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GREECE MACRO MONITOR

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# Greece: how feasible is an early exit from the IMF lending program

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***Heading to the inception of official talks in the context of Greece's next (5th) program review[2], market uncertainty about their evolution and, most importantly, the timing and the potential structure of a new debt relief package by official lenders has been on the rise. Further clouding the near term outlook is a demanding program review agenda and a number of important milestones that could potentially affect, to a greater or lesser extent, the negotiations process along the way. Among others, these include the announcement of the EU-wide stress test results on October 26, the asymmetric time profile of remaining EFSF and IMF loan disbursements[3], a number of key votes in the Greek Parliament as well as the election of the new President of the Hellenic Republic by early next year. In our September 19, 2014 Greece Macro Monitor we analyzed the agenda of the next program review and presented a brief timeline of key dates and events in the crucial six months ahead. In the present note we touch upon a number of additional issues, including the timing and structure of the expected debt relief package as well as the nature of relationship between the Greek State and the troika after the European part of the present lending program expires.***

**What after the expiration of European lending program for Greece?**

With the European part of the existing lending program for Greece now expected to expire before year end (*i.e.*, after the release of the next EFSF loan tranche) and the last IMF disbursement being scheduled no earlier than in Q1 2016, a key question is whether a new financing/monitoring arrangement will eventually replace the existing one so as to ensure adequate financing of the country's public borrowing requirement and a reasonable degree of continuity in the fiscal consolidation effort and the structural reforms agenda. In theory, one could think of several potential outcomes ranging from a discontinuation of official financing and termination of the troika's regular quarterly program reviews to an agreement with EU lenders for a *precautionary* funding facility or even a fully-fledged 3rd lending program that would likely come with additional conditionality. As a reminder, upon completion of the next program review, Greece is expected to receive €7.2bn of additional official funds, consisting of: (i) the last EFSF loan disbursement under the present bailout program (€1.8bn); (ii) €3.5bn from the IMF under the Extended Fund Facility; and (iii) €1.9bn in ANFA and SMP profits. In addition, scheduled cumulative IMF loan disbursements in the period 2015-Q1 2016 (*i.e.*, after the last EFSF loan disbursement) amount to €12.5bn.

[2] According to Greek press reports, the heads of the troika mission will return to Athens on September 29, 2014, with discussion with domestic authorities in the context of the 5th program review expected to incept the day after.
[3] As per Greece's current (2nd) bailout program, the last EFSF loan disbursement is due upon completion of the next (5th) program review, while the last IMF loan release is scheduled for the end of Q1 2016.

**Government seems unwilling to seek a new (3rd) official funding program**

Comments by high level government officials in recent months suggest that the coalition government will not opt for a new lending program by official lenders.[4] Furthermore, a barrage of media reports over the last several days went so far as to suggest that the government now plans to discontinue IMF funding (reportedly after the next IMF loan disbursement of €3.5bn), replacing it with internal sources and new sovereign bond issuance in order to cover any additional borrowing needs *i.e.,* over and above these currently projected in the troika baseline scenario. These claims were supported by Greece's Prime Minister himself, who admitted after a meeting with German Chancellor Angela Merkel on September 23rd that Greece could exit its current financing program earlier than scheduled. Mr Samaras refuted talk of "divorce" from the IMF, noting that such a development "would be a success, not a divorce". Finally, regarding the official discussions on a new debt relief package for Greece, he said that he expects them to begin after the completion of the next troika review and the release of the EU-wide stress test results. Reportedly, the rationale behind an early exit from the present funding program is that the government wants to communicate to its parliamentary deputies and the voter base that Greece has managed to bring to an end the tight surveillance imposed by the MoU conditionality. That is, especially in view of the upcoming parliamentary vote for the election of the new President of the Hellenic Republic by early next year.[5] Abstracting from any political considerations as regards the discontinuation of remaining (committed) IMF funding under the present bailout program, it is important to see whether such scenario would be feasible from a government borrowing requirement standpoint. The following section attempts a quantitative analysis of the latter issue.

