next EFSF disbursement to Greece (€43.7bn) and consider a range of initiatives laid out in the 26/27 November 2012 Eurogroup statement, aiming to improve the country's solvency outlook and facilitate a gradual return to market financing. As stressed in the Eurogroup statement, these initiatives would accrue to Greece in a *phased manner* and *conditional upon* a strong implementation by the country of the reform measures agreed with official lenders.

- Besides facilitating a significant reduction in the Greek public debt-to-GDP ratio by FY-2020 and beyond, the implementation of the relief measures announced at the 26/27 November 2012 Eurogroup should be broadly adequate to cover most of the general government borrowing need in 2013-2016.

- Assuming realization of the new troika baseline scenario for Greece, we estimate that the new measures will reduce the cumulative borrowing gap over the aforementioned period by ca **€23.9bn** to ca **€8.7bn**. This remaining shortfall could *potentially* be eliminated by some additional measures, including *inter alia* a re-profiling of maturities of Greek government bonds held at the investment portfolios of Eurosystem national central banks.

- We estimate the overall financing provided by the new relief measures in 2012-2022 to amount to ca **€67.8bn.** That will take the form of reduced interest and amortization payments over that period, mainly as a result of the debt buyback operation, the return of SMP-related profits to Greece and the deferral of EFSF interest payments.

- Assuming a rigorous implementation of the agreed fiscal and reforms programme, the relief measures announced at the 26/27 Eurogroup should also be adequate to cover most of Greece's general government borrowing requirement for the coming decade (2013-2022). That would in practice mean that Greece could stay out of the financial markets for most of that period, without necessarily facing insuperable funding problems.

- Following the recent Eurogroup announcements, the average interest rate on all euro area loans expected to be disbursed to Greece by the end of this year (in the context of both the 1st and 2nd programmes) falls to pretty concessional levels, i.e., slightly below than **1.80%,** according to our estimates.

- Overall, the recent Eurogroup decisions for Greece and the successful debt buyback operation substantially reduce the risk of sovereign default and provide a valuable window of opportunity to the Greek government to focus on strategies to stabilize the domestic economy.

In this brief note we update our earlier analysis on the sustainability of Greek public debt[1], taking into account the results of a debt buyback operation conducted in furtherance to the decisions taken at the 26/27 November 2012 Eurogroup. As a reminder, Greece announced on December 3 an official invitation to eligible holders of Greek government bonds (nGGBs) to submit offers to exchange their securities (together with accrued and unpaid interest) for up to €10bn aggregate principal amount of six-month EFSF notes. Purchase prices offered by the Greek side were at a premium over market prices, ranging, as a percentage of principal amount of designated securities, from a minimum of 30.2 to 38.1 percent to a maximum of 32.2 to 40.1 percent, depending on the maturities of the outstanding bond series.[2] The initial deadline for the expiration of the buyback invitation was at 5:00 p.m. London time on December 7, but an extension was given until mid-day on December 11 in a effort to receive additional offers from bondholders.

Greek finance ministry announces results of debt buyback

In an official statement released earlier today, the Greek ministry of finance disclosed that some €31.9bn worth of bonds (notional terms) were validly tendered for exchange at a weighted average price of 33.8 percent. According to local newspaper, *Kathimerini*, Greek banks submitted offers totaling around €14.3bn, with the rest of the amount being offered by foreign investors. The estimated aggregate principal amount of six-month EFSF notes required to absorb the *full* amount of bonds offered is estimated at €11.29bn. The Greek ministry of finance also said that it intends to accept the whole amount of bonds tendered. ***Table 1.1*** below shows our estimates of the (pre-buyback) possessions of Greek government bonds (nGGBs) by type of holder. Upon completion of the buyback transaction, Greece's public debt stock will decline by ca €21.1bn. Moreover, the State will realize considerable future savings, to the tune of ca €9.2bn cumulatively in 2012-2022, in the form of reduced coupon payments on outstanding government securities. An extraordinary Eurogroup (via teleconference) yesterday reportedly discussed the outcome of the buyback operation. A final decision on how to cover any incremental costs arising for the settlement of the buyback transaction (as well as ways to facilitate fulfillment of the 124%-of-GDP target for the debt ratio in FY-2020) is expected to be taken at the 13 December 2012 Eurogroup. Our understanding is that the required financing initially earmarked for the implementation of the buyback (up to €10bn) constitutes part of the 2nd bailout package for Greece agreed with official lenders earlier this year (i.e., it does not represent *new* official-sector funding *per se*). In our view, the same treatment will apply to any incremental amount needed to finance the buyback operation. In any case, assuming full implementation of the debt buyback (as well as the rest of debt relief measures announced at the 26/27 November 2012 Eurogroup), we expect the general government cumulative borrowing gap in 2012-2016 to decline to ca €8.5bn, from €32.6bn estimated earlier (see analysis below).

