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General government borrowing requirement & sources of funding, the need for a post-program precautionary credit facility and the case for OSI

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This note provides analysis on a number of crucial issues related to the ability of Greece to meet regular interest and amortization payments on its public debt going forward. In more detail, we take a close look at the projected evolution of the general government borrowing needs and sources of funding in the crucial months ahead (and on a multiyear basis), we analyze the potential size and structure of a post-program precautionary credit facility and emphasize the need for a new package of relief measures (OSI) to further reduce the net present value of public debt and smooth out a pretty demanding borrowing requirement profile post 2022/23. In addition, we highlight the main stumbling blocks that have so far prevented the completion of the present EU/IMF program review, and stress that there is an urgent need to conclude the said review ahead of the new (extended) program deadline of February 28, 2015. That is, to allow the timely release of the next EU/IMF financing tranche of €7.2bn *(=€3.5bn IMF + €1.8bn EFSF + €1.9bn ANFA & SMP profits)* and prevent any unforeseen cash shortages going forward. All in all, our analysis suggests that, under current planning, there is limited room for major deviations from present fiscal targets as that could severely undermine the government's cash position and instigate a sharp increase in borrowing needs going forward. As regards the present structural reforms agenda, we note the significant progress made thus far in modernizing the public sector and improving the institutional framework and the domestic business environment. Yet, a range of relevant indicators suggests that the said progress has so far been broadly uneven, while additional efforts are needed to reach the critical mass of reforms that could boost investment activity and improve export performance.

Snap national election scheduled for January 25, 2015

A Presidential Decree dissolving the Parliament and calling for early national elections was issued on December 31st, a couple of days after the third and final vote for the election of a new President of the Hellenic failed to yield the required 3/5ths majority *i.e.,* 180 votes. As per the said decree, general elections will take place on January 25th, with the new Parliament scheduled to convene on February 5, 2015.

Tight government finances in Q1 2015

Apart from the impact the latest bout of political uncertainty may have on the domestic economy, we reiterate that this uncertainty is unfolding in an uncomfortably tight trajectory as regards government finances. According to our calculations, available liquidity at State coffers is currently less that €5bn, while the government is facing interest and amortization payments of c. €4.8bn in the first quarter of this year. To meet these payments, the government could further compress/delay discretionary expenditure (*e.g.* related to the Public Investment Budget), strengthen its tax collection effort so as to facilitate the generation of a cash primary surplus and increase short-term debt issuance, though the total outstanding amount of T-bills is currently close to the maximum program limit (€14.8bn vs. €15bn). Some additional liquidity could be potentially secured by short-term borrowing (via repo operations) from certain general government entities, though this borrowing has already reached levels above €6.5bn. Longer term, our revised projections point to a financing gap in 2015 of ca €21bn (or 13.6bn if one assumes a timely release of the next program disbursement) followed by another shortfall of €6.9bn in 2016. In turn, all these suggest that the present troika review needs to be completed by the end-February deadline so as to: i) allow the release of the next financing tranche of €7.2bn; and ii) provide the base of an agreement on a post-program precautionary credit facility.

Government borrowing needs & sources of funding (2015-2020)

Table 1 below presents our updated projections as regards the evolution of general government borrowing needs and sources of funding over the period 2015-2020. Our updated projections are derived based on the following assumptions:

Assumptions underlying Table 1 projections

i. Underlying macroeconomic and fiscal variables broadly evolve in line with the most recent baseline troika scenario[1];
ii. total outstanding amount of T-bills declines to ca €9bn in 2017 onwards from ca €15bn currently;
iii. for the purpose of our exercise, we assume zero issuance of medium- & long-term government bonds over the full projection horizon 2015-2020;
iv. significant government borrowing from a number of public entities via short-term repo operations (to the tune of ca. €6.6bn, currently); with half this borrowing assumed to expire in 2015 and the remaining amount by end 2016;
v. finally, we assume that the next troika disbursement in the context of the present program (€7.2bn = 3.5bn IMF + 1.8bn EFSF + 1.9bn ANFA & SMP profits) is released in early 2015.

