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Eurobank EFG

GREECE MACRO MONITOR

January 21, 2011

Focus notes: Greece

Latest macro & market developments

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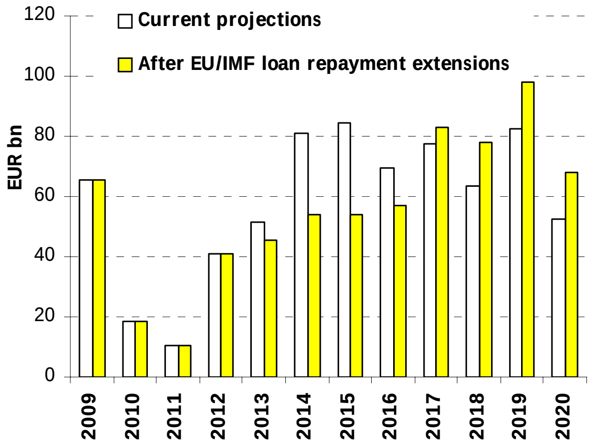
Decision on Greece's loan repayment extension expected by March

In line with a Eurogroup statement in late November on the need to "rapidly examine" the necessity of aligning the maturities of EU bilateral loans to Greece with those to Ireland, Chairman Jean-Claude Juncker confirmed that the issue was formally discussed at this week's meeting, though no final decision was taken. Reportedly, a decision to grant Greece a loan repayment extension needs to be ratified by EU national parliaments and, as such, it will be a part of a "comprehensive package" of reforms EU officials are expected to assemble by March. The news did not come as a surprise as the possibility for such a development was explicitly signaled in recent months by a number of high-level EU and IMF officials. Under the existing EU/IMF loan agreement, Greece will need to repay each loan in eight equal installments over a period of 2 years, following an initial grace period of 3-3¼ years. On the other hand, provided that the proposed repayment extension will be granted, repayment of each loan tranche would take place over a 7-year period, following an initial grace period of 4 years. As to the expected incremental cost of the proposed arrangement, according to an earlier statement by Greek Finance Minister, George Papaconstantinou, the loan repayment extension would be given in return for a higher effective fixed interest rate of 5.8 percent, compared to 5.5 percent per annum applied currently. Yet, a number of key EU officials, including Mr. Papaconstantinou himself, confirmed earlier this week that a lowering of the effective interest rate charged to euro area member states resorting to the existing EFSF mechanism was discussed at the January 17 Eurogroup meeting. Again, no concrete decision was taken on the latter issue, though this will reportedly be considered as part of a more comprehensive package to address the EMU debt crisis. All in all, an extension of EU/IMF loans to Greece will render the country's future borrowing needs considerably more manageable, especially in the period 2014-2015 that will see a significant rise in the sovereign's borrowing requirement to annual levels in excess of €70bn. *Note that over 50 percent of Greece's current debt stock matures over the coming 5 years.* Even with a repayment extension, however, the country's borrowing requirements will remain challenging, especially in the absence of a new financing program after the present EU/IMF lending facility expires in mid 2013.

Graph 1 below depicts our estimates of the required issuance of Greek marketable government debt *(mainly for debt rollover purposes)* over the coming decade, in the absence of a new EU/IMF loan package after mid-2013. Table 1 also shows our projections regarding the evolution of Greece's gross borrowing need and financing sources in the period 2011-2020. *(The projections depicted in Graph 1 and Table 1 assume that the domestic macro environment in 2011-2020 will broadly evolve according to that assumed in the EU/IMF program baseline scenario)*

Graph 1: Required issuance of marketable government debt in €bn (current projections and after EU/IMF loan repayment extensions)



