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GREECE MACRO MONITOR

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# Funding gaps, OSI and why Greece's aim to access wholesale funding markets in 2014 constitutes a reasonable (and conditionally feasible) proposition

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In this report, we take a close look at some important aspects of the agenda of the upcoming negotiations between the Greek government and the troika in the context of the present (4th) program review. In addition, we offer an updated analysis of projected financing gaps in the years ahead and highlight a number of potential sources for their coverage, including a new debt relief package by official lenders (OSI) expected later this year. We finally look at the evolution of gross (and net) government borrowing requirements across euro area Member States and, on the basis of the recent bond issuance history in Portugal and Ireland, we explain why the Greece's stated aim to approach wholesale funding markets with a small 5-year bond issue in 2014 constitutes a reasonable (and conditionally feasible) proposition.

## 1. New OSI and ways to bridge projected funding gaps: available options & expected timeline of events

With the bulk of the current program's financing having already been disbursed (Table 1) and the troika baseline scenario envisaging a cumulative financing gap of ca €11bn in 2014-2016 it is apparent that some additional funding will be needed over the said period to fully cover the government's borrowing need.[1,2,3] Market speculation about potential ways to cover the aforementioned gap has been on the rise in recent months, especially after a number of key euro area policy makers explicitly signaled the possibility of a new aid package.[4] In a number of our earlier research pieces on Greece we provided analysis on potential ways to cover the projected financial shortfall.[5] These could include, inter alia, **(i)** utilization of the HFSF buffer (ca €11bn,

[1] Under the first (May 2010-March 2012) and the second (March 2012-today) bailout programs, a total of ca €246bn has been earmarked for Greece with a view to prevent a sovereign default and to assist the country implement an ambitious fiscal consolidation and structural reforms program. Since May 2010, ca €215bn in EU/EFSF and IMF funding (plus €2bn of profits accrued to the ECB's SMP portfolio) has been disbursed to Greece upon fulfillment of strong program conditionality, with the remaining amount earmarked under the country's 2nd bailout program amounting to € 30.7bn.

[2] Under the troika's July 2013 baseline macro scenario, funding gaps equivalent to €4.4bn in H2 2014 and €6.5bn in 2015 are projected to arise in Greece's general government accounts. That is, provided that: (i) the country will manage to meet the key primary fiscal balance and privatization revenue targets agreed with official lenders; (ii) the domestic economy will broadly evolve in line with the baseline scenario, which envisages a switch into positive GDP growth from 2014 onwards; and (iii) the schedule of official-sector disbursements to Greece in the context of the present bailout program will not encounter any major delays.

[3] A constructive conclusion of the current (4th) troika review is a key precondition for the release of the next EFSF/IMF loan installment of €4.9bn that was originally scheduled for Q4 2013. The installment consists of €3.1bn in EFSF funding and a €1.8bn tranche from the IMF under the Extended Fund Facility.

[4] See *e.g.* German FinMin Wolfgang Shaeuble's relevant comments to Germany's *Handelsblatt* in late August.

[5] See *e.g.* Greece Macro Monitor, *"A technical study on Greece's sovereign solvency: How an elevated debt ratio conceals dramatic improvement in the debt rollover profile"*, Eurobank Global Markets research, Oct 7, 2013. http://www.eurobank.gr/Uploads/Reports/Greek%20debt%20sustainability%20(October%207%202013).pdf

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currently) after subtracting from it any amounts needed to cover potential capital shortfalls in the domestic banking system identified by a new stress test conducted by Bank of Greece. BlackRock consultant reportedly submitted to BoG in December 2013 the results of the new stress tests on bank loan portfolios. The new tests are based on end-June 2013 bank-related data and updated macro scenarios. As per the same sources, Bank of Greece has already started processing the said results and, under the oversight of a steering committee comprised of representatives from the EC/ECB/IMF troika and EBA, it is expected to officially announce individual lenders' capital needs by end January 2013; **(ii)** rollover of euro area National Central Banks' GGB holdings (ANFAs) as a means of securing some additional financing, though the ECB appears to be objecting to such an option[6,7]; **(iii)** rollover of ca €4.5bn worth of Greek government bonds owned by domestic banks and maturing in May 2014[8]; **(iv)** a new (3rd) financing package by the euro area (ESM) after the current one expires. Note that according to the present stabilization program (and barring any major delays in the disbursement of funds) Greece is scheduled to receive the last EFSF loan tranche in Q2 2014, whereas the last IMF loan disbursement is due in Q1 2016; and **(v)** return to international wholesale funding markets some time later this year, with issuance of a relatively small amount of a medium-term government paper *e.g.* €2.0-2.5bn of a 5-year bond, as suggested by some recent press reports.

