Blog Post
Greek Debt

May 15, 2017

Greece Seeks Debt Forgiveness Whilst Eying Bond Market

- **IMF and Eurozone cannot agree on Greek debt forgiveness.**
- **Yields have fallen in anticipation of a deal.**
- **Assumptions are new Greek debt will be supported by ECB QE.**

On Friday, May 12 the International Monetary Fund (IMF) and Eurozone government lenders reported that that they needed more time to reach an agreement on debt relief for Greece. They need to hurry as the nation is struggling with a debt to GDP burden of 179%, Figure 1.

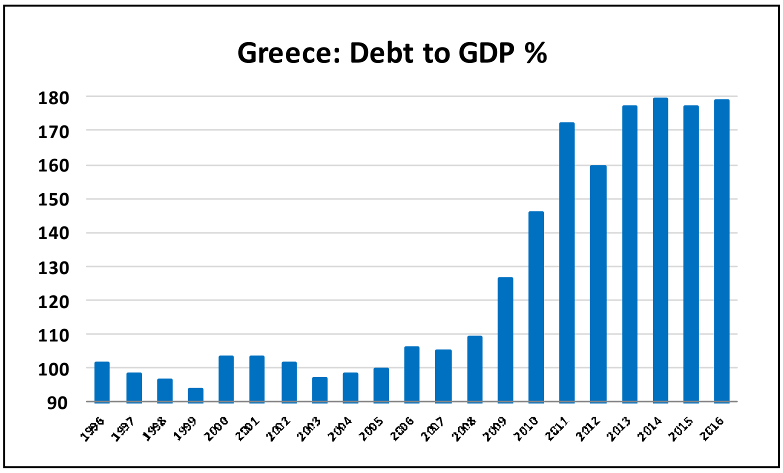

Figure 1: Greece ~ Deb t: GDP %   Source: Eurostat

Christine Lagarde, Managing Director of the IMF met with leading Eurozone officials in the Italian port of Bari with a view to discuss Greek debt relief. This was the latest round of talks on an idea that had been agreed, in principal by the Eurogroup of Eurozone Finance Ministers in May 2016, provided strict conditions were met by Greece including pension cuts of up to 18% and the privatisation of power generation.

The Eurogroup of Finance Ministers should approve the deal at a meeting on May 22, provided the reforms are passed by Greece's parliament.

The IMF's Lagarde told waiting markets journalists:

"...We will carry on working on this debt relief package. There is not enough clarity yet. Our European partners need to be more specific in terms of debt relief which is an imperative ..."

The IMF has made debt relief for Greece an absolute requirement if it is to be part of the "troika" that would provide resources toward the latest bailout for Athens; the third since 2010. [1] [2]

However, several Eurozone governments are extremely reluctant to provide Greece with further debt cancelation. They do, however, recognise that any extension of financial assistance to the Greeks will only be credible in the eyes of the outside world if the IMF participates.

German Finance Minister, Wolfgang Schäuble said on Friday:

"...We are prepared to stick to what we have agreed in May 2016. That is the basis on which we are working ... I am still in favour of getting a solution, at least a political solution, in the Eurogroup on the 22nd of May. ..."

Primary surplus...a misleading metric

A key concept for grasping the Eurozone sovereign debt crisis is the idea of a budget that's in "*primary surplus.*" This means that tax revenues exceed planned state spending.

Put it another way, if one ignores interest on outstanding debt, the country can afford to finance its current spending; the issue of the primary surplus is proving a tricky one. Firstly, we at Spotlight find the whole idea somewhat misleading as it is of little value to claim one has a certain amount of liquidity if debts do not have to be serviced or paid; when of course, debts do have to be paid.

Last year the EU Commission said Athens had attained a primary surplus of 0.7% of GDP in 2015 based on Eurostat data, comfortably exceeding a target for a 0.25% deficit.

Spotlight takes the view that If a nation was bold enough borrow on the open capital market, then surely it should be big enough to pay its debt, even if must borrow again to roll the debt over.

Germany and its supporters claim that if Greece has a large enough and long lasting primary surplus it would not need any further debt relief. They correctly point to the fact that Greece has been the beneficiary of low-cost Eurozone loans. The savings afforded Greece from these as against paying commercial rates has saved the Greek government EUR 8 Billion per annum, an amount equal to 4.5 % of GDP.