Source: IMF Dec 2010, Eurobank EFG Research projections

Greek Finance Minister dismisses debt restructuring rumors

In a televised interview earlier this week, Finance Minister, George Papaconstantinou, categorically dismissed market speculation that official discussions among EU policy makers regarding a Greek debt restructuring are currently underway. His comments followed a press report in German Die Zeit newspaper –staunchly denied by German finance officials-, citing unnamed official sources suggesting that the government is considering an emergency plan that would allow Greece to buy back some of its debt using funds from the European Financial Stability Facility (EFSF) "with favorable interest conditions". Along these lines, FT Deutschland reported y-day that the Ecofin discussed at its latest meeting on January 17 a concrete Greek debt restructuring scheme, involving the EFSF. According to the aforementioned report, the EFSF would buy Greek debt in the secondary market at a discount rate and then sell it on to Greece at a further discount. The key financial aspect of this structure would reportedly be the gap in the interest rates though which the EFSF can raise funds, due to its AAA rating, and the Greek sovereign yields. The article added that the costs would be borne by investors who paid Greek sovereign bonds to their value and have not written them down. On a separate note, Mr. Papaconstantinou declined to comment on recent remarks by Greek Deputy Prime Minister Theodoros Pangalos suggesting that it would be beneficial for the country to negotiate a repayment extension for its *entire* debt stock, and not just the loans taken under the existing EU/IMF lending facility. The Greek Finance Minister expressed his optimism that there will be a comprehensive solution to the sovereign debt crisis within the next two months and reiterated the government's commitment to bold structural reforms.

Table 1

Table 1: Grece's projected borrowing requirement & financing sources in € bn

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Gross borrowing need	70.3	55.1	58.1	66.9	55.5	52.1	56.0	59.2	84.8	80.2	100.1	70.2
deficit finacing	36.1	22.3	16.8	14.9	11.4	6.4	6.4	5.5	5.3	5.0	4.9	3.1
Amortizations	29.7	26.0	37.1	45.8	42.9	48.3	48.4	52.5	78.4	74.0	94.0	65.9
Other	4.5	6.8	4.2	6.2	1.2	-2.6	1.2	1.2	1.2	1.2	1.2	1.2
	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Gross financing source including offical (EU/IMF) loans	70.3	55.1	58.1	66.9	55.5	52.1	56.0	59.2	84.8	80.2	100.1	70.2
Privatization	0.9	0.0	1.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0
Other	3.8	5.3	0	0	0	-3.8	0	0	0	0	0	0
Market access	65.6	18.3	10.6	40.9	45.5	53.9	54.0	57.2	82.8	78.2	98.1	68.2
EU/IMF loans	0	31.5	46.5	24	8	0	0	0	0	0	0	0

Source: IMF Dec 2010 and Eurobank EFG Research estimates

A technical note on the sustainability of Greek public debt

In our Economy & Markets December 2010 issue (see Eurobank EFG Research, "Assessing fiscal policy with the use of sustainability indicators: The case of Greece") we presented an empirical investigation on the *sustainability* and *solvency* of Greece's fiscal position. As we noted back then, there appears to be no unanimity in the existing literature as to what really distinguishes fiscal sustainability from solvency. Yet, drawing a more clear distinction between the two terms is of particular importance in the current trajectory, especially in view of the November 29th Eurogroup statement, which provided a general outline of a proposed permanent crisis resolution mechanism – the so-called European Stability Mechanism (ESM) – that will replace the existing EFSF/EFSM facility, when it expires in June 2013.

According to that statement, private sector bondholders would share some of the rescue costs in the event of a sovereign default, but only on "a case-by-case basis", in line with current IMF policies. Specifically, in the case that a sovereign borrower is deemed *solvent* on the basis of a debt sustainability analysis conducted by the EC, ECB and the IMF, private sector creditors will be encouraged "to maintain exposure" in the sovereign. However, in the unexpected event that a country appears to be *insolvent*, the Member State would need to negotiate a comprehensive restructuring plan with its private creditors, in line with IMF practices with a view to restoring debt sustainability.

