A 2nd look at Greece's projected borrowing needs & debt dynamics post July 21 EU Council

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This note takes a second look at the potential implications of the July 21 EU Council decisions for **a)** Greece's state borrowing needs and financing sources and **b)** the evolution of the country's debt-to-GDP ratio over the period mid 2011-2020. The note is, to a large extent, complementary to our *July 29 Greece Macro Monitor "Recent EU Council announcements: Some additional analysis on their implications for Greece"* and incorporates our latest analysis of the aforementioned issues.

Regarding issue **a)**, as we emphasized in our July 29 Greece Macro Monitor, we believe that new bailout package for Greece agreed at the last EU Summit provides adequate funding to broadly cover the country's borrowing need over the next three years. This is demonstrated in Table 1 below, which shows the projected evolution of the government's borrowing requirement and sources of financing in the period mid 2011 – mid 2014.

Table 1

Borrowing need and finacing sources [1] (euro billion) mid 2011 - mid 2014	
A. Borrowing need (inclusive of the cost of PSI, DBB & bank recap.)	
a1. General gvtn deficit & amortizations *MLT (non-official) and official creditors*	161,0
a2. Cost of credit enchancement	35,0
a3. Cost of DBB	20,0
a4. Cost for bank recapitalisation	20,0
Total (a1+a2+a3+a4)	**236,0**
B. Financing source (official sources & PSI)	
b1. Privatization receipts	28,0
b2. EU/IMF (still undisbursed from existing Greek Loan Facility)	45,0
b3. New EFSF/IMF loans	109,0
B4. PSI (90% participation)	54,0
Total (b1+b2+b3+b4)	**236,0**

Source: EU, IIF, Eurobank research projections
[1] The table above assumes roll over of full ammount of maturing T-bills

In addition to the table presented above, we examine a couple of different scenarios for PSI participation rates and annual primary balances in the period 2015-2020 and we conclude that the government's (post-2014) borrowing requirement becomes <u>significantly</u> more manageable than projected before the latest EU Council.

Specifically, according to our calculations, the new bailout deal provides significant cash-flow relief to the State, at least until 2020. That would be mainly the result of:

- reduced interest expenditure due to lower interest rates on new (and old?) EA/EFSF loans
- a 10-year grace period for (old and new) EA/EFSF loans
- longer maturities of EA/EFSF loans
- reduced amortization-related refinancing needs due to PSI and debt buy backs (DBB).

Tables A1 and A2 below depict our projections for the evolution of the general government gross borrowing needs & financing sources in the period 2015-20. Table A1 assumes: **i)** €10bn revenue from asset sales, **ii)** 90% PSI participation (and DBB in line with the IIF's assumptions), **iii)** the impact of buybacks (affecting some €32.6bn of maturing notional) is assumed to be evenly split over the period 2011-2020 and **iv)** nominal GDP growth and primary surpluses in line with the IMF's baseline scenario (July 2011). Please note that under the (admittedly optimistic) scenario portrayed in Table A1, the government's cumulative budget position broadly balances in 2015-2020 (mainly as a result of high primary balances and lower interest rate expenditures). Furthermore, according to our calculations the State's projected market access *(vis.* the issuance of MLT notes and bonds) becomes very low, i.e., close to €2.3bn/annum (on average) over the corresponding period.

Table A1 - Optimistic scenario

Gross borrowing need & financing sources[(2)] (euro billion)	2015 - 2020
Borrowing need	
a1. General government deficit (+) / surplus (-)	**0,0**
a2. Amortizations (a2.1+a2.2)	23,8
MLT (non-official)	*102,6*
MLT (non-official) after 90% PSI	*21,6*
a2.1. MLT (non-official) after PSI & DBB	*2,6*
a2.2. Official creditors (IMF loan amortization)	*21,2*
Total (a1+a2)	**23,8**
Financing source	
b1. Privatization receipts	**10,0**
b2. Market access (MLT bond issuance)	**13,8**
(Average MLT bond issuance / annum)	*2,3*
Total (b1+b2)	**23,8**

Source: EU, IIF, Eurobank research projections
(2) Assumes roll over of maturing T-bills and no privatisation revenue after 2015

Table A2, depicts a less benign scenario than Table A1. It assumes: **i)** €10bn revenue from asset sales, **ii)** 60% PSI participation (and DBB in line with the IIF's assumptions), **iii)** the impact of buybacks (affecting some €32.6bn of maturing notional) is assumed to be evenly split over the period 2011-2020 and **iv)** annual primary surpluses of only 3%-of-GDP in the period 2015-2020 (vs. 6%-of-GDP of higher in the July 2011 IMF baseline). Under the scenario portrayed in Table A2, the government's projected market access *(vis.* the issuance of MLT notes and bonds) is ca €19bn / annum (on average). The latter amount is approximately equal to the corresponding *market access* figure projected in the July 2011 IMF baseline, which, however, assumes primary surpluses in excess of 6%-of-GDP/annum in 2015-2020).

