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Focus notes: Greece

Public debt ratio still at elevated levels but servicing costs broadly manageable over the coming decade

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This note presents the second installment of a comprehensive Eurobank Research study on Greece's sovereign solvency position. In the first installment we examined the attainability of this year's programme target of generating a balanced general government primary position following a lower than expected deficit of 1.3%-of-GDP in 2012. Moreover, we discussed the case for some new OSI to improve the sustainability of Greek public debt and presented a detailed analysis of the general government borrowing needs and funding sources over the present adjustment programme's implementation horizon (2012-2016).1 This note takes a closer look at Greece's debt rollover risks by extending the aforementioned analysis over a longer forecasting horizon and comparing Greece's public debt servicing costs to those of other euro area countries.

1. Summary of views

Despite an unprecedented (and painful) fiscal consolidation programme implemented in Greece over the last three years, the country's gross public debt to GDP ratio remains the highest in the euro area. As per the present troika baseline scenario, the debt ratio is expected to peak at 175.8% in 2013, before embarking on a downward trajectory, reaching around 124% at the end of 2020 and falling "substantially lower" than 110% in 2022.

To facilitate the aforementioned targets, official lenders have committed to consider additional (not yet identified) relief measures for Greece, provided that the country reaches an annual primary surplus and abides fully with programme conditionality.[2] According to our calculations, the necessary contingency measures to reduce the debt ratio to sub-110% levels by 2022 (under the troika's present baseline scenario) amount to around 7ppts-of-GDP on a cumulative basis.

Provided that the country manages to eliminate its general government primary deficit this year, the projected increase in the debt ratio in 2013 will be mainly attributed to the so-called "snowball effect" *i.e.,* the automatic increase in the debt ratio due to the fact that nominal GDP growth will continue to lag behind the average nominal interest rate on the overall debt stock. Official funding provided this year to recapitalize domestic banks and the recognition of implicit/contingent liabilities will also contribute to the projected increase in the debt ratio, albeit to a much lesser extent.

[1] *"Attainability of 2013 fiscal target, medium-term financing gap and the case for new OSI", Eurobank Research, 18 July 2013.* http://www.eurobank.gr/Uploads/Reports/GR%20Monitor%2018%20July%202013.pdf
[2] See *Eurogroup statement on Greece, 27 November 2012.*

According to our forecasts, the snowball effect will be broadly neutralized in 2014, before start reducing the debt ratio from 2015 onwards. Note that Greece's effective interest rate on the overall public debt stock is presently among the lowest in the euro area, and it is expected to remain so over the coming decade.

Our analysis of the general government borrowing needs and sources of funding in the context of Greece's present adjustment programme broadly concurs with the troika baseline macro scenario, which envisages funding gaps equivalent to €4.6bn in H2 2014 and €6.5bn in 2015-2016. We do not expect the coverage of the aforementioned gaps to necessarily prove an insurmountable hurdle, for a number of reasons we presented in our earlier report.

Our updated analysis on the evolution of the government net funding requirement in the period stretching beyond the present adjustment programme's implementation horizon reveals a sharp decline in borrowing needs in 2017-2022, chiefly as a result of a 10-year deferral in EFSF interest payments agreed as part of the relief measures for Greece announced at the November 2012 Eurogroup.

Assuming that all relevant macro and fiscal variables will evolve in line with the troika's present bailout scenario, we estimate the cumulative financing gap in 2017-2020 to fall below €10bn, even after assuming a significant decline of outstanding T-bill issuance from present elevated levels (ca €15bn). Moreover, the average maturity of Greek sovereign debt is currently 17 years (around double the corresponding euro area average), while around 90% of the overall debt stock is now in official hands (troika, ECB and euro area national central banks).

The aforementioned point to a sharp decline in Greece's sovereign rollover risks over a period stretching well beyond the present adjustment programme's implementation horizon. This effectively implies that debt servicing costs over the coming decade will remain broadly manageable, notwithstanding the current elevated public debt ratio. Apparently, the latter view is conditional on the timely disbursement of remaining programme financing and the attainability of agreed targets as regards privatization revenue and the primary balance.