***Table 1 - Greece: Disbursements under 1st & 2nd adjustment programs (EURbn)***

| | Total disbursements under 1st adjustment program | Disbursements (till today) under 2nd adjustment program | Pending disbursements under 2nd adjustment program | Total disbursements under 2nd adjustment program | Total disbursements under both 1st & 2nd adjustment programs |
|---|---|---|---|---|---|
| | May 2010-Dec 2011 | Mar 2012-Jan 2014 | Today - Q1 2016 | Mar 2012-Q1 2016 | May 2010-Q1 2016 |
| **EU/EFSF** | 52.9 | 133.6 | 11.1 | 144.7 | 197.6 |
| **IMF** | 20.1 | 8.4 | 19.6 | 28 | 48.1 |
| **Total** | 73.0 | 142.0 | 30.7 | 172.7 | 245.7 |

Source: EU Commission (July 2013), Eurobank Global Markets Research

As we have earlier, additional official financing to Greece in the form of new loans would further increase the country's gross debt ratio and thus, some form of indirect financing via a new debt restructuring operation (OSI) would be the most preferable option from a debt sustainability perspective. As per the November 2012 Eurogroup statement, such an arrangement would be possible upon confirmation of a primary surplus in Greece's ESA95 general government accounts. Eurostat's next EDP report is due on April 23, 2014 and we expect it to confirm that the country managed to generate a small primary fiscal surplus in FY-2013. Depending on its structure and modalities, a new OSI for Greece would probably be a more palatable option for euro area politicians than an additional package of official loans, as the latter would require approval by national parliaments.

In our October 31, 2013 Greece Macro Monitor[9] we presented the structure of a theoretical OSI package for Greece involving lower interest rates on and extended maturities of EU bilateral loans provided in the context of the 1st bailout program (GLF) and showed

[6] As per the European Commission report on the first review of Greece's second adjustment program (Dec 2012, page 54), the revised troika baseline scenario for the general government borrowing needs and sources of funding assumes a rollover of ANFA holdings on equal term, while acknowledging that this option would still need to be assessed and independently decided by NCBs. Such a rollover would reduce the financing need and smoothen the debt repayment profile over the program period, without having a significant impact on the evolution of the debt-to-GDP ratio. The overall financing secured by the rollover of ANFA holdings would amount to €3.7bn in 2012-2014 and to €1.9bn in 2015-2016.

[7] On October 15, 2013, ECB Executive Board member Joerg Asmussen told Reuters that "We must find a way to close this gap [i.e., Greece's ca €11bn financing gap for 2014-15] and there is absolutely no way that it can be done in a way of rollover bond or whatsoever which results in monetary financing"..

[8] The so-called Alogoskoufis' bonds were issued by the Hellenic Republic and were given to domestic banks under the 3723/2008 law (dubbed as Alogoskoufis' law). Aiming to enhance liquidity and address the impact of the international financing crisis on the domestic banking sector, the Hellenic Republic increased domestic banks' share capital by issuing non-voting preference shares. They amount to ca €4.5bn and expire in May 2014. The ECB reportedly opposes the rollover of these bonds on the basis that the bonds have been recorded on domestic banks' books and if the government does not pay them out, two Greek banks' Tier 1 capital ratio will fall below the 9% threshold thus, necessitating additional recapitalization funding.

[9] Greece Macro Monitor, *"Debt forgiveness is not a necessary precondition for restoring debt sustainability"*, Eurobank Global Markets Research, October 31, 2013 http://www.eurobank.gr/Uploads/Reports/Greek%20debt%20sustainability%20(October%207%202013).pdf

that such a package could both facilitate the fulfillment of the agreed debt ratio targets and improve the manageability of the government borrowing requirement on a multi-decade basis. In more detail, the said package was assumed to involve a swapping of the GLF facility (€52.9bn in notional terms) into a 50-year fixed coupon amortizing bond with a 10-year grace period on principal and interest payments. Tables 2.1 & 2.2 depict the amount of debt and financing relief implied by such a package, though this particular arrangement would not be enough by itself to provide the necessary financing for the full coverage of the projected general government borrowing gap in 2014-2015.