In the existing literature, a number of authors distinguish between solvency and fiscal sustainability as follows: a government is often deemed to be solvent when it satisfies the government's *intertemporal budget constraint* over an *infinite* horizon. In other worlds, solvency relates to a sovereign borrower's ability to finance its debts through future primary surpluses over an infinite time horizon. On the other hand, the term sustainability is often used to indicate a government's ability to attain a *specific target value* for the debt-to-GDP ratio over a finite horizon. *(For a quantitative analysis on the definition and mathematic derivation of the above terms please see Eurobank EFG Research's Economy & Markets* December 2010 issue). As a final point on this paragraph, note that in its second review *(Dec 2010)* under the existing stand-by arrangement, the IMF states that Greece's fiscal position is deemed sustainable, provided that **a)** the government implements rigorously the agreed stabilization program of fiscal austerity and structural reforms and **b)** the domestic economic trajectory evolves according to the program's baseline macro forecasts.

In this section, we concentrate on the issue of sustainability of Greece's fiscal position over a long term horizon (up to the year 2030) with the use of a fiscal indicator commonly appearing in the literature, in the lines suggested by, among others, Buiter (1985, 1987) and Blanchard (1990). The fiscal indicator we calculate here is the *sustainable* primary balance**,** corresponding to three discrete terminal values for the public debt ratio in 2030; namely: 141.2%-of-GDP *(i.e., the ratio's estimated level at the end of 2010),* 100%-of-GDP and 80%-of-GDP**.** The latter value broadly corresponds to the current average ratio in the euro-area. In our case, the *sustainable* primary balance corresponds to the annual primary surplus (expressed in ppt-of-GDP terms) that needs to be generated so as to ensure that the terminal debt ratio takes one of the values specified above. As a final note, the difference between the *sustainable* primary balance and the *current* primary balance yields the value of the so-called *primary gap* indicator, which effectively measures the magnitude of the adjustment required to reach a predetermined value of the debt-to-GDP ratio by the end of the corresponding horizon (year 2030).

Naturally, in calculating the sustainable primary balance *(and the corresponding primary gap indicator),* one needs to know the current value of the primary balance-to-GDP ratio and to also use long-term forecasts for the average values of interest rate on debt, inflation and the rate of growth of real GDP. In our study (results presented in Table 3i-3iii), we take as *baseline* scenario the latest IMF baseline forecasts for the evolution of Greece's main macroeconomic and fiscal variables as well as privatization revenue and other stock-flow adjustments in the period 2011-2020 (Table 2). For the remaining years under consideration (period 2021-2030), we make the simplifying assumption that the key variables of interest *(i.e., real GDP growth, GDP deflator and interest rates)* remain constant at their 2020 levels.

Table 2: IMF baseline M-T macro scenario for Greece

	2009	2010	2011	2012	2013	2014	2015	2020
GDP Growth (%)	-2.6	-4.2	-3	1.1	2.1	2.1	2.7	2.7
GDP deflator (%)	1.8	3	1.5	0.4	0.8	1.2	1.3	1.8
Nom. GDP (€ bn)	235	230	227	230	237	244	254	311
Int. Rate (%)	4.8	4.9	4.6	5	5.4	5.7	5.7	5.7
Bund Rate	-	225	275	350	350	350	350	350
Spread over Bund	-	550	525	350	300	300	300	250
Public debt (% GDP)	**127**	**141**	**152**	**158**	**158**	**154**	**150**	**131**

Source: IMF Dec. 2010

Tables 3i-3iii below shows the main results of our exercise. Notation-wise, **y** stands for real GDP growth and **r** for the interest rate on new debt. In these tables, we calculate the required primary surplus (in ppt-of-GDP terms) required to ensure that the debt-to-GDP ratio assumes in year-2030 a predetermined value, under various assumptions for real GDP growth and interest rates. For instance, the line 1-column 2 value of Table 3i indicates that for real GDP growth (and interest rate on new debt) that is higher (lower) by 1ppt (150bps) relative to the baseline scenario, an annual primary surplus of 1.8%-of-GDP is need to ensure that the debt to GDP ratio is stabilized by 2030, *i.e., returns to its end-2010* *level*. Similarly, line 1-column 2 of Table 3ii indicates that under the same assumptions for real GDP growth and the real interest rate, an annual primary surplus of 4.5%-of-GDP is required to bring the debt-to-GDP ratio to 100% by the end of the forecasting horizon (year 2030).