2. An assessment of Greece's medium-term net borrowing needs

2.1 Rollover risks down sharply despite still elevated debt ratio

Tables A1 & A2 below depict the projected evolution of Greece's general government borrowing needs and sources of funding over the following two sub-periods: 2013-2016 (*i.e.,* the remaining adjustment programme implementation horizon) and 2017-2020. For the first sub-period, the headline figures and main components broadly concur with the troika's current baseline scenario (see *e.g.* IMF Country Report No. 13/153, June 2013), while these for 2017-2020 constitute official sector & Eurobank Research estimates and forecasts. As shown in Table A1, the overall general government funding gap over the period 2013-2016 is currently projected at €11.1bn (€4.6bn in H2 2014 & €6.5bn in 2015), while that of the 2017-2020 period is expected to amount to only €5.9bn. These forecasts assume that all relevant macro and fiscal variables will evolve broadly in line with the baseline scenario depicted In Table A2 and crucially incorporate realization of the present programme target for privatization revenue (€22bn by 2020). Notably, our forecasts assume a reduction in annual outstanding T-bills issuance after 2016, to €9bn from around €15bn, currently. It is also important to emphasize that the relief measures for Greece announced by the 27 November 2012 Eurogroup have had a sizeable (beneficial) impact on the government's medium-term funding needs and liquidity conditions as depicted in Table B below. The key message of all these is that despite a still elevated debt ratio, rollover risks have fallen precipitously post the November 2012 Eurogroup, allowing Greece to remain away from financial markets for the greater part of the coming decade without necessarily facing insurmountable funding hurdles.[3]

[3] A European commission spokesman was quoted recently as saying that the small shortfall expected in late 2014 (€4.6bn) could be covered by an unused buffer of ca €7bn in the €50bn programme envelope used to recapitalize domestic banks. Looking beyond that year, the troika's baseline scenario projects a funding gap of €6.5bn in 2015, with the government funding need being fully covered by internal sources (*i.e.,* primary surplus, privatization revenue and T-bills issuance) in 2016. Provided that the agreed fiscal consolidation plan will continue to be implemented without major deviations, we believe that the coverage of the 2015 gap will not necessary prove an insurmountable hurdle, especially as some new OSI would also result in additional (indirect) programme financing.

Table A1 – Greece: General government funding needs & sources of funding (EURbn)

In EURbn	2013-2016	2017-2020
I. Gross borrowing need (I.1 + I.2 + I.3)	**84.0**	**28.1**
I.1 Overall general gvnt balance (accrual)	**17.0**	**4.5**
I.2 Amortization (I.2.1 + I.2.2 + I.2.3)	**64.4**	**40.3**
I.2.1 Bonds and loans after exchange	*40.2*	*19.5*
I.2.2 Short-term (net)	*3.4*	*6.0*
I.2.3 Official creditors	*20.8*	*14.8*
IMF	*20.8*	*12.0*
EA/EFSF	*0.0*	*2.8*
I.3 Other (I.3.1 + I.3.2 +... + I.3.6)	**2.5**	**-16.7**
I.3.1 Bank recap	*7.2*	*0.0*
I.3.2 Cash upfront for PSI (sweetener & accrued interest)	*0.0*	*0.0*
I.3.3 Arrears clearance	*7.5*	*0.0*
I.3.4 Privatization	*-9.2*	*-12.7*
I.3.5 ECB related income (SMP & ANFA)	*-8.9*	*-4.0*
ANFA	*-2.2*	*-1.4*
SMP	*-6.7*	*-2.6*
I.3.6 Other (debt buyback cost, cash buffer, contribution to ESM capital)	*5.8*	*0.0*
II. Gross financing source (II.1+II.2+II.3)	**72.8**	**22.2**
II.1 Market access	**0.0**	**0.0**
II.2 Official financing, including disbursed & committed (II.2.1 + II.2.2 + II.2.3)	**74.1**	**22.2**
II.2.1 EC bilateral loans/EAMS	*36.5*	*0.0*
II.2.2 IMF	*26.4*	*0.0*
II.2.3 EC interest deferral	*11.2*	*22.2*
II.3 Deposit financing & other	**-1.3**	**0.0**
III. Financing gap (I-II)	**11.1**	**5.9**