***Table 2.1 - General government borrowing requirement improvement (-) / deterioration (+) in EURbn***
*(Impact of GFL loan swap into 50yrfixed coupon amortizing bond)*

| | | |
|---|---|---|
| **2014-2016** | | **-2.2** |
| **2014-2022** | | **-15.9** |
| **2023-2032** | | **-25.4** |
| **2033-2042** | | **-7.2** |
| **2043-2052** | | **15.5** |
| **2053-2062** | | **14.7** |
| **2063-2064** | | **2.8** |
| **Total saving (2014-2064)** | | **-15.5** |

Source: IMF (July 2013), EFSF, Eurobank Global Markets Research

***Table 22 – General government gross debt cumulative improvement (-) / deterioration (+)***
*(Impact of GFL loan swap into 50yrfixed coupon amortizing bond)*

| | EURbn | ppts-of-GDP |
|---|---|---|
| **2014-2020** | -7.6 | -3.2 |
| **2021-2030** | -17.5 | -4.0 |
| **2014-2030** | -25.1 | -7.1 |

Source: IMF (July 2013), EFSF, Eurobank Global Markets Research

In view of the analysis above, we believe the government's stated aim to re-approach private wholesale funding markets this year is a fairly reasonable (and, conditionally, feasible) proposition. We will take a closer look at this particular topic in the following section but before doing that we will touch upon some additional issues that will be useful in our analysis

*When to expect a final decision on ways to cover the 2014-2015 financing gap*

Under the troika's July 2013 baseline macro scenario, funding gaps equivalent to €4.4bn in H2 2014 and €6.5bn in 2015 are projected to arise in Greece's general government accounts. That is, provided that: (i) the country will manage to meet the agreed targets for the primary surplus and privatization revenue; (ii) the domestic economy will broadly evolve in line with the baseline scenario; and (iii) the schedule of official-sector disbursements to Greece in the context of the present bailout program will not encounter any major delays.[10] The identification of specific ways and strategies to cover the projected funding gap for H2 2014 has been one of the key items in the agenda of the present (4$^{th}$) troika review, as the release of new official loans formally requires

[10] Note that the July 2013 baseline scenario envisages no funding gap for the year 2016.

secured program financing on a 12-month forward basis. Conclusion of the 4th review was initially scheduled for the end of September 2013, but negotiations between the troika and the Greek government have proven to be more protracted that expected earlier. The heads of the troika mission are now expected to return to Athens in mid-January to continue discussions with Greek authorities in the context of the present program review and the government reportedly expects an agreement on all pending issues ahead of the February 17 Eurogroup. Note that according to some recent press reports, the projected financing gaps for H2 2014 and 2015 will both be formally dealt with after the completion of the present review, as part of a more holistic solution (OSI) to Greece's debt sustainability issue.

*When to expect a new debt relief package for Greece*

Formal discussions on a new debt relief package for Greece are expected to commence after Eurostat's confirmation of a primary surplus in the country's FY-2013 general government accounts (relevant announcement expected in late April 2014). Earlier comments by a number of key euro area officials suggested that a final decision on the issue is unlikely before the May 2014 European Parliament elections, but Greece's Finance Minister said earlier this week that an agreement on Greek debt may be reached during the current European Presidency term, which is scheduled to conclude at the end of June 2014. Note that Greece assumed the 6-month rotating EU Presidency on 1.1.2014.

*2014 debt redemption profile and funding sources*

Table 3.1 below depicts the Hellenic Republic Government Bond redemption profile for 2014. Table 3.2 extends our analysis by presenting: a) the scheduled redemptions of IMF loans (there is currently a 10-year grace period for principal payments on EU bilateral and EFSF loans); and b) government interest payments throughout this year.

***Table 3.1 - Hellenic Republic Government Bond redemption profile for 2014 in EUR thousands***

*(Table excludes T-bills)*

| Coupon | Maturity | Principal Due (€mn) | Interest Due (€mn) |
|---|---|---|---|
| 6.500 | 01/11/14 | 1,478,750 | 96,119 |
| 6.500 | 01/11/14 | 374,412 | 24,337 |
| 4.500 | 05/20/14 | 2,905,250 | 130,736 |
| 4.500 | 05/20/14 | 1,249,500 | 56,228 |
| FLOAT | 05/21/14 | 5,147,186 | 41,898 |
| VAR | 05/21/14 | 1,000 | 40 |
| FLOAT | 05/21/14 | 40,000 | 326 |
| 4.500 | 07/01/14 | 30,000 | 1,350 |
| FLOAT | 07/23/14 | 78,300 | 475 |
| FLOAT | 08/10/14 | 1,500,000 | 7,598 |
| 5.500 | 08/20/14 | 3,565,820 | 196,120 |
| 5.500 | 08/20/14 | 393,000 | 21,615 |
| **Total** | | **16,763,218** | **480,723** |