Table 3i - Required annual primary balance (% GDP) to stabilise the debt ratio at its 2010 level by 2030

y / r	r - 300bps	r - 150bps	Baseline	r + 150bps	r + 300bps
y+ 1 ppt	0.7	1.2	1.8	2.3	2.8
y + 0.5ppt	1.8	2.3	2.8	3.4	3.8
Baseline	2.9	4.9	3.8	4.3	4.8
y - 0.5ppt	3.9	4.4	4.8	5.3	5.7
y - 1 ppt	4.8	5.3	5.8	6.2	6.6

Table 3ii- Required primary balance (% GDP) to reduce the debt ratio to 100% by 2030

y / r	r - 300bps	r - 150bps	Baseline	r + 150bps	r + 300bps
y+ 1 ppt	4.1	4.5	4.9	5.3	5.8
y + 0.5ppt	4.9	5.3	5.7	6.2	6.6
Baseline	5.8	6.2	6.6	6.9	7.3
y - 0.5ppt	6.6	6.9	7.3	7.7	8.1
y - 1 ppt	7.3	7.7	8.1	8.4	8.8

Table 3iii - Required primary balance (% gdp) to reduce the debt ratio to 80% by 2030

y / r	r - 300bps	r - 150bps	Baseline	r + 150bps	r + 300bps
y+ 1 ppt	5.7	6.1	6.5	6.8	7.2
y + 0.5ppt	6.5	6.8	7.2	7.5	7.9
Baseline	7.2	7.5	7.8	8.2	8.5
y - 0.5ppt	7.9	8.2	8.5	8.9	9.2
y - 1 ppt	8.5	8.9	9.2	9.5	9.8

Source: EC/ECB/IMF, Greek Finance Ministry, Eurobank EFG Research

Disregarding the first and last lines/columns of Tables 3i-3iii (which contain comperatively more extreme values relative to the baseline) we are left with the a range of (broadly feasible) value for the sustainable primary balance required to either stabilize or reduce the debt ratio to more sustainable levels by the end of the examined horizon. That is, assuming the following: **a)** a return to positive and sustainable medium-term economic growth (via fiscal austerity and structural reforms aiming to reinstate competitiveness, boost productivity and reduce the crowding out of the private sector) **b)** establish the conditions for a gradual de-escalation of sovereign spreads and the sovereign's return to bond markets and **c)** a vigilant implementation of the present fiscal austerity program.

Fitch cuts Greece's sovereign credit rating to junk; says may lower rating again if country misses any quarterly EU/IMF review or fails to return to positive economic growth by Q3 2011

Citing persisting concerns about the country's ability to service its debt and embark on a sustained economic recovery, Fitch cut earlier this week Greece's sovereign credit rating by one notch to below investment grade with a negative outlook. In the accompanying statement, the ratings agency said that while Greece's economic and fiscal performance has in many respects exceeded expectations, its heavy public debt burden renders fiscal solvency highly vulnerable to adverse shocks. The ratings agency added that prohibitively high borrowing costs casts further doubts on the country's stated intention to regain access to international bond markets some time this year.

Fitch became the third major agency to cut Greece's rating into junk territory, with its senior analyst for Greece signaling the possibility of a further downgrade, in case that the country fails to return to a positive growth path by Q3 2011 or fails to meet any quarterly EU/IMF reviews under the current bailout programme. Fitch placed Greece under review for a possible downgrade in early December, with a number of recent press reports suggesting that the downgrade was originally intended to be as sizeable as three notches. However, following a teleconference Fitch hold with the Greek Finance Ministry and information provided by the EU/IMF, the downgrade was limited to one notch. Even so, a statement released by the Greek Finance Ministry shortly after the downgrade read that the move could not be justified on the basis of the country's fiscal consolidation efforts, reforms already implemented, those underway and an anticipated repayment extension of EU/IMF loans.