[1] Eurobank Research, Greece Macro Monitor Nov 30, 2012 "*The arithmetics of the November 26th Eurogroup*". http://www.eurobank.gr/Uploads/Reports/GREECE%20November%2030%202012.pdf

[2] In total, 20 bond series, covering a maturity spectrum between February 2023 and February 2042.

Table 1.1 - nGGB possessions by type of holder (notional terms in euro billions, as of Dec. 7, 2012)

	nGGB
Greek banks	14.2
Non-Greek banks in Greece	2.9
Pension funds	6.9
Other Greek accounts	3.0
Total Greece	27.0
Hedge Funds	22.0
Other international accounts	12.4
Total Foreigners	34.4
Total nGGB holdings	61.4

Source: Eurobank Global Markets

Buyback success opens the way for the unlocking of official funding to Greece, implementation of new package of debt relief measures

As per the 26/27 November Eurogroup statement, upon completion of the relevant national procedures and following a review of the outcome of a possible debt buyback operation by Greece, the Eurogroup would be in a position to formally decide on the next EFSF disbursement by 13 December. Moreover, euro area Member States would be prepared to consider a number of initiatives aiming to improve Greece's public debt dynamics and sovereign liquidity position. On her part, IMF Managing Director Christine Lagarde said during the post-Eurogroup press conference that the Fund would wait for the completion of the bond buyback before deciding to release its share of Greece's next loan installment. In view of the apparent buyback success, we expect the upcoming Eurogroup to formally approve the resumption of official financing to Greece. The 1st loan tranche of €34.4bn is expected to arrive in Greece's state coffers by the end of December. Out of this, €23.8bn will come in the form of EFSF bonds earmarked for bank recapitalization and €10.6bn for budgetary financing needs, part of which will be utilized to settle outstanding State arrears to the private sector (~€8.7bn as of the end of October 2012). The remaining €9.3bn will be released in three sub-tranches during the first quarter of 2013, provided that Greece fulfills by that time a number of prior actions agreed with official lenders, including, among others, the implementation of the agreed tax reform by January as well as the identification and parliamentary approval of an additional package of fiscal measures for the period 2015-16, worth between €4.0bn and €4.5bn.

Updated sustainability analysis of Greek public debt

In what follows, we update our earlier public debt sustainability analysis (DSA) for Greece taking into account the reported results of the debt buyback operation (see ***Table A*** & accompanying explanatory note).

Table A – Updated sustainability analysis of Greek public debt incorporating buyback operation and other relief measures announced at the 26/27 November 2012 Eurogroup

Baseline Scenario												
	2011	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**	**2021**	**2022**
Real GDP growth (%)	-7.1	-6.0	-4.2	0.6	2.9	3.7	3.5	3.4	2.8	2.6	2.5	2.5
Nominal GDP growth (%)	-6.1	-6.5	-5.4	0.2	3.2	4.9	4.7	4.7	4.6	4.4	4.2	4.2
Primary balance (% GDP)	-2.3	-1.5	0.0	1.5	3.0	4.5	4.5	4.3	4.3	4.2	4.2	4.2
Avrg interest rate on debt (%)	4.5	3.0	2.9	3.2	3.5	3.7	3.7	3.6	3.6	3.5	3.5	3.6
Stock flow adjustment (% GDP)	3.6	-12.6	-2.7	-3.2	-3.4	-2.5	-1.6	-1.6	-2.0	-2.3	-1.0	0.0
Gross public debt (% GDP)	**170.6**	**176.8**	**189.4**	**190.1**	**184.7**	**175.7**	**167.9**	**160.2**	**152.2**	**144.4**	**138.3**	**133.2**
Scenario I *Baseline scenario incorporating 100bps reduction in interest rate of GLF loans*												
Gross public debt (% GDP)	**170.6**	**176.8**	**189.2**	**189.6**	**183.9**	**174.6**	**166.7**	**158.8**	**150.7**	**142.7**	**136.4**	**131.3**
Scenario II *Scenario I incorporating 10bps reduction in EFSF guarantee fee*												
Gross public debt (% GDP)	**170.6**	**176.8**	**189.1**	**189.4**	**183.6**	**174.3**	**166.3**	**158.4**	**150.2**	**142.2**	**135.9**	**130.7**
Scenario III *Scenario II incorporating return of SMP profits*												
Gross public debt (% GDP)	**170.6**	**176.8**	**187.6**	**186.6**	**180.0**	**170.8**	**162.6**	**154.7**	**146.2**	**138.4**	**132.2**	**127.1**
Scenario IV *Scenario III incorporating deferral of EFSF interest payments*												
Gross public debt (% GDP)	**170.6**	**176.8**	**187.6**	**186.6**	**180.0**	**170.8**	**162.6**	**154.7**	**146.2**	**138.4**	**132.2**	**127.1**
Scenario V *Scenario IV incorporating debt buyback*												
Gross public debt (% GDP)	**170.6**	**165.9**	**175.9**	**174.5**	**168.0**	**158.8**	**150.7**	**142.9**	**134.6**	**126.8**	**120.6**	**115.5**
Scenario VI *Scenario V incorporating increased T-bil issuance vs. March 2012 baseline*												
Gross public debt (% GDP)	**170.6**	**165.9**	**176.1**	**175.0**	**168.7**	**159.7**	**151.6**	**143.8**	**135.4**	**127.6**	**121.4**	**116.2**
Scenario VII *Scenario VI incorporating contingency measures*												
Gross public debt (% GDP)	**170.6**	**164.6**	**174.6**	--	--	--	--	--	--	**124**		**<110**