Source: Bloomberg

To these borrowing requirements one also needs to add monthly payments of €500mn to €700mn to settle outstanding arrears to third parties, while on the funding side, the government is expected to utilize a number of sources, including: (i) the primary surplus accumulated throughout 2014 (projected by the new Budget to amount to 1.6% of GDP or €2,956mn); (ii) remaining official funding under the present bailout program (Table 3.3); (iii) privatization revenue of €3.5bn (official target) and (iv) any additional financing secured by a new debt relief package for Greece.

***Table 3.2 – Greece: Amortization and interest payments in 2014 (EURbn)***
*(Table excludes T-bills)*

| | | 1Q 2014 | 2Q 2014 | 3Q 2014 | 4Q 2014 |
|---|---|---|---|---|---|
| **A.** | **Total debt maturities (A1+A2)** | **3.5** | **11.7** | **7.6** | **2.6** |
| A1. | Bonds & loans after exchange (a1+a2) | 2.2 | 9.8 | 5.7 | 0.3 |
| *a1.* | *Bonds after PSI & buyback* | *1.9* | *9.5* | *5.4* | *0.0* |
| *a2.* | *Other incl. loans* | *0.3* | *0.3* | *0.3* | *0.3* |
| A2. | Official-sector loan amortizations (a3+a4) | 1.3 | 1.9 | 1.9 | 2.3 |
| *a3* | *EU/EFSF* | *0.0* | *0.0* | *0.0* | *0.0* |
| *a4* | *IMF* | *1.3* | *1.9* | *1.9* | *2.3* |
| B. | **Interest payments** | **2.0** | **1.3** | **2.0** | 0.9 |
| C. | **Total Amortization & interest payments (A+B)** | 5.5 | 13.0 | 9.6 | 3.5 |
| | Full-year sum | | | | 31.6 |

Source: IMF (July 2013), Eurobank Global Markets Research

***Table 3.3 – Greece: Loan disbursements under the 2nd adjustment program for the period Q4 2013-q4 2014 (EURbn)***

| | Q4 2013 | Q1 2014 | Q2 2014 | Q3 2014 | Q4 2014 |
|---|---|---|---|---|---|
| **EFSF** | **3.1** | **5.7** | **2.9** | **0.0** | **0.0** |
| **IMF** | **1.8** | **3.5** | **1.8** | **1.8** | **1.8** |
| **Total** | **4.9** | **9.2** | **4.7** | **1.8** | **1.8** |

Source: EU Commission (July 2013), Eurobank Global Markets Research

As shown in the tables above, May 2014 is going to be the most challenging month in terms financing needs, as the State will have to make total amortization payments north of €9bn. Reportedly, the government hopes to ensure the release of the December 2013 EFSF/IMF tranche (€4.9bn) upon completion of the present review (expected by end January or mid-February) or alternatively to receive the €4.9bn tranche and all or part of the Q1 2014 disbursement (€9.2bn) in several instalments upon fulfilment of certain required milestones.

## 2. Is Greece's return to wholesale funding markets as early as in 2014 a feasible proposition?

The outbreak of the Greek sovereign debt crisis in late 2009 and the subsequent downgrading of the country's government debt to junk status caused a skyrocketing of Greek bond yield spreads, with private capital markets becoming a prohibitively expensive source of government financing. Greece has been shut off from financial markets since early 2010, with the EU/ECB/IMF troika of official lenders effectively replacing the private sector as the main source of financing of the county's external imbalance. With the bulk of the current program's financing having already been disbursed and the troika baseline scenario envisaging a cumulative financing gap of ca €11bn in 2014-2016 it is apparent that some additional funding will be needed over the said period to fully cover the government's borrowing need. In the analysis above we examined a number of potential funding sources. In addition to these, a swift return of the Hellenic Republic to wholesale funding markets would go a long way towards facilitating the coverage of the government's borrowing requirement on a multi-year basis. On the latter issue, the government currently appears keen to re-approach financial markets some time later this year, though certain doubts and objections have been raised as regards the feasibility of such an endeavor.[11]

[11] Prime Minister Antonis Samaras said during his televised New Year's address that "in 2014, Greece will venture out to the markets". In similar lines, Greece's Minister of Finance was recently quoted (Realnews) as saying that the country hopes to tap bond markets in H2 2014, conditional on a return of the domestic economy to positive growth and the generation of a full-year primary surplus in 2013. On the other hand, PIMCO's Executive Vice President and Portfolio Manager Myles Bradshaw said recently that Greece is not expected to be in a position to return to international bond markets this year (Sueddeutsche Zeitung). Furthermore, a European Commission document dated December 16, 2013 that was recently leaked to press suggested that Greece is expected to only make a partial return to the markets in 2015.