**Is practically possible to discontinue IMF funding under the present bailout program?**

This section estimates the net government borrowing needs that would arise in the following years under the following two scenarios: i) absence of a new (3rd) bailout package; and ii) absence of a new bailout along with a discontinuation of the IMF financing program after the Funds' disbursement of the next loan tranche (€3.5bn). Based on the updated baseline macroeconomic scenario for Greece[6], Table A on the next page of this document depicts the projected evol*u*tion of the general government borrowing needs and sources of funding up to year 2020. The table incorporates: (i) a number of strategies currently sought for the coverage of the projected financing gap over the next 12 months and beyond; (ii) the estimated cash flow relief provided by a new (hypothetical) package of debt reducing measures by the official sector; and (iii) some future bond issuance. It also assumes that outstanding T-bills issuance drops to €9bn in 2017 and beyond, from ca €13.5bn, currently. On the other hand, Table A *does not* incorporate potential utilization of two additional funding sources. These include *a)* any remaining amount in the HFSF buffer (currently estimated at €11.3bn) post the upcoming EU-wide stress tests; and *b)* the use of idle resources available in other parts of general government for liquidity purposes.[7] Apparently, items *a)* and *b)* above could be utilized in tandem with the package of other strategies presented in this note in order to secure additional government financing *i.e.,* over and above that assumed in Table A. As demonstrated in the aforementioned table (line *H*), under certain conditions Greece can indeed secure adequate financing of its public borrowing requirement, without necessarily resorting to a new official financing. Indeed, under the assumed underlying scenario (which incorporates average net bond issuance of ca €5.7bn/annum) the general government borrowing needs are fully covered throughout the period 2014-2020. In addition a cumulative cash buffer of ca €5bn is generated. This along with some further bond issuance and the resources secured by items *a)* and *b)* above could also cover the additional funding needs resulting from a decision to forego remaining IMF disbursements worth €12.5bn (=€16bn in current commitments minus the next loan disbursement of €3.5bn). To put it more simply, we note that the latest troika projection for a funding gap in Greece's general government accounts in 2015-16 is estimated at €12.6bn, out of which €2bn corresponds and an additional cash buffer to be generated by the end of that period.8 However, this constitutes a gross figure, not taking into account new issuance

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[4] For instance, Greece's Minister of Finance was quoted in Kathimerini newspaper (20.9.2014) as saying that "we can now make it even without the euro area and IMF money".

[5] According to the Constitution of Greece (Article 32, paragraphs 1, 3 & 4), the vote in Parliament for the election of the President of the Hellenic Republic should take place at least one month before the expiration of the tenure of the incumbent. The relevant procedure incorporates three separate ballots. In the first two, a 2/3rd majority of the total 300 MPs is required (i.e., 200 in-favor votes). If both fail to produce a decisive outcome, a third ballot takes place where a majority of 3/5th is needed (i.e., 180 in-favor votes). Should this also fail to produce a qualified majority, Parliament has to be dissolved within ten days, and elections for a new Parliament shall be called. Based on recent press commentaries written by some well-known Greek constitutionalists, the procedure in Parliament for the election of the President could commence on February 11, 2015, at the latest. As a reminder the ruling coalition enjoys the support of 154 lawmakers; New Democracy controls 126 and socialist PASOK 28 seats.

[6] European Commission, *"The Second Economic Adjustment Programme for Greece"*, Fourth Review, April 2014; IMF Country Report No. 14/151, June 2014.

[7] The European Commission's fourth review of Greece's second economic adjustment program (April 2014) notes that domestic authorities have agreed to develop a plan for cash management reform to be implemented as of 1 January 2015. The plan aims to reduce the currently high segmentation of the management of various general government accounts. A first step in this reform will be to analyze the accounts held by Central Government entities in commercial banks and to close down all unnecessary accounts, bringing the money back into the Treasury Single Account (TSA). The closure of the unnecessary accounts was expected to take place by end-June 2014, bringing added liquidity back to the TSA.

[8] IMF Country Report No. 14/151, June 2014.

of government bonds or any of the potential resources listed above. As demonstrated in Table A, the utilization of these resources and a reasonable amount of bond issuance could not only cover the aforementioned funding gap (without recourse to a new funding program), but it might also allow an early exit from the IMF lending program. Of course, all these assume that current program targets (as regards *e.g.* the primary fiscal balance and privatization revenue) are met and that the projections of the revised troika macroeconomic scenario are vindicated. As a final comment, our analysis shows that the government borrowing requirement appears broadly manageable until 2022/23, but becomes more challenging thereafter, mainly due to: a) the expiration of the 10-year grace period on principal payments on EU loans provided under both the first and the second economic adjustment programs; b) the expiration of the 10-year grace on interest payments on EFSF loans; and c) maturing post-PSI market debt. To a large extent, these issues will be addressed in the context of a new debt relief package for Greece by the official sector.