Source: EC, IMF, Eurobank Research

Explanatory note to Table A

Baseline Scenario: Purports to replicate the troika's new baseline scenario for Greece that was discussed at the 26/27 November Eurogroup. Note that the 2nd draft of the European Commission's 1st review of the new adjustment programme for Greece (released on November 27) did not reveal detailed information as to its underlying assumptions regarding the evolution of key macro and fiscal variables affecting debt dynamics in the period after FY-2016.

Scenario I: This scenario incorporates the projected effects of the reduction by 100bps of the interest rate charged to Greece on the EU bilateral loans provided in the context of the 1st bailout programme (Greek loan Facility *or* GLF). As per the 27 November Eurgroup statement "Member Sates under a full financial assistance programme are not required to participate in the lowering of the GLF interest rate for the period in which they receive themselves financial assistance". Note that along with a number of other concessions for Greece endorsed at the 26 October 2011 Summit, it was also decided to: (i) extend the maturity of GLF loans to 15 years from 10 years; (ii) lengthen the grace period of repaying principal on GLF loans to 10 years from 5 years; and (iii) reduce the interest charge on these loans from 3 month Euribor+275bps to 3 month Euribor+150bps. With the decisions taken at the 26/27 November 2012 Eurogroup, the interest rate charged on GLF loans is now expected to decline further to 3 month Euribor+50bps, which will effectively bring the average interest rate on all euro area loans disbursed to Greece so far (in the context of both the 1st and the 2nd programmes) to pretty concessional levels (slightly lower than 1.80%, currently, according to our estimates).[3] Finally, note that the 100bps cut in the interest charge on GLF loans, will have a beneficial effect on both the future evolution of the public debt ratio and the general government net financing need. Under the new baseline scenario, the latter is expected to amount to €32.6bn in 2013-2016 (=€15bn in 2013-2014 + €17.2bn in 2015-2016). Following the GLF loan rate reduction, the general government borrowing gap will decline by an estimated amount of ca €2.05bn in 2013-2016 and by more than €5bn cumulatively over the full projection horizon 2012-2022. In our analysis, we assume that the GLF interest rate reduction becomes effective from FY-2013 onwards.

Scenario II: In our analysis we assume that the 10bps reduction in EFSF guarantee fee becomes effective from FY-2013 onwards. Besides it beneficial effect on the overall debt stock, this particular measure is estimated to *ceteris paribus* reduce the general government borrowing need by ca €0.58bn in 2013-2016 and by around €1.44bn cumulatively in 2013-2022.

Scenario III: Along with other debt-reducing operations for Greece announced at the 21 February 2012 Eurogroup, it was also decided back then to pass on to the country, an amount equivalent to the income on the investment portfolio of Greek government bonds (GGBs) accruing to Euro system national central banks (NCBs). As per the 26/27 November Eurogroup statement, the income on the SMP-related GGBs portfolio accruing to Eurosystem central banks will also pass on to Greece, starting in FY-2013. In *Table A,* we assume that the total notional of the SMP portfolio of GGBs currently held by the Eurosystem is ca €34bn. Note that most of these bonds were bought at a significant discount. According to our estimates, the return of SMP profits to Greece will save the country around €10.5bn in future interest payments and amortization costs (on a ceteris paribus basis).