Further rating downgrades by Moody's and S&P may also be in the offing

Rating agencies S&P and Moody's, both of which currently maintain non investment grade ratings for Greek sovereign debt, have also warned that further imminent sovereign credit downgrades may well be in the offing. S&P cautioned last month that Greece, a potential recipient of the post-2013 European Stability Mechanism, could have its sovereign rating lowered by a many as a couple of notches if the permanent rescue mechanism would assign "preferred credit" status to public creditors, a development that could be detrimental to the ability of non-official holders of sovereign debt to be repaid. *Note that the specific modalities and operations characteristics of the future permanent crisis resolution mechanism are not expected to be finalized before the March 2011 EU Summit.* Following a similar move, Moody's also put Greece on Watch for a possible downgrade in late 2010, warning that a multi-notch downgrade remains in the cards if the country fails to reduce its debt to "sustainable levels" in three to five years. Moody's, which plans to complete its review on Greece "as quickly as possible", currently places the country's sovereign rating at Ba1, equal to S&P's and Fitch's BB+, the highest junk-level status rating.

Latest T-bill auction met strong market demand

Greece's Public Debt Management successfully sold €650mn of 13-week T-bills, including €150mn in non-competitive bids on January 18, its second tender for the year. The auction produced a yield of 4.10%, unchanged from a previous auction of similar maturity paper that took place on November 16. The auction was oversubscribed 4.98 times, with some 80% of the T-bills sold being purchased by foreign investors, up from 30-40% in November. A €1.95bn of 26-week T-bills auction on January 12, was also easily absorbed, reflecting a recent improvement in market confidence towards struggling EMU periphery economies. The PDMA sold €1.95bn of 26-week T-bills, including €450mn in non-competitive bids at a yield of 4.90%, in line with market expectations. The EU/IMF rescue package allows Greece to stay away from bond markets until Q1 2012, but since September, when quarterly tenders of short-term government paper were abandoned for the sake of a better cash management and more leeway, the government continues to issue T-bills on a monthly basis for rolling-over maturing short-term paper. Greece will need to borrow some €58.1bn for the whole 2011 to finance its deficit and roll over existing debt. Out of this amount, some €46.5bn will be in the form of EU/IMF loans under the existing financial support scheme, with the remaining amount representing net borrowing from the market via T-bill issues.

In a similar positive note, Spain issued €5.5bn in 12- and 18-month T-bills on January 18, both at a lower yield than the previous auctions in December. Belgium, whose funding cost moved sharply higher recently amid concerns that a domestic political deadlock would prevent it from tackling its debt problem, sold 12-month T-bills earlier this week at a lower yield compared to that in December, while a separate 3-month Treasury bills auction produced the lowest yield in two months. These positive auction results were received with considerable relief by investors in EMU periphery debt markets. Rising expectations for a more comprehensive solution to the EMU sovereign debt crisis, the recent increase in the pace of ECB sovereign bond purchases and Japanese Finance Minister Yoshihiko Noda's remarks that his country is considering buying about 20% of the initial EFSF offering in late January provided additional support to market sentiment.