[1] See e.g. IMF Country Report No. 14/151

Table 1 – General government borrowing needs and sources of funding (EUR bn)

	2014	2015	2016	2014-2016	2017	2018	2019	2020	2017-2020
A. Gross borrowing need (I.1 + I.2 + I.3)	**26.6**	**21.8**	**8.7**	**57.1**	**16.3**	**7.4**	**15.5**	**11.3**	**50.5**
I.1 General government cash deficit	**2.2**	1.5	1.2	4.9	**1.4**	**1.6**	**1.4**	**1.6**	**6.0**
I.2 Amortization (I.2.1 + I.2.2 + I.2.3)	**22.9**	**16.8**	**7.5**	**47.2**	**14.9**	**5.8**	**14.1**	**9.7**	**44.5**
I.2.1 Bonds and loans (after PSI & DBB)	15.7	8.0	4.4	28.1	7.5	3.3	10.5	2.4	23.7
I.2.2 Short-term (net)	-0.2	0.2	0.0	0.0	6.0	0.0	0.0	0.0	6.0
I.2.3 Official creditors (1.2.3.1 +1.2.3.2)	7.4	8.6	3.1	19.1	1.4	2.5	3.6	7.3	14.8
1.2.3.1 IMF	*7.4*	*8.6*	*3.1*	*19.1*	*1.4*	*2.5*	*3.6*	*4.5*	*12.0*
1.2.3.2 EU	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*2.8*	*2.8*
I.3 Other (I.3.1 + I.3.2 +…+ I.3.5)	**1.5**	**3.5**	**0.0**	**5.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
I.3.1 Bank recap	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
I.3.2 Cash upfront for PSI (sweetener & accrued interest)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
I.3.3 Cash upfront for debt buyback (DBB)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
I.3.4 Arrears clearance	2.0	2.5	0.0	4.5	0.0	0.0	0.0	0.0	0.0
I.3.5 ESM capital	0.5	0.0	0.0	0.5	0.0	0.0	0.0	0.0	**0.0**
I.3.6 Cash buffer	-1.0	1.0	0.0	0.0	0.0	0.0	0.0	0.0	**0.0**
B. Financing source (II.1+II.2+II.3+II.4+II.5)	**26.7**	**8.2**	**1.8**	36.7	4.3	4.1	4.3	4.3	**16.9**
II.1 Market access	**6.1**	**0.0**	**0.0**	**6.1**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
II.2 Privatisation revenue	**1.5**	**2.2**	**3.4**	**7.1**	**2.9**	**3.0**	**3.4**	**3.6**	**12.9**
II.3 ANFA & ESM profits	**0.6**	**3.9**	**1.7**	**6.2**	**1.4**	**1.1**	**0.9**	**0.7**	**4.0**
II.4 Official loan disbursements (III.1+III.2)	**11.9**	**5.3**	**0.0**	**17.2**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
III.1 EU	*8.4*	*1.8*	*0.0*	*10.2*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*
III.2 IMF	*3.5*	*3.5*	*0.0*	*7.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*
II.5 Use of subsector deposits through repo transactions & other	**6.6**	**-3.3**	**-3.3**	**0.1**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
C. Financing gap (A-B) ***"-" indicates deficit ; "+" indicates surplus***	**0.1**	**-13.6**	**-6.9**	**-20.4**	**-12.0**	**-3.3**	**-11.2**	**-7.0**	**-33.6**

Source: IMF, EC, 2015 budget, Eurobank Global Markets Research

Bottom-line Even assuming release of the next troika disbursement (€7.2bn) upon completion of the present program review sometime in early 2015, Greece is expected to face a significant net borrowing requirement to the tune of €20bn or higher over the next couple of years. In the absence of renewed market access and/or cash flow relief from a new package to reduce public debt (OSI) the only plausible way to cover the said shortfall is via official-sector financing.