Table A2 - Less benign scenario

Gross borrowing need & financing sources(3) (euro billion)	2015 - 2020
Borrowing need	
a1. General government deficit (+) / surplus (-)	**55,0**
a2. Amortizations (a2.1+a2.2)	68,3
MLT (non-official)	*102,6*
MLT (non-official) after PSI	*66,6*
a2.1 MLT (non-official) after PSI & DBB	*47,1*
a2.2 Official creditors (IMF loan amortization)	*21,2*
Total (a1+a2)	**123,3**
Financing source	
b1. Privatization receipts	**10,0**
b2. Market access (MLT bond issuance)	**113,3**
(Average MLT bond issuance / annum)	*18,9*
Total (b1+b2)	**123,3**

Source: EU, IIF, Eurobank research projections

(3) Assumes roll over of maturing T-bills and no privatisation revenue after 2015

In addition to the cash-flow analysis provided above, we next look at the potential implication of the July 21 EU Council announcements for Greece's debt dynamics. In our prior note on the latter issue, we examined three scenarios for the evolution of the debt-to-GDP ratio in the period 2011-2020. These included:

i. The **July 2011 IMF baseline scenario**, which projects a peak of the debt ratio in 2012 (at levels around 172%-of-GDP) and a gradual de-escalation thereafter, with a terminal forecasted value of 130%-of-GDP in 2020.

ii. The **July 2011 IMF baseline scenario's underlying assumptions** (i.e., for nominal GDP growth, primary balances and stock-flow adjustments inclusive of privatization revenue) **adjusted for** lower interest rates on official (EA/EFSF) loans **as well as** the impact of PSI and debt buy backs.

iii. **Scenario ii)** described above **adjusted for** more benign (and, in our view, more realistic) assumptions for nominal GDP growth (ca 4%/annum after 2014) and primary surpluses (ca 4.0%-of GDP-after 2013).

In our earlier projections for the evolution of the debt ratio (*Greece Macro Monitor*, *July 29, 2011)* we did not take into account the initial impact (on the debt ratio) of the EFSF loans to Greece for the purchase of credit enhancements (AAA zero coupon bonds for collateralizing the principal of the new bonds offered in the exchange). These would cost €35bn for the PSI scheme affecting Greek government bonds (GGBs) maturing between mid 2011 and mid 2014 (and €42bn for GGBs maturing between mid 2011 and 2020).

The effect of the aforementioned transactions would be to increase, at an initial stage, Greece's gross debt (by an equiproportional amount), though leaving unaffected the country's net debt position. *(Our understanding is that the initial upward effect on gross debt as a result of the purchase of guarantees will start being amortized --and gradually reducing the gross debt-to-GDP ratio -- after the 10 year grace period granted to EFSF loans).*

Regarding the €20bn part of the *new* EFSF loan to be used for domestic bank recapitalizations, note that the July 2011 IMF baseline scenario already accounts for **a)** a €16bn additional contribution to the existing FSF (back-stop) facility for potential recapitalizations, assuming that these funds would be disbursed to domestic banks "in the near term", with the government recovering the resulting equity investment by 2014–15 and **b)** the creation of a deposit buffer of up to €10bn by mid-2014, aiming to help contain risks from unexpected developments.

Taking into account all these factors we have revised our projections for Greece's debt to GDP ratio (scenarios **i., ii.** and **iii.** specified above) for the period 2011-2020, as shown in Table 2 below:

Table 2

	2010	2011	2012	2013	2014	2015	2020
Scenario i) - IMF Baseline scenario (July 2011)							
Primary balance (% GDP)	**-4,9**	**-0,8**	**1,5**	**3,5**	**6,4**	**7,7**	**6,4**
Nominal GDP growth (%)	**-2,0**	**-2,4**	**1,3**	**3,1**	**3,3**	**3,6**	**4,9**
Average interest rate on debt (%)	**4,2**	**4,6**	**4,9**	**5,0**	**5,5**	**5,9**	**6,7**
Interest rate (% GDP)	5,5	6,8	8,0	8,4	9,1	9,2	8,6
Debt-to-GDP projections (%)	**143**	**166**	**172**	**170**	**160**	**146**	**130**
Scenario ii) - IMF Baseline scenario adjusted for lower interest rates on official loans & the effect of PSI & DBB							
Debt-to-GDP projections (%)	**143**	**175**	**182**	**177**	**167**	**150**	**118**
Scenario iii) - IMF Baseline scenario adjusted for lower interest rates on offical loans, the effect of PSI & DBB and lower primary surpluses as well as lower nominal GDP growth relative to the IMF baseline							
Debt-to-GDP projections (%)	**143**	**175**	**182**	**177**	**169**	**154**	**138**

Source: IMF July 2011, Eurobank EFG Reseach

Notes to Table 2:

An average interest rate on the overall debt stock of ca 4.5% in 2011-2020 is assumed in scenarios ii) and iii)

Scenarios ii) and iii) assume that the projected impact of PSI and DBBs on the debt ratio is evenly split over the 2011-2020 projection horizon

The cost of credit enhancements is spit by 2/3rds and 1/3rd between 2011 and 2012,respectively

Concluding remark

As demonstrated by the analysis in this report, a major implication of the July 21 EU Council decisions is the significant cash flow relief provided to Greece. This should allow the country a valuable (multi-year) time window to implement fiscal consolidation and long-due structural reforms.

On a less positive note, the impact of the new bailout package on Greece's gross debt will likely be limited in 2011-2020 since the beneficial effects of lower interest rates (and the PSI & DBB schemes) will be largely offset by the initial increase in gross debt as a result of the credit enhancements.

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