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Focus
Euro Area leaders agree on aid package for Greece

European Union leaders agreed yesterday to create **a joint financial safety net** to help crisis-hit Greece or any other euro area member state facing difficulties in accessing credit markets. Separately**, ECB President Jean-Claude Trichet** said yesterday that **the central bank would maintain its present minimum rating threshold for collateral accepted against central bank funds at BBB- beyond the end of 2010** and introduce a ''haircut'' system of discounting collateral.

The main points of the EuroGroup draft agreement on Greece are as follows:

- The aid package involves **substantial IMF financing** and **a majority of European financing** in the form of coordinated **bilateral loans** by euro area member states.

- The support mechanism should be considered as an ***ultima ratio*** i.e., last resort lending in case that market financing of a member state is insufficient.

- Disbursement of bilateral loans would be decided by the euro area member states and it will be based on an assessment by the European Commission and the ECB on the ''degree of the risk instability in the country concerned and the euro area as a whole''.

- **A decision to extend bilateral lending** to any member state having problems in accessing credit markets will need to be **unanimous** and subject to **strong conditionality**.

- Euro area member states will participate in such bilateral lending on the **basis of their respective shareholding** in the ECB.

- The objective of the mechanism ''will not to provide financing at average euro area interest rates, but to set incentives to return to market financing as soon as possible by risk adequate pricing''.

- Loans will be provided at "average euro area interest rates," suggesting that they would include a certain **risk premium** that reflects **the risk in the euro area as a whole.** The loans would also be non-concessional i.e., not include any subsidy element.

- **A task force will be established** by European Council President Herman Van Rompuy to explore **ways to improve budgetary surveillance** of euro area member states and the **instruments required to prevent budgetary risks**, including a strengthening of the existing excessive deficit procedure (EDP). The task force will consist of representatives of member states, the European Commission and the ECB and it will need to present its measures by the end of the year.

The draft did not specify the total amount of financial assistance that would be given to Greece in case the country faced immense difficulty in accessing credit markets, but a senior European Commission source was quoted as saying that **the package would be worth 20-22bn euros**. Furthermore, French President Nicolas Sarkozy said that the **Eurozone would put up to two-thirds of the money**, with the IMF providing the rest.

Our assessment

We believe that the Eurogroup agreement on a joint financial safety net for member states facing financing difficulties plus the extension of the percent minimum rating threshold for collateral accepted against ECB funds constitute very positive developments for the Greek economy and the domestic banking system. The measures effectively remove the risk of sovereign default and offer the government a valuable time window to show further tangible progress in implementing its fiscal consolidation program.

On the government's consolidation program, we re-iterate our view that the fiscal package is strong enough to ensure attainability of the 4ppts-of-GDP targeted reduction in the general government deficit this year. We also expect data on budget execution to surprise positively in the coming months.

Greek sovereign bond spreads tightened sharply and the yield curve steepened on the news. The yield spread of the 10-year benchmark stood at ca 300bps at the time of writing, some 25bps tighter relative to its closing levels on Wednesday. Also, the 5-year and 2-year bond yield spreads stood at 323bps and 343bps, respectively or 37bps and 50bps tighter from late Wednesday levels. We see further room of outperformance of the Greek government bonds (GGBs) and reiterate our 230bps ''fair value'' spread estimate for the 10-year tenor.

Written by:

Gikas Hardouvelis
Chief Economist &
Director of Research
Ghardouvelis@eurobank.gr

Platon Monokroussos
Assistant General Manager
Head of Financial Markets Research
pmonokrousos@eurobank.gr