December CPI resumes its uptrend; Greek unemployment rises again in October

Greek CPI came in at 5.2%yoy in December, matching its October level following a temporarily drop to 4.9%yoy in the prior month reflecting the impact of firmer energy prices. In the same month last year, the annual rate of change of the CPI was 2.6%yoy. For the whole 2010, CPI averaged 4.7%yoy in 2010 vs. 1.2%yoy in 2009 while, based on the final 2011 budget document, domestic inflation is seen averaging 2.2%yoy this year, before easing to 0.5% and 0.7% in 2012 and 2013 respectively on warning base effects and a negative output gap. Separately, Greece's unemployment rate remained in a rising trend in October, jumping to a record rate of 13.5% from 9.8% in the same month of last year and 12.6% in September, as the ongoing domestic economic recession takes its toll on the labor market. Greece's unemployment rate was the fourth-highest in the 16-member euro area in October after Spain, Slovakia and Ireland as well as 3.4 percentage points higher than the region's average. According to the final budget plan for this year, the unemployment rate is estimated to rise further to 14.6% in 2011 as the economy is expected to experience its third consecutive year of recession and 14.8% in 2012, before falling modestly to 14.3% in 2013. Adding to the recent string of domestic macro data releases, industrial production dropped 7.6%yoy in November, a higher pace of decline relative to October's -5.2%yoy mainly due to a sharp fall in sectors such as foods, beverages, apparel and consumer durables. In the eleven-month period January-November 2010, industrial production fell 5.7% yoy compared with a drop of 9.6% yoy in the same period last year.

January 17 Eurogroup meeting: No concrete decisions on the EFSF framework.

Eurogroup Chairman, Jean Claude Juncker, confirmed earlier this week that that European Finance Ministers discussed a range of measures to address the sovereign debt crisis at the January 17th meeting. But, as broadly expected, no tangible results were produced. According to official sources, some of the issues discussed included:

i) an increase in the lending ceiling of the EFSF. To secure its covered triple-A rating, the EFSF can not lend, in its current form, more than €255bn (lenders have to set aside cash reserves). Cumulated with the EFSM (€60bn funds raised by the European Commission and backed by the EU budget) as well as a further 50% IMF contribution of the total of the EFSF and EFSM programmes, the full amount of the available funds stand at €409.8bn after subtracting €62.7bn allocated to Ireland. That said, room for manoeuvre to deal with an escalation of the crisis is limited.

ii) EFSF purchases of sovereign bonds of financially distressed euro countries, a move that would release the ECB from the need to make such purchases itself.

iii) lower interest rate charged for EFSF loans.

Germany, once again, rebuffed a European Commission proposal for an increase in the effective lending capacity of the EFSF. Finance Minister Wolfgang Schaeuble insisted that the idea of increasing the size of the EFS is "not realistic" given that, so far, hardly any funds have been used. He admitted however that there should be a debate on facilitating the use of the fund's €440bn total quota. More importantly, the German official pointed out that, given the recent tentative improvement in market sentiment, EU officials were in no rush to reach an agreement. Instead, Mr. Schaeuble suggested that European Finance Ministers should work and get prepared for a comprehensive package of reforms by March, when EU leaders are scheduled to meet for a summit. But although Germany seems to be open to a debate regarding the EFSF size and its lending capacity, it appears that is still opposing the proposal for a lower EFSF interest rate and for allowing the EFSF to purchase sovereign bonds.

Upcoming elections in seven German states, might be a reason behind Germany's reluctance to reach a rapid agreement on potential changes to the EFSF's framework, especially as recent option polls suggest that around 92% of the German population opposes to an outright increase in the EU bailout fund's size. The first state election is scheduled on February 20 and the last one on September 18 with recent opinion polls suggesting that the centre-right CDU/FDP coalition government, which has suffered a sharp decline in its popularity over the last year, is likely to loose several regional elections (it is worth recalling that the North Rhine Westphalia state election on May 9, 2010 had a major impact in delaying the approval of Greece's bailout package).

The sole issue European Financial Ministers came to an agreement on at this week's Eurogroup meeting was for new EU-wide bank stress tests to include revised criteria. The stress tests, that will be conducted in H1-2011 and will encompass the same 91 European banks tested in mid-2010, will utilize a stricter methodology, covering not only bank trading books but also banking books and tough tests on core tier 1 capital. Nevertheless, EU officials dismissed the idea of incorporating any sovereign debt restructuring scenario in the tests. Press reports indicated that, in spite the European Banking Authority's intention to keep the review internal, officials have stated that there might be some disclosure of the results that are expected in mid-2011. The ECB, which will play a key role in designing the methodology of the tests, expects more banks to fail than the five that did so last year. EU sources also said that in parallel to the EU bank stress tests, the IMF will conduct a similar exercise in the UK, Sweden and Luxembourg.