### 2.1 Fiscal sustainability concerns remain one of the most important factors raising doubts over Greece's ability to re-approach financial markets as early as in 2014

Assuming that a formal agreement will be reached some time in H1 2014 on ways to secure adequate State financing for the current year and the next two (and abstracting from any lingering uncertainty related to the course of the upcoming negotiations with the troika and, more generally, the difficult sociopolitical environment), debt sustainability is the single most important consideration supporting doubts about the country's ability to re-approach financial markets as early as this year. Greece's public debt ratio remains the highest in the euro area, currently estimated to reach levels slightly below 185%-of-GDP this year (2014 Budget), before embarking on a declining trajectory, reaching 124% at the end of 2020 and falling substantially below that level thereafter.[12] In view of the still exceptionally high debt ratio, doubts exist as to the country's ability to reinstate fiscal sustainability without a more radical restructuring of its public debt *i.e.,* one of a size (and type) stretching well beyond that signaled by the November 2012 Eurogroup.[13] Yet, as we explained in a number of our earlier research pieces[14], the country's present debt ratio conceals the dramatic improvement having already been made in the serviceability of debt (i.e., rollover risk profile) and the potential for a radical reversal in debt dynamics once the domestic economy returns to positive growth rates (expected from 2014 onwards).

***Greek public debt dynamics expected to improve considerably after 2014.*** The interplay between GDP growth and the interest rate on the overall debt stock in determining public debt dynamics (i.e., snowball effect) is expected to improve considerably from 2015 onwards, assuming that domestic economic growth will broadly evolve in line with the troika's baseline macro scenario. To make this point easier to understand, consider that the snowball effect has accounted for around 12ppts out of the ca 16ppts-of-GDP increase in Greece's debt ratio in 2013 (Eurobank Global Market Research estimate). To a much lesser extent, the aforementioned increase was due to official funding provided that year to recapitalize domestic banks as well as the recognition of implicit or contingent liabilities. In line with the aforementioned projections, the snowball effect will be broadly neutralized in 2015, before starting to automatically reduce the debt ratio from that year onwards. Note that the troika's July 2013 baseline macro scenario implies that the snowball effect will turn positive (*i.e.,* start automatically increasing the debt ratio) after 2025, with a value of 0.9ppts-of-GDP expected in 2030. However, this forecast is based on a rather conservative outlook for Greek real GDP growth over the period 2021-2030 (between 2.0% and 1.8%), which may be failing to take into account the impact of structural reforms on the long-term growth potential of the economy.[15]

***Debt service costs expected to remain manageable over the coming decade, with additional support to be provided by new OSI.*** Assuming that all relevant macro and fiscal variables (including privatization receipts) will evolve broadly in line with the troika's July 2013 baseline scenario we estimate Greece's overall general government funding gap to amount to ca €11bn in the period 2014-2016 and to no more that €10bn over the period 2017-2020.[16] Moreover, as we explained in the previous section of this document, we expect official lenders to provide a new relief package for Greece (OSI) sometime later this year. As demonstrated in Tables 2.1 & 2.2, such a package could be structured in such a way so as to improve debt dynamics and the government's borrowing requirement on a multi-year basis, without necessarily involving outright forgiveness (i.e., haircuts on the principal of official loans).

**Bulk of Greek debt is now in official hands**. 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 and Eurosystem central banks).

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[12] See e.g. IMF Country Report No. 13/241, July 2013.

[13] The Eurogroup of 26/27 November, 2012 announced a number of relief measures for Greece aiming to improve debt dynamics and to reduce medium-term rollover risks. In addition, euro area Member States committed to consider further measures and assistance, if needed, including, inter alia, lower co-financing in structural funds and/or further interest rate reduction of the GLF facility, so as to ensure that Greece can reach a debt-to-GDP ratio of 124% in 2020 and "substantially lower" than 110% in 2022. Such assistance has been made conditional on an annual primary surplus in Greece's general government accounts (and the full implementation of program conditionality) and it should reduce the debt ratio by a further (cumulative) 7ppts-of-GDP by 2022, according to our calculations.