The case for a post-program precautionary credit facility

Recent official comments and the need to bridge a significant financing shortfall over the coming two years (as per the analysis provided above) suggest that Greece should aim to reach an agreement with official lenders on a precautionary credit facility sometime early next year *i.e.,* post the expiration of the present program. Note that the present program is set to expire at the end of February 2015, unless a further extension is granted. Furthermore, upon completion of the present program review, Greece is set to receive a new tranche of official sector financing totaling €7.2bn. This would still leave c. €12.5bn in undisbursed IMF loan commitments. Taking all these into account, it appears that a precautionary credit facility to ensure financing of the government borrowing requirement over the period 2015-2016 could potentially have the following structure:

Potential structure of a precautionary credit facility for Greece

I. Enhanced Conditions Credit Line (ECCL) provided by the ESM (partial utilization of the Hellenic Financial Stability Fund buffer), of a total amount up to €10.5bn; and

II. Precautionary credit facility extended by the IMF; of a total up to €12.5bn
Total commitments (I+II) up to €23bn

Note that the said credit facility could come with some additional conditionality that could include, among other items, a number of measures/reforms not introduced/completed under the present program. Furthermore, to the extent that Greece would manage to re-establish market access during the coming two years, it would not necessarily need to borrow the full amount of agreed loan commitments.

Bottom-line: Contingent on the disbursement of the next tranche of official sector financing (€7.2bn) sometime early next year, a precautionary credit facility aiming to ensure full-coverage of the government borrowing requirement in 2015-2016 would not likely necessitate fresh EU/IMF loan commitments *i.e.,* over and above these envisaged under the present program. The potential size of the said facility could be €20bn or higher and it would come with some form of fiscal and structural reforms conditionality. To the extent that an agreement on such a precautionary facility would improve market sentiment towards Greece, the country might not need to utilize the full-amount of committed funds.

The case for OSI

As we noted in previous research notes[2], some form of new OSI would be necessary down the road so as to: i) deliver further debt relief (mainly in NPV terms); and ii) smooth out a demanding government borrowing profile post 2022/23 *i.e.*, after the expiration of the 10yr grace period currently applied on GLF interest payments and on EFSF loan principal and interest payments. Given the debt ratio targets set at the November 2012 Eurogroup and based on a more general assessment of political dynamics in the euro area, we reiterate below a theoretical OSI structure that would fit the bill.

Theoretic structure of new OSI

i. 20-year maturity extension on EU bilateral loans (GLF) given to Greece in the context of the 1st adjustment program (total notional €52.9bn);

ii. 10-year grace on interest payments on GLF loans; and

iii. further interest rate reduction on GLF loans to 0.6% fixed, from 3m Euribor + 50bps, currently.

Table 2 below shows the cash relief provided by the assumed OSI structure, while Graph 1 portrays the incipient reduction in the gross public debt to GDP ratio under the troika's macro baseline scenario.