Scenario IV: The deferral of interest payments of Greece on EFSF loans by 10 years (as well as the extension of the maturities of the bilateral and EFSF loans by 15 years) is not going to directly affect country's public debt stock, but it will significantly reduce the general government borrowing need over the DSA-relevant projection horizon (i.e., by ca €18.5bn in 2013-2016 and by €43.8bn cumulatively in 2013-2022, according to our estimates). Note that along with a number of other concessions for Greece endorsed at the 26 October 2011 Summit, It was decided back then to extend long-term loans from the EFSF having an average tenor of at least 15 years, maturities up to 30 years and a 10-year grace period on principal payments. The average interest rate on EFSF loans to Greece is currently equal to the mechanism's funding cost + 15bps.

Scenario V: Here we adjust *Table A* to also incorporate the effects of the *just-completed* buyback operation. Besides facilitating a significant upfront reduction in the public debt to GDP ratio (by ca €21.1 bn or 10.8% of projected 2012 GDP), the buyback will also save Greece up to €9.2bn in future coupon payments on outstanding government bonds.

Scenario VI: *Table A* assumes increased T-bills issuance vs. what was initially assumed in the second adjustment programme for Greece (*i.e.,* a reduction of the stock of T-bills to €6bn at the end of 2013 from the original level of €15bn). Specifically, the assumed cancelation of the T-bills stock reduction in 2012-2016 would help reduce the projected government borrowing need over that period by €9bn minus the extra cost implied by the higher interest rates on T-Bills compared to EFSF funding. On the other hand, the increased T-bills issuance assumed in *Table A* is estimated to increase the debt-to-GDP ratio by about 1ppt in 2020 and 2022

Scenario VII: As per the 26/27 November 2012 Eurogroup statement, besides the relief initiatives highlighted above, euro area Member States would be ready to consider further measures and assistance, if needed, including inter alia lower co-financing in structural funds and/or further interest rate reduction of the Greek Loan Facility, in order to ensure that Greece can reach a debt-to-GDP ratios of 124% in 2020 and "substantially lower" than 110% in 2022. We emphasize that the overall amount of contingency measures assumed in our updated DSA (*Table A*) is somewhat higher than what we believe the 26/27 November Eurogroup statement implied. That is because the buyback operation was actually conducted at higher than-initially-expected prices.[4] In other words, our analysis assumes that the next Eurogroup (13 December 2o12) will announce some additional relief measures for Greece to facilitate fulfillment of the 124%-of-GDP target for the debt ratio in FY-2020, under the new baseline scenario.

[3] For a more detailed analysis of the current breakdown of Greek public debt stock and its servicing costs see *Eurobank Research, Greece Macro Monitor "A closer look at public debt service costs and potential strategies to improve sovereign solvency".*
http://www.eurobank.gr/Uploads/Reports/1GREECE%20MACRO%20FOCUS%20November1qw%2019%202012.pdf

[4] The 26/27 Eurogroup Statement read that the buyback would be conducted at prices no higher than these at the market close of 23 November 2012. http://www.eurobank.gr/Uploads/Reports/1GREECE%20MACRO%20FOCUS%20November1qw%2019%202012.pdf

Overall, assuming a rigorous implementation of the agreed adjustment programme as well as the relief measures agreed at the 26/27 November Eurogroup, Greece's public debt-to-GDP is expected to decline by ca 20ppts by the end of FY-2020 and by more than 23ppts by the end of FY-2022, relative to the new troika baseline scenario that reportedly formed the basis of discussing at that Eurogroup (***Table B***).

Table B – Contributors to the projected decline in the Greek public debt ratio in FY-2020 (vs. new baseline scenario), assuming full implementation of relief measures announced at the 26/27 November Eurogroup (in ppts)

	Δ Gross public debt-to-GDP in FY-2020 (ppts)
Debt buyback (due to upfront reduction in the public debt stock)	**-8.8**
Debt buyback (due to reduced coupon payments)	**-2.8**
100bps cut in GLF interest rate	**-1.7**
10bps reduction in EFSF guarantee fee	**-0.5**
Return of SMP profits	**-3.8**
EFSF interest payment deferral & loan maturities extension	**0.0**
Increased T-bills issuance	**0.9**
Deferral (and reduction in the size of) cash buffer	**0.0**
Contingency measures (implementation assumed after 2016)	**-3.2**
Total	**-20.0**