The reluctance of several Eurozone nations to concede more debt relief is making it increasingly difficult for the IMF to participate in a future financing arrangement. It has argued that debt relief, or at least a clear promise of it now, is needed to restore investor confidence in Greece. It might help Greece if successive governments had not dragged their feet of reform and privatisation at every stage of every negotiation.

The discussions are getting ever deeper in technicalities and detached from reality as the IMF and Eurozone parties are deliberating over how many years Athens is to keep the primary surplus at 3.5% of GDP. The range of opinion varies from just 2-3 years to 10 years. The IMF dismiss the decade long projection as completely unrealistic.

We have often written that Greece should have been shown a Eurozone exit door, however, one understands that in the heat of 2010/11 there was a fear that if Greece was ejected the markets may well have pushed to see who would be next...Ireland, Spain or even Italy. So Greece was kept in, but at what a cost!

Our view is sympathetic to that of Germany as making a commitment to debt relief upfront will provide no incentive for the Greek government to deliver on promised reform.

Is it not better to extract a pledge of reform, followed by signs that the pledge is being enacted and only then taking a decision on debt at the end of the bailout in 2018, when the latest economic data is known?

This is at odds with the IMF who require outline details now on how many years the Eurozone could extend Greek loan maturities, even if described only as a possible range.

The IMF said:

"...Debt relief measures don't have to be calibrated to the last decimal or delivered before the end of the programme, ... But promises would have to be quantified with detail going well beyond measures previously offered. ... They need to have numbers on what are the potential measures, to show that these potential measures really entail a game changer as far as debt is concerned, ... Waiting until 2018 for the latest numbers, as Germany wants, will not change the need for debt relief. ..."

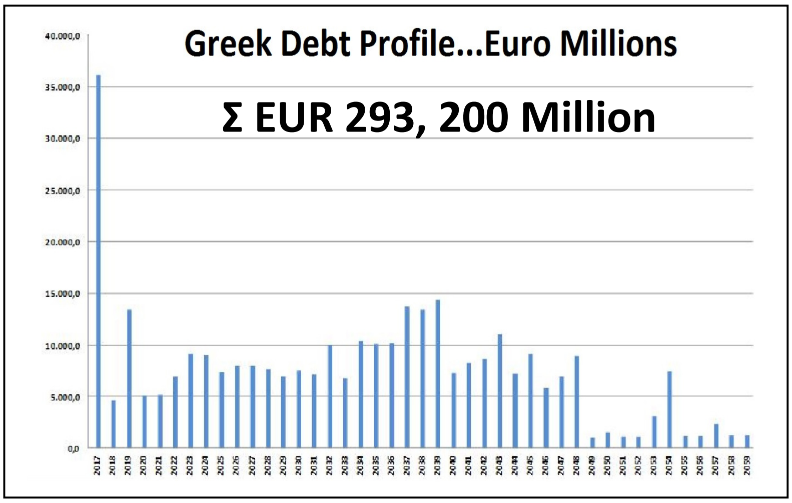

Figure 2: Greek Debt Profile   Source: Public Debt Management Office

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Figure 2 illustrates that 2017 is a year of high redemptions. Below we itemise every obligation that needs to be honoured this year, it amounts to EUR23.3 Billion.

Greece, Debt Profile 2017

Treasury bill holders	May 12, 2017			2.70%
Treasury bill holders	June 9, 2017	€1,600,000,000	Short-term treasury bills	2.70%
Treasury bill holders	June 9, 2017	€2,000,000,000	Short-term treasury bills	2.97%
Treasury bill holders	June 16, 2017	€1,600,000,000	Short-term treasury bills	2.70%
Treasury bill holders	July 7, 2017	€2,000,000,000	Short-term treasury bills	2.97%
Treasury bill holders	July 14, 2017	€1,000,000,000	Short-term treasury bills	2.70%
Private investors	July 17, 2017	€2,089,100,000	Bonds issued by Greece (2014 and later)	
IMF	July 18, 2017	€290,226,972	Loan by IMF's second bailout for Greece, in 2012.	
ECB	July 20, 2017	€2,412,206,000	Held by ECB exempted from the 2012 default	4.30%
ECB	July 20, 2017	€1,455,700,000	Held by NCB's exempted from the 2012 default	4.30%
EIB	July 20, 2017	€10,000,000	Held by the ECB exempted from the 2012 default	4.30%
Treasury bill holders	Aug. 4, 2017	€1,000,000,000	Short-term treasury bills	2.97%
Treasury bill holders	Sept. 1, 2017	€1,400,000,000	Short-term treasury bills	2.97%
IMF	Sept. 19, 2017	€145,113,485	Loan by the IMF's second bailout for Greece, in 2012.	
Treasury bill holders	Oct. 6, 2017	€1,400,000,000	Short-term treasury bills	2.97%
Treasury bill holders	Nov. 3, 2017	€1,400,000,000	Short-term treasury bills	2.97%
IMF	Dec. 4, 2017	€156,284,040	Loan under the IMF's second bailout for Greece, in 2012.	