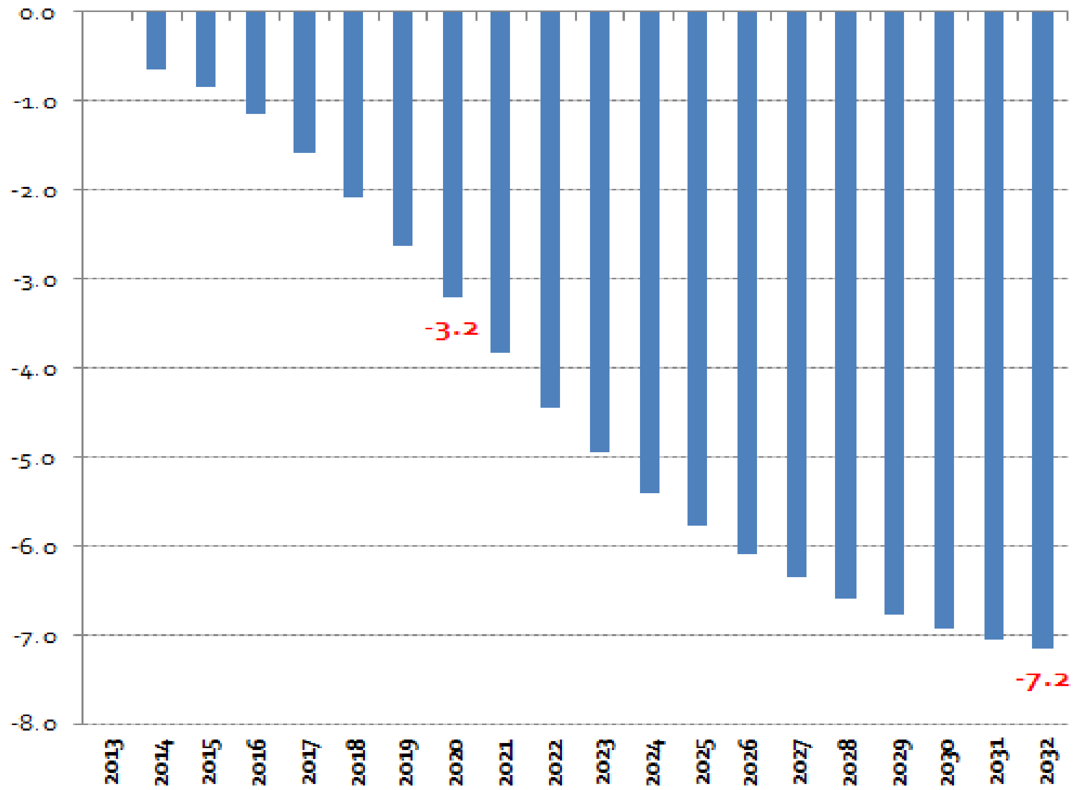
[2] See e.g. Greece Macro Monitor, "Debt forgiveness is not a necessary precondition for restoring debt sustainability", Eurobank Global Markets Research, October 31, 2013.
http://www.eurobank.gr/Uploads/Reports/GREECE%20Macro%20Monitor%20-%20October%2031%202013.pdf

Table 2 - Estimated improvement (-) /deterioration (+) in government borrowing requirement due new OSI

2015-2016	-2.2
2015-2022	-15.9
2023-2032	-25.4
2033-2042	-7.2
2043-2052	15.5
2053-2062	14.7
2063-2064	2.8
Total saving (2014-2064)	**-15.5**

Source: IMF, Eurobank Global Markets Research

Graph 1 - Cumulative impact of public debt ratio due to assumed OSI structure



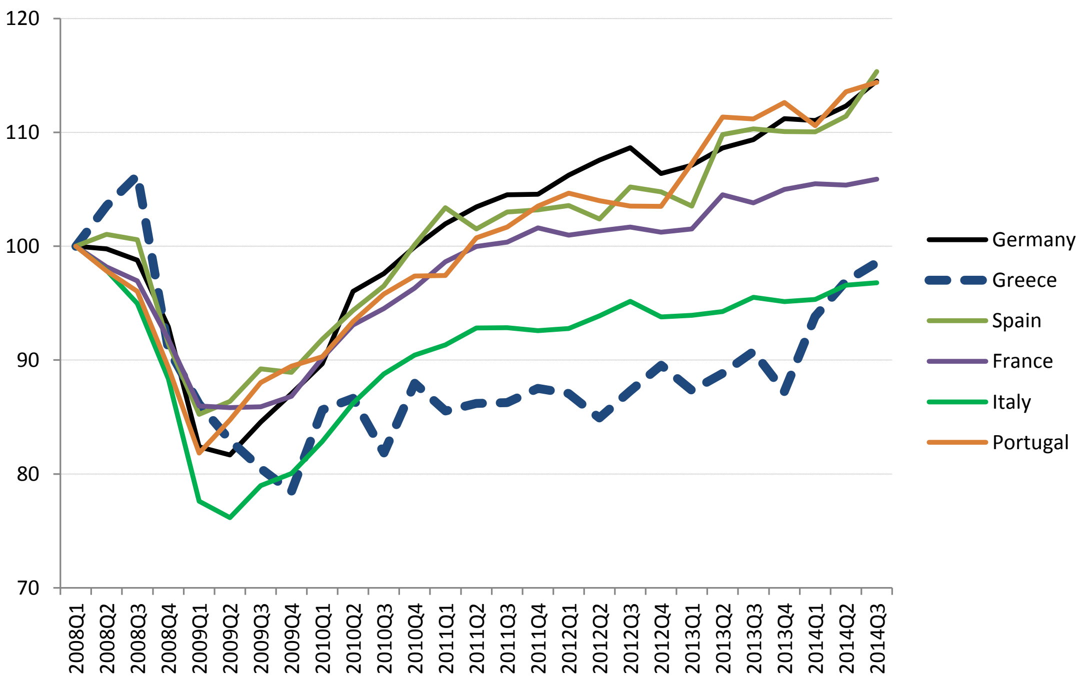
Source: IMF, Eurobank Global Markets Research