**Table A - Greece: General government borrowing needs & funding sources (EURbn)**

| | 2012 | 2013 | 2014 | 2015 | 2016 | 2014-2016 | 2017 | 2018 | 2019 | 2020 | 2017-2020 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| **A. Gross borrowing need (I.1 + I.2 + I.3)** | **109.3** | **37.3** | **31.1** | **21.3** | **8.7** | **61.1** | **16.2** | **7.4** | **17.9** | **16.3** | **57.8** |
| **I.1 General government cash deficit** | **10.1** | **7.5** | 3.3 | 2.2 | 1.2 | **6.7** | **1.4** | **1.6** | **1.4** | **1.6** | **6.0** |
| **I.2 Amortization (I.2.1 + I.2.2 + I.2.3)** | **9.4** | **16.2** | **25.3** | **16.6** | **7.5** | **49.4** | **14.8** | **5.8** | **16.5** | **14.7** | **51.8** |
| I.2.1 Bonds and loans (after PSI & DBB) | 12.8 | 11.0 | 17.9 | 8.0 | 4.4 | 30.3 | 7.4 | 3.3 | 12.9 | 7.4 | 31.0 |
| I.2.2 Short-term (net) | -3.4 | 3.4 | 0.0 | 0.0 | 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) | 0.0 | 1.7 | 7.4 | 8.6 | 3.1 | 19.1 | 1.4 | 2.5 | 3.6 | 7.3 | 14.8 |
| *1.2.3.1 IMF* | *0.0* | *1.7* | *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* | *0.0* | *0.0* | *2.8* | *2.8* |
| **I.3 Other (I.3.1 + I.3.2 +…+ I.3.6)** | **89.7** | **13.6** | **2.5** | **2.5** | **0.0** | **5.0** | **0.0** | **0.0** | **0.0** | **0.0** | **0.0** |
| I.3.1 Bank recap | 41.0 | 7.2 | 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) | 34.6 | 0.0 | 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) | 11.3 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| I.3.4 Arrears clearance | 0.5 | 5.5 | 2.0 | 2.5 | 0.0 | 4.5 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| I.3.5 Cash buffer | 1.5 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| I.3.6 ESM capital | 0.9 | 0.9 | 0.5 | 0.0 | 0.0 | 0.5 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| **B. Financing source (II.1+II.2+II.3)** | **0.3** | **3.7** | **12.5** | **9.2** | **10.1** | **31.8** | **14.3** | **6.6** | **17.4** | **14.3** | **52.5** |
| II.1 Market access | 0.0 | 0.0 | 8.5 | 5.0 | 5.0 | **18.5** | 10.0 | 2.5 | 13.1 | 10.0 | **35.6** |
| *Market access on a net basis i.e., after substracting bond issuance to rollover debt issued from 2014 onwards* | *0.0* | *0.0* | *7.0* | *5.0* | *5.0* | *17.0* | *9.5* | *2.5* | *6.0* | *5.0* | *23.0* |
| II.2 Privatisation revenue | 0.0 | 1.0 | 1.5 | 2.2 | 3.4 | 7.1 | 2.9 | 3.0 | 3.4 | 3.6 | 12.9 |
| II.3 ANFA & ESM profits | 0.3 | 2.7 | 2.5 | 2.0 | 1.7 | 6.2 | 1.4 | 1.1 | 0.9 | 0.7 | 4.0 |
| **C. Net financing needs (A.-B.)** | **108.9** | **33.6** | **18.6** | **12.1** | **-1.4** | **29.3** | **1.9** | **0.8** | **0.5** | **2.0** | **5.3** |
| **D. Official loan disbursements (III.1+III.2)** | **109.9** | **32.1** | **17.2** | **10.7** | **1.8** | **29.7** | **0.0** | **0.0** | **0.0** | **0.0** | **0.0** |
| *III.1 EU* | *108.2* | *25.3* | *10.2* | *0.0* | *0.0* | *10.2* | *0.0* | *0.0* | *0.0* | *0.0* | *0.0* |
| *III.2 IMF* | *1.6* | *6.8* | *7.0* | *10.7* | *1.8* | *19.5* | *0.0* | *0.0* | *0.0* | *0.0* | *0.0* |
| **E. Financing gap (D.-C.)**<br>***"-" indicates deficit ; "+" indicates surplus*** | | | **-1.4** | **-1.4** | **3.2** | **0.4** | **-1.9** | **-0.8** | **-0.5** | **-2.0** | **-5.3** |
| | | | | | | | | | | | |
| **F. Strategies to cover financing gap with internal sources other than bond issuance (IV.1 + IV.2 + IV.3 + IV.4)** | | | **2.9** | **3.7** | **-2.0** | **4.6** | **1.2** | **1.5** | **0.9** | **1.8** | **5.4** |
| IV.1 Rollover of 5-yr gvnt bond owned by ETEAN (=€ *1.5bn-€0.43bn)* | | | 0.7 | | | | | | -0.7 | | |
| IV.2 Purchase by Pireaus Bank & Alpha Bank of preference shares from the State (€*1.7bn)* | | | 1.7 | | | | | | | | |
| IV.3 Use of subsector deposits through repo transactions | | | | 3.0 | -3.0 | | | | | | |
| IV.4 New debt relief package/assumed cash flow relief | | | 0.5 | 0.7 | 1.0 | | 1.2 | 1.5 | 1.6 | 1.8 | |
| | | | | | | | | | | | |
| **G. Financing gap after utilisation of internal sources & debt relief package (E.+F.)**<br>***"-" indicates deficit ; "+" indicates surplus*** | | | **1.5** | **2.3** | **1.2** | | **-0.7** | **0.7** | **0.4** | **-0.2** | |
| **H. Cumulative financing gap after utilisation of internal sources & debt relief package**<br>**"-" indicates deficit ; "+" indicates surplus** | | | **1.5** | **3.8** | **5.0** | | **4.2** | **4.9** | **5.3** | **5.1** | |