EFSF launches its first bond issuance next week

The European Financial stability Facility EFSF, set in May 9, 2010 to provide temporary financial assistance to euro area states in financial difficulty and unable to borrow at bearable rates, announced that it appointed lead managers (Citigroup, HSBC and Societé General) for its first issuance next week. The €3-5bn 5-yr benchmark syndication is part of the €85bn assistance programme for Ireland agreed in late November. More specifically, the European part of financial aid to Ireland is split between two funds: the EFSF and the EU's European Financial Stability Mechanism (EFSM). Both funds are rated triple-A by the three major rating agencies and their issuances for providing financial support to Ireland will be mainly in standard benchmark maturities of 5, 7 and 10 years denominated in euros. Further support to the debt-laden economy will be made available through the IMF (€22.5bn) and bilateral loans from the UK, Sweden and Denmark totaling €4.8bn. Ireland contributes € 17.5bn. With the support of the German Debt Management Office (DMO), backed by guarantees providing by euro member states of up to €440bn, the EFSF will raise up to€17.7bn in 2011 and 2012. The EU will raise up to €22.5bn for its EFSM facility, €17.6bn expected in this year and €4.9bn in 2012 *(amounts subject to revision and Ireland's requirements).* The first €5bn EU issuance on January 5, also placed through a syndicated format, met strong demand (the auction was oversubscribed three-times and was sold within an hour). The auction produced a yield of 12bps more than the benchmark swap rate, or about 2.5%. That compares with the 5.7% rate being charged to Ireland for the EU-IMF loans.

EMU sovereign bond markets recover after well-received bond auctions, hopes for a powerful policy response to the current crisis

After hitting multi-week highs in early January, EMU debt spreads moved lower over the last few sessions reflecting a string of well-received debt auctions by a number of fiscallyvulnerable euro area sovereigns, including Spain and Portugal. Market optimism that the European authorities are pushing for a concrete plan to address the lingering sovereign debt crisis also assisted market sentiment. Jean Claude Juncker, the chairman of the Eurogroup, said late this week that a comprehensive response to the current crisis is likely to be announced in a few weeks time, echoing similar remarks from German FinMin Schaeuble. Separately, the ECB stepped up the pace of sovereign bond buying with the latest official data suggesting that purchases settled until last Friday amounted to €2.3bn, the highest in five weeks. Recent comments from Chinese and Japanese government officials that their countries are considering investing in EMU sovereign debt also supported the latest relief rally in EMU bond markets. Spain has lately been among the best performers in the EMU sovereign space, on news that the country is finalizing a plan for a second round of recapitalization of its troubled savings banks, cajas. The plan, which envisages regional banks raising funds from private investors, is expected to be announced once the lenders detail in coming weeks their full exposure to the collapsed property sector. Indicatively, the 10-yr Spanish/German government bond yield spread eased to levels below 210bps late this week for the first time since mid-November, moving further away from a 284bps record high marked in early January. Greece lagged behind. The 10-yr Greek government bond (GGB) yield spread to German Bund was standing close to 813bps at the time of writing, some 12bps wider from a near three-month trough marked early this week on resurfaced market talk of an imminent debt restructuring. Despite the latest widening move, the spread was still some 160bps tighter from all-time highs marked just a couple of weeks earlier with secondary market volume in the HDAT platform moving higher lately. So far this month, the daily average turnover stood around €35mn, up from €11.7mn in December 2010 but lower compared with €1.11bn during the same month a year earlier. Technically, a clear move below the 800/750bps zone could open the way for a retest of the crucial 650/660bps area (mid-October lows). On the upside, strong resistance stands at 880/900bps in the way to 974bps record closing highs seen on January 7, 2011.

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