International Monetary Fund = IMF *European Central Bank = ECB* *National Central Bank = NCB*

Table 1: Greek Debt Profile 2017 Source: Public Debt Management Office

Greece seeks debt forgiveness whilst eying the market again?!

Greece is considering tapping the capital markets for the first time in three years as a potential bond sale in July or September is being evaluated. We are not sure we see the logic in allowing Greece to have debt write-off one month for it then go and tap the market for more debt in the next whilst expecting the ECB to act as a backstop to cap yields through adding Greek debt to the range of securities it can buy through its quantitative easing asset purchase programme.

Greece also expects the profits made from a portfolio of Greek bonds bought by Eurozone national central banks will be transferred back to Athens. No reward for the risk takers then.

This sounds like the Greek tail is wagging the Eurozone dog and that the recent decline in yields, driven by anticipation of a new debt restructuring deal has been interpreted as solid end investor appetite See in Figure 3.

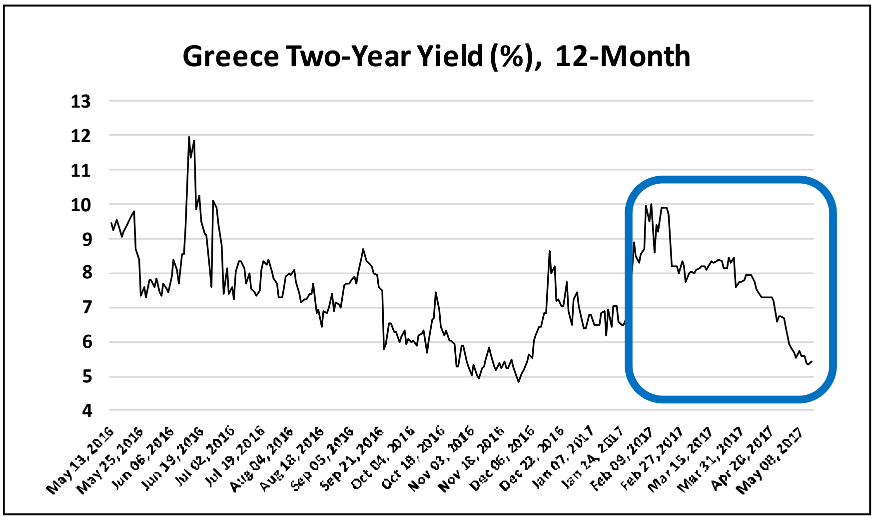

Figure 3: Greek Two-Year Yield (%) 12-Month Chart   Source: www.investing.com

This is a mistake as the recent decline in yields is down to investors sensing that the European Stability Mechanism (ESM), will replace some of the existing loans to Greece extended by the IMF. These new ESM loans would be structured with longer maturities and carry deeply discounted interest charges that would be beneficial to Greece.

Such speculative buying is vastly different from Greece being so well regarded that it can stand alone in the international capital market. Spotlight remains convinced that the Greek crisis is far from over and this sad saga has several years left to run with more requests for financial aid and accommodation. All we would add is if one feels inclined to buy Greek debt, remember the first rule of investing, *"caveat emptor", "let the buyer beware"*.

References:

[1]

First Economic Adjustment Programme (May 2010 – June 2011).

A three-year €110 Billion loan, paying 5.5% interest conditional on the implementation of austerity measures.

Credit rating agencies immediately downgraded Greek governmental bonds to a lower junk status.

[2]

Second Economic Adjustment Programme (July 2011 and ongoing).

On July 21, 2011 at a summit in Brussels, Eurozone area leaders agreed to extend the Greek loan repayment periods from 7 years to a minimum of 15 years and to reduce interest rates to 3.5%.

They also approved an additional €109 Billion support package, with exact content to be finalized at a later summit.

On October 27, 2011, Eurozone leaders and the IMF settled an agreement with banks whereby they accepted a 50% write-off of outstanding Greek debt.

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