Source: EC, IMF, Eurobank Research

New relief measures to cover most of the government borrowing gap in 2012-2016, provide significant financing thereafter

Assuming full implementation of relief measures highlighted in ***Scenarios I*** to ***VI*** of *Table A*, we estimate the *cumulative* general government borrowing gap in 2012-2016 to decline by ca €23.9bn *i.e.,* to ca €8.7bn, from €32.6bn (=€15bn in 2013-2014 + €17.6bn in 2015-2016) envisaged in the updated troika baseline scenario, which does not take into account the relief measures announced at the 26/27 November Eurogroup (see ***Table C***). Arguably, this remaining financing gap could be reduced further (or even be eliminated completely) by some additional measures such as a re-profiling of maturities of Greek government bonds held at the investment portfolios of Eurosystem NCBs.

Our preliminary calculations on the projected decline of the general government borrowing need over the entire forecasting horizon under review (2012-2022) have also shown quite impressive results. Specifically, as a result of the EFSF interest payment deferral, the debt buyback and the other measures decided at the 26/27 November Eurogroup, the cumulative borrowing gap in 2012-2022 is expected to decline by €67.8bn relative to what is implied by the troika's updated baseline scenario. This practically means that that Greece could effectively state out of the financial markets for most of the next decade, without necessarily facing insuperable funding problems. Of course, that is a assuming fulfillment of the agreed programme targets with respect to *e.g. future* general government primary balances and privatization revenue.

Table C – Estimated impact of new relief measures on the general government borrowing requirement in the period 2012-2016 and beyond (EURbn) - Negative (positive) sign signifies reduction (increase) in the cumulative borrowing need

	Δ Net cumulative borrowing need in 2012-2016 (EURbn)	Δ Net cumulative borrowing need in 2012-2022 (EURbn)
Increase in funding need due to debt buyback 1/	11.3	11.3
Reduced coupon payments on outstanding *privately-held* government bonds (post-buyback)	-2.9	-9.2
100bps cut in GLF interest rate	-2.1	-5.1
10bps reduction in EFSF guarantee fee	-0.6	-1.4
Return of SMP profits (coupons & capital gains)	-7.2	-10.5
EFSF interest payment deferral	-13.4	-43.8
Extension of GLF maturitities	0.0	0.0
Extension of EFSF maturitities	0.0	0.0
Increased T-bills issuance 2/	-9.0	-9.0
Higher interest payment due to increased T-bills issuance 2/	2.0	2.0
Cash buffer deferral (and reduction in size) 3/	-2.0	-2.0
Total	-23.9	-67.8

Source: EC, IMF, Eurobank Research

Explanatory note to Table C

1/ Our understanding is that the EFSF loan to finance the debt buyback operation *does not* constitute new official sector financing for Greece *i.e.,* over and above the amount earmarked for the country in the context of the 2nd bailout programme.

2/ Increased T-bills issuance vs. what was initially assumed in the second adjustment programme for Greece (*i.e.,* a reduction of the stock of T-bills to €6bn at the end of 2013 from the original level of €15bn). Specifically, the assumed cancelation of the T-bills stock reduction in 2012-2016 would help reduce the projected government borrowing need over that period by €9bn minus the extra cost implied by the higher interest rates on T-Bills compared to EFSF funding.

3/ 2-year postponement in the creation of a cash buffer (initially envisaged for the period 2013-2014) along with a €2bn reduction in its size to €3bn.

As a final note to this report, ***Table D*** below demonstrates the kind of interest savings the Greek State is expected to realize in the period 2012-2022 as a result of the relief measures decided at the 26/27 November Eurogroup.

Table D – General government interest payments (in EURbn & in ppts-of-GDP) before & after the implementation of relief strategies announced at the 26/27 November Eurogroup

	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	cumulative (2012-2022)
In EURbn												
Before	10.6	10.0	11.1	12.2	13.0	13.0	12.8	12.5	12.3	12.3	12.3	132.2
After	10.6	6.3	7.4	6.6	6.5	6.4	6.2	5.8	5.6	5.4	5.2	72.0
in ppts-of-GDP												
Before	5.4%	5.4%	6.0%	6.4%	6.5%	6.2%	5.8%	5.5%	5.1%	4.9%	4.7%	62.0%
After	5.4%	3.4%	4.0%	3.5%	3.2%	3.0%	2.8%	2.5%	2.3%	2.2%	2.0%	34.5%

Source: EC, IMF, Eurobank Research

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