Source: IMF (July 2013), EC(April 2013), Eurobank Research

Table A2 – Greece baseline macro scenario (memorandum items to Table A1)

	2012	2013	2014	2015	2016	2017	2018	2019	2020
Real GDP (%)	-6.4	-4.2	0.6	2.9	3.7	3.5	3.3	3.0	2.6
GDP deflator (%)	-0.8	-1.1	-0.4	0.4	1.1	1.3	1.4	1.7	1.7
Nominal GDP (%)	-7.1	-5.3	0.3	3.4	4.8	4.8	4.7	4.8	4.3
Nominal GDP (EURbn)	193.7	183.6	184.0	190.2	199.4	209.1	219.0	229.4	239.4
General gvnt balance (% GDP)	-6.3	-4.1	-3.2	-2.1	-0.7	-0.6	-0.8	-0.5	-0.2
Primary balance (% GDP)	-1.3	0.0	1.5	3.0	4.5	4.5	4.3	4.3	4.3
Gross public Debt (% GDP)	156.9	175.8	174.2	168.2	159.5	149.7	140.9	132.0	124.2
Debt (EURbn)	304.0	322.7	320.6	319.9	318.1	313.0	308.6	302.8	297.3

Source: IMF (July 2013), EC (April 2013), Eurobank Research

Table B – Estimated impact of the November 2012 Eurogroup measures on Greece's general government borrowing needs & funding sources
(Negative/positive sign signifies reduction/increase in 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/	10.0	10.0
Reduced coupon payments on outstanding *privately-held* government bonds (post-buyback)	-2.7	-8.7
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	-25.0	-76.5

Source: EC, IMF, Eurobank Research

Explanatory note to Table B

1/ The EFSF loan to finance the debt buyback operation (Dec. 2012) did not constitute *new* official sector funding to Greece *i.e.,* over and above that initially earmarked under the 2nd bailout programme.

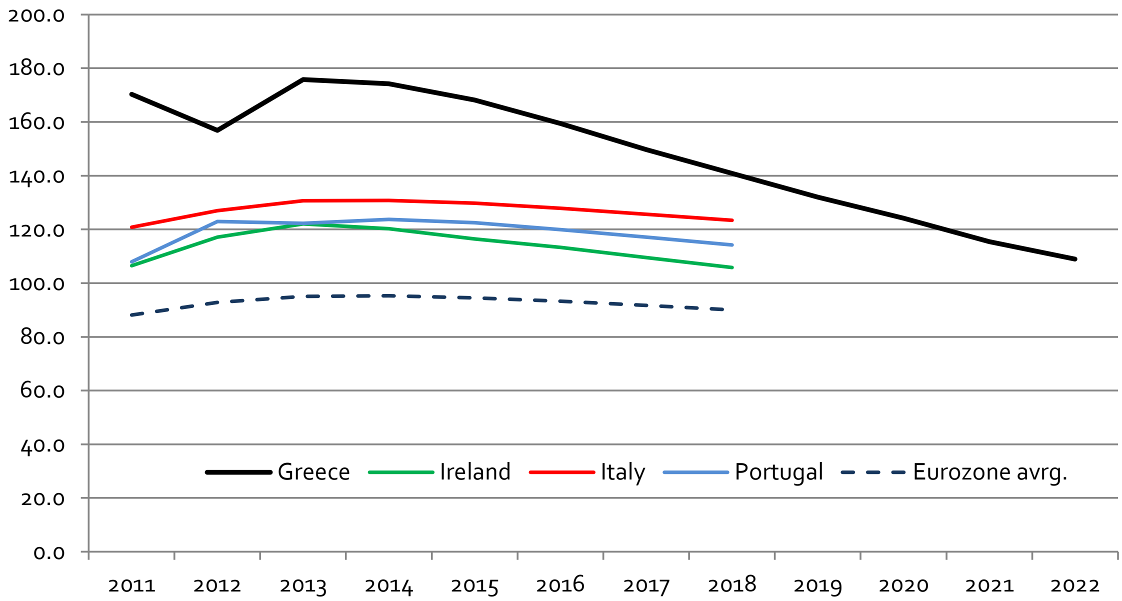
2/ Increased T-bills issuance vs. what was initially assumed in the context of the second adjustment programme (*i.e.,* a reduction of the stock of T-bills to €6bn at the end of 2013 from the original level of €15bn).