Bottom line: Contingent on the completion of the current program review and an agreement on a precautionary credit line to ensure full coverage of the government borrowing requirement over the next couple of years, some form of new OSI would be necessary down the road so as to: i) deliver further debt relief (mainly in NPV terms); and ii) smooth out a demanding government borrowing profile post 2022/23.

The need for a continuation of structural reforms

As regards the present structural reforms agenda, we note the significant progress made thus far in modernizing the public sector and improving the institutional framework and the domestic business environment. Yet, a range of relevant indicators (see e.g. World Bank Doing Business 2015; WEF Global Competitiveness Indicator 2014) suggests that the said progress has so far been broadly uneven, while additional efforts are needed to reach the critical mass of reforms that could boost investment activity and improve export performance. For instance, the labor market reform introduced in early 2012 and the domestic recession have facilitated a sharp decline in domestic wages, with Greece's real effective exchange rate based on relative ULCs having already more than fully offset its cumulative overvaluation during the post EMU entry period. However, more effort is still needed to boost non-price competitiveness so as to facilitate a more business-friendly and extrovert model of economic development (Graph 2).

Graph 2 - Greece's exports performance has broadly lagged that of other euro area countries throughout the crisis period, but it is catching up lately



Source: Eurostat, Eurobank Global Markets Research

5th program review: main items on the agenda

The main stumbling blocks on the agenda of official discussions in the context of the current program review include: (i) identification of measures for the coverage of a €1.7bn fiscal gap official lenders expect to arise in 2015; (ii) a newly adopted scheme for the settlement of overdue tax payments and social security contributions that was recently approved by the Hellenic Parliament without the troika's consent; (iii) identification of measures to address potential challenges to the medium-term viability of the social security system; and (iv) a number of additional measures to enhance flexibility in the domestic labor market. In more detail:

Identification of measures to cover 2015 fiscal gap

Opposing the government's projection for no fiscal shortfall in 2015, the troika reportedly expects a fiscal gap of ca €1.7bn to arise this year. In an effort to reach a compromise on that issue, the government has proposed a number of additional fiscal measures, which would purportedly boost this year's budget revenues by at least €980mn. These include: (i) increase in the hotel VAT rate to 13% from 6.5% currently for the generation of additional State revenue of at least €350mn; (ii) new interventions in the social security system for attaining addition savings to the tune of ca. €132mn; and (iii) implementation of certain administrative measures for addressing tax fraud and evasion as well for enhancing the efficiency of VAT administration. These measures are reportedly projected to generate additional revenue of at least €500mn/annum and include, among other, the cross-checking of business-to-business invoices and the adoption of a VAT lottery scheme similar to that applied in Portugal, Malta and Slovakia. In addition to these measures, the Greek government has reportedly committed to introduce by mid this year a supplementary budget, should budget execution data for the first months of 2015 point to an unexpected deviation from the agreed targets. According to press reports, the government estimates that the said supplementary budget could generate additional revenue of at least ca €500mn via: a) the removal of a 30% discount on a special solidarity surcharge that came into effect on 1.1.2015; b) the imposition of a luxury tax on a range of high-ticket items; and c) an increase in the excise tax on tobacco and alcoholic beverages. On the other hand, it seems that the Greek side is currently opposing a number of proposals made by troika inspectors as a means of covering next year's projected fiscal shortfall, including an increase of the VAT rate on books and medicine (to 13% from 6.5%, currently), the outright abolishment of a 30% discount on all VAT rates applied in many Greek islands and additional horizontal cuts in main and supplementary pensions. Addressing the 25th annual Greek Economy Conference organized by the American-Hellenic Chamber of Commerce earlier last month, Greece's Prime Minister Antonis Samaras said that official lenders "forecast a fiscal shortfall that cannot be confirmed", adding that the his government has rejected their "unreasonable" demands that could prove "catastrophic" for the domestic economy.