Source: EC (April 2014); IMF (June 2014); Eurobank Global Markets Research

**Explanatory notes to Table A**

***Line I.1 "Government cash deficit"*** depicts the General Government balance in cash (*non*accrual) basis.

***Line I.2.1 "Bonds and loans (after PSI and DBB)"*** incorporates the expected maturities of existing debt (bonds and loans) as well as the maturities of newly-issued bonds, as per the corresponding explanatory note for ***Line II.2*** below.

***Line I.2.2 "Short-term (net)"*** depicts the corresponding maturities of T-bills (on a net basis); here we assume that the total outstanding amount of T-bills declines to ca €9bn in 2017 onwards from ca €13.5bn, currently *i.e.,* following the recent swap of €1.5bn worth of T-bills with 3- and 5-year fixed coupon bonds. Here, it is implicitly assumed that the total notional amount of outstanding T-bills will stand at €15bn at the end of 2014.

***Line 1.2.3.2 "EU"*** - There is currently a 10-year grace period on principal payments on all EU loans provided to Greece under the first and the second (current) bailout programs.

***Line II.1 "Market access"*** - For simplicity, we assume here that market access over the period 2014-2020 is conducted via issuance of 5-year fixed coupon bonds, carrying (an average-weighted) coupon of ca 3.6%.

***Line II.2 "Privatization revenue"*** - In the context of the last (4th) program review, targeted privatization revenue for FY-2014 has been revised downwards by €1.5bn; while the respective targets for the fiscal years 2015 and 2016 have been raised by €0.2bn and €1.2bn.

***Line IV.1 "Rollover of 5-yr gvnt bond owned by ETEAN" –*** ETEAN is an extra-budgetary fund whose main objective is to give guarantees to SMEs so that the latter can have access to financing. In 2009, the government issued bonds to ETEAN (total notional amount of ca €1.5bn), but fewer guarantees have been called than expected initially. This has allowed the government to cancel some of these bonds when they matured i.e., in August 2014 (see *European Commission, The Second Economic Adjustment for Greece Fourth Review – April 2014*).

***Line IV.2 "Purchase by Pireaus Bank & Alpha Bank of preference shares from the State (€1.7bn)"*** - In 2009 Greece issued the so-called pillar I bonds to capitalize Greek banks. In exchange for these bonds, the Greek State was given preference shares in the banks that required the recapitalization. In the course of the on-going recapitalization, two banks have raised higher amounts from the markets in order to buy back the state preference shares. This reduced the government financing needs for May 2014, when the pillar I bonds matured.

***Line IV.3 "Use of subsector deposits through repo transactions***" - While the State cash reserves run relatively low, other general government entities have sizable cash reserves. As part of the program, a mechanism will be put in place to enable the State to use idle resources available in other parts of general government to cover part of its financing needs. As a first step, the authorities are setting up a repo framework using state government assets as collateral to draw on excess liquidity in general government subsectors for up to €3 bn. This framework will be implemented as part of a prior action and although the repos will be short-term, they can be rolled over as needed (see *European Commission, The Second Economic Adjustment for Greece Fourth Review – April 2014*).

***Line IV.4*** - ***"New debt relief package/assumed cash flow relief"*** depicts the ensuing decline in the Government borrowing requirement resulting from an assumed (new) debt relief package involving: **a)** 20-year maturity extension on EU bilateral loans (GLF) given to Greece in the context of the 1st adjustment program (total notional €52.9bn); **b)** 10-year grace on interest payments on GLF loans; and **c)** further interest rate reduction on GLF loans to 0.6% fixed, from 3m euribor + 50bps, currently. The specific interest rate has been chosen so as to deliver a reduction in the public debt ratio over the period 2014-2022, which is broadly consistent with the respective targets set at the November 2012 Eurogroup. More analysis on the implications of this structure for the government borrowing requirements and the gross debt stock can be found in our *Greece Macro Monitor* of October 31, 2013, *"Debt forgiveness is not a necessary precondition for restoring debt sustainability"*).

http://www.eurobank.gr/Uploads/Reports/GREECE%20Macro%20Monitor%20-%20October%2031%202013.pdf

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