TD Economics

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Euro zone agrees Greek debt deal with the IMF, significant hurdles remain

- Euro zone finance ministers, the IMF, and the European Central Bank have reached agreement to modify the terms and conditions of Greece's bail-out program. This would allow the disbursement of €43.7 billion over the next four months, provided parliamentary approval for the new conditions is secured in several euro zone countries and that Greece continues to meet its program targets.

- The revised program includes the postponement of a primary surplus target of 4.5% of GDP from 2014 to 2016, an improvement of the current debt profile after 2020, and an easing of its financing, including:

    1) A 100 basis-point reduction of the interest rate charged to Greece on the loans provided in the context of the Greek Loan Facility (GLF), which amounts to €56 billion from the first bail-out. Ireland and Portugal are not required to participate in the lowering of the GLF interest rates for the period in which they receive themselves financial assistance.

    2) An extension of the maturities of the bilateral and EFSF loans by 15 years and a deferral of interest payments by Greece on EFSF loans by 10 years;

    3) A commitment by euro zone countries to pass on to Greece the profit accruing to their national central banks stemming from their holdings of Greek debt. Ireland and Portugal are not required to participate in this scheme for the period in which they receive financial assistance.

- Greece will also receive financial support to engage in a debt buyback targeting some €62 billion of Greek sovereign debt held by private investors that was restructured earlier this year. European authorities have stated that any tender or exchange prices are expected to be no higher than those at the close on Friday, 23 November 2012. If this were to be the case, the buyback would achieve a debt reduction of roughly €40 billion over the total €350 billion of total Greek debt outstanding.

- Euro zone countries will consider further measures and assistance, including lower co-financing in structural funds and/or further interest rate reduction of the Greek Loan Facility, if necessary, for achieving a further credible and sustainable reduction of Greek debt-to-GDP ratio. This is contingent upon Greece reaching an annual primary surplus, as well as on the full implementation of all conditions contained in the program. The final objective is to ensure that by the end of the IMF program in 2016, Greece can reach a debt-to-GDP ratio of 175% in that year, 124% in 2020, and substantially below 110% by 2022.

Key Implications

- Assuming parliamentary approval is secured by December 13th, euro zone finance ministers will be in a position to release €34.3 billion to Greece before year's end. This provides some immediate relief, but it does not remove the risk of a more drastic debt restructuring in the coming months. Simply put, the concessions being made to Greece do not provide fiscal room to make the adjustment less stringent on Greece's economy. They only make up for the funding gap created by the deepening Greek recession and failed program implementation. Until the Greek economy stabilizes and begins to grow, the country will continue to struggle to meet its program targets.

- If the debt buyback is not successful, then Greece is once again off the targeted path towards debt sustainability by 2020. The issue with the debt buyback is that, on November 23, most Greek sovereign bonds were trading at around 35 cents on the dollar. For investors carrying those bonds on their books as "hold-to-maturity", participating in the buyback would imply taking an immediate loss of 65 cents on the dollar. In the case of Greek banks holding Greek sovereign debt, some of those loses might circle back to euro zone creditors, as the capital shortfall of these banks increase.

- Christine Lagarde, head of the IMF, has stated that the multilateral organization will wait for the results of the debt buyback to conduct the first review of this modified program and release its share of Greek aid. A less than optimal outcome on the debt buyback will see the IMF once again pressuring euro zone authorities to provide a more front-loaded debt reduction for Greece. In other words, in less than a month we could be watching a repeat of the negotiations of the last few weeks.

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