New installment scheme for overdue tax payments and social security contributions[3]

The Hellenic Parliament approved last November a new scheme allowing up to 100 monthly installments in the payment of overdue tax and social security liabilities verified up to October 1, 2014 (rather than up to end-March 2015 as was initially planned).[4] Reportedly, the troika deems the new scheme as too "generous" and has requested the imposition of more stringent income criteria. On its part, the government has opposed the latter demands, arguing that any amendments to the new installment scheme could weigh on projected budget revenues.

Social security reform

The Greek side has reportedly opposed the adoption of new interventions in the social security system that could effectively lead to further horizontal cuts in main and supplementary pensions. Instead, it has counter-proposed the implementation of a number of alternative measures including, inter allia:

(i) maintenance of nominal pensions at 2015 levels for this year and the next. Under such a scenario, the planned increase as of 1.1.2016 in nominal pensions (Law 4024/2011, Article 2, par. 10) would not materialize. According to press reports, the Ministry of Finance projects that the said measure could secure savings of ca €50mn in 2016 and €140mn in 2017;

(ii) increase in the number of social security insurance years required for the minimum pension to 20 years from 15 currently (to be applied on pensioners born after 1975);

(iii) gradual abolishment of an early retirement scheme (i.e., at the age of 62) that it is currently in effect for certain categories of public and private-sector employees (e.g. working mothers of minor children);

(iv) tighter criteria applied in granting Pensioners' Social Solidarity Benefit (EKAS). The said benefit is currently granted to ca 230k pensioners with annual declared income no higher than €9.9k.

Labor market reform

The Greek government is reportedly opposing the troika's proposal for: (i) modifications in the existing framework for collective dismissals in the excess of the current layoff limit, a view also shared by the International Labour Organization (ILO)[5]; (ii) reintroduction of employers' right to stage lockouts during worker strikes;[6] and (iii) changes in the procedure currently applied for trade unions engaging in a strike. As a compromise, the Greek side reportedly accepted certain amendments as regards the operation of trade unions including, inter allia, reassessment of certain trade unionists' privileges (e.g,. number of days they are entitled to be absent from work without an excuse).

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[3] Cumulative overdue social security contributions accrued up to end-October 2014 reportedly reached €20bn while, based on the latest data from the Secretariat General for Public Revenues, cumulative tax arrears totaled €71.5bn in the same period, out of which ca €11bn was accumulated in the first ten months of this year.

[4] The scheme foresees, among other: (i) 12 to 100 monthly instalments for debtors owning up to €15.000 and 12 to 72 installments for overdue debts between €15.001 and €1.000.000; (ii) a haircut between 20-100% on overdue payment penalties, depending on the number of monthly installments; (iii) a reduction in the applied fixed interest rate on overdue liabilities (to 4.56% from 8.05% previously); and (iv) a minimum monthly installment of €50. The deadline for enrolling in the said scheme is March 31, 2015.

[5] The existing procedure for the approval of collective company redundancies which is in line with the relevant Council Directive 98/59 and has been approved by Greece's main employer organizations (SEV, ESEE, GSEVEE, SETE) and the General Confederation of Greek Workers (GSEE) envisages that the final decision on collective company redundancies rest with the Supreme Labour Council, which is headed by the General Secretary of the Labor & Social Security Ministry. According to the current labor regulation, the monthly limit of layoffs is a follows: (i) 5% of staff for companies with more than 150 employees (with an upper limit of 30 employees); and (ii) 6 employees for companies with 20-150 employees.

[6] A lockout is usually implemented by refusing the admission of employees onto company premises, e.g. via the change of locks.

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