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.

2.2 Cross-country comparison on public debt levels & servicing costs

Tables C below shows the forecasted path of the general government gross debt to GDP ratio of the four most-indebted euro area economies along with the corresponding EU17 average. The realized data and forecasts for Italy, Ireland, Portugal and the euro area are from the IMF's World Economic Outlook Database (April 2013), while the corresponding figures for Greece are from the troika's current baseline scenario. As per the current projections, Greece's debt ratio is going to begin to materially converge towards the corresponding Eurozone average no earlier than in 2015-2016. However, what is important from a sovereign solvency standpoint is not only a country's nominal debt level (and the corresponding ratio to GDP), but also the expected debt dynamics and medium-term servicing costs. On that account, Greece does not currently stand in a largely disadvantageous position relative to other programme countries, as its interest payments as percent of GDP over the coming decade will not be much higher than these of Italy, Portugal, Ireland and Spain (Table D1). Furthermore, Greece's nominal interest rate on the overall debt stock is expected to remain among the lowest in the euro area in the years to come (Table D2)[4], pointing to the possibility of a relatively faster reversal of the snowball effect, once positive domestic output growth resumes.

Table C – General government gross debt (% GDP)



Source: IMF, Eurobank Research

[4] We estimate Greece's nominal interest rate on the overall public debt stock to average around 3.1% in 2013-2022.

Table D1 – Projected interest payments on general government debt (% GDP)

	2013	2014	2015	2016	2017	2018
Austria	2.0	2.0	2.0	1.9	1.9	1.9
Belgium	3.2	3.4	3.4	3.3	3.2	3.1
France	2.3	2.4	2.4	2.4	2.4	2.5
Germany	2.1	1.9	1.7	1.6	1.5	1.4
Greece	4.1	4.7	5.1	5.1	5.1	5.0
Ireland	4.3	4.4	4.5	4.3	4.3	4.2
Italy	5.3	5.3	5.4	5.6	5.7	5.8
Netherlands	1.2	1.2	1.5	1.6	1.6	1.6
Portugal	4.1	4.0	4.1	4.1	4.2	4.1
Slovak Republic	1.7	1.8	1.9	2.0	2.2	2.1
Slovenia	2.1	2.9	3.2	3.5	3.6	3.8
Spain	3.1	3.3	3.5	3.7	3.9	4.1
Euro area average	2.8	2.8	2.8	2.8	2.9	2.9

Source: IMF, EC, Eurobank Research

Table D2 – Projected evolution of nominal interest rate on overall debt stock

	2013	2014	2015	2016	2017	2018
Austria	2.7	2.7	2.8	2.8	2.8	2.8
Belgium	3.3	3.5	3.5	3.4	3.4	3.3
France	2.6	2.6	2.6	2.7	2.7	2.8
Germany	2.6	2.4	2.2	2.1	2.2	2.0
Greece	2.5	2.7	3.0	3.2	3.4	3.6
Ireland	3.8	3.8	3.9	3.8	3.9	4.0
Italy	4.1	4.1	4.2	4.4	4.6	4.7
Netherlands	1.7	1.7	2.0	2.2	2.1	2.2
Portugal	3.3	3.3	3.4	3.5	3.6	3.6
Slovak Republic	3.4	3.3	3.5	3.8	4.0	3.9
Slovenia	4.0	4.3	4.7	4.9	5.0	5.2
Spain	3.6	3.7	3.7	3.8	3.8	3.9

Source: IMF, EC, Eurobank Research

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