[14] See e.g. *"A technical Study on Greece's Sovereign Solvency: How an elevated debt ratio conceals dramatic improvement in the debt rollover profile"*, Eurobank Global Markets Research, Oct. 7, 2013.

[15] For instance, the IMF expects that a satisfactory implementation of Greece's present structural reforms program could boost the county's long-term GDP growth by as much as 10ppts (IMF Country Report No. 13/155, June 2013).

[16] See *"A technical Study on Greece's Sovereign Solvency: How an elevated debt ratio conceals dramatic improvement in the debt rollover profile"*, Eurobank Global Markets Research, Oct. 7, 2013.

***Greece's debt servicing needs do not compare unfavorably to these of other euro area economies***

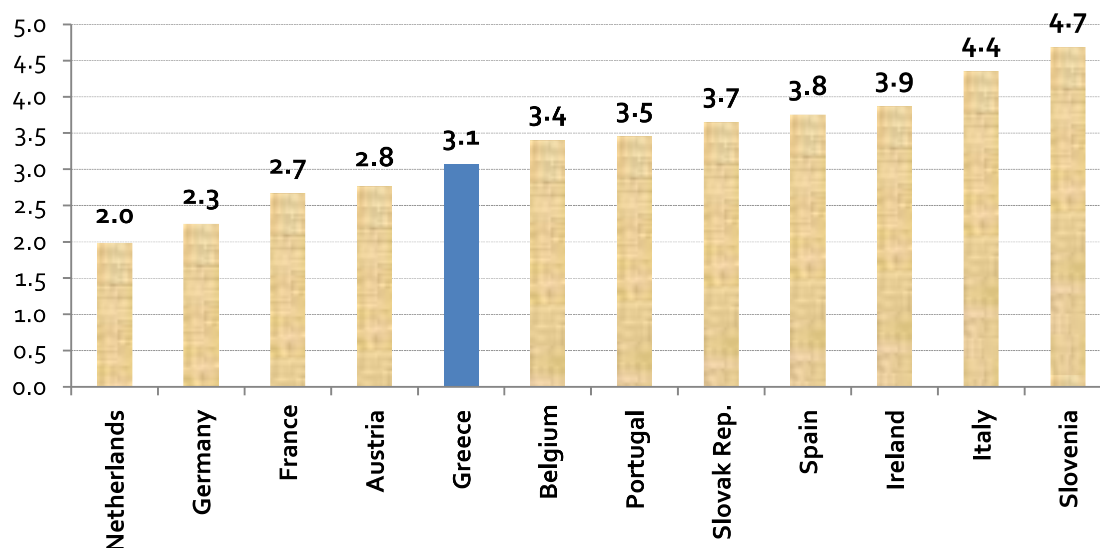
Graphs 1.1 & 1.2 below show the nominal interest rate (%) and projected interest payments as percent of GDP for a number of euro area economies, including Greece, Portugal, Ireland, Spain and Italy. Moreover, Table 4 depicts the FY-2014 projected *gross* funding need (proxied by the sum of scheduled bond redemptions and the forecasted cash fiscal deficit) for most of these economies. As demonstrated by the graphs and table below, Greece's gross funding requirement over the next 5 years or so does not necessarily compare unfavorably with these of the other euro area countries. Moreover, under the present adjustment program, Greece is set to receive additional EFSF/IMF funding to the tune of ca. €31bn in several quarterly instalments extended to Q1 2016 (see Table 1), while a new debt relief package by official lenders as early as this year would further reduce projected borrowing needs of a multi-year basis.

***Table 4 – Bond redemptions & budget deficits of selected euro area economies (EURbn)***

| | Bond Redemptions (1) | Deficit (2) | Gross funding need (1+2) |
|---|---|---|---|
| **Germany** | 144.0 | 16.3 | 160.3 |
| **France** | 107.8 | 68.0 | 175.8 |
| **Finland** | 6.8 | 8.1 | 14.9 |
| **Netherlands** | 32.0 | 21.7 | 53.7 |
| **Austria** | 24.5 | 6.1 | 30.6 |
| **Belgium** | 27.9 | 9.0 | 36.9 |
| **Italy** | 190.5 | 45.0 | 235.5 |
| **Spain** | 67.9 | 63.0 | 130.9 |
| **Ireland** | 7.6 | 8.1 | 15.7 |
| **Portugal** | 14.1 | 7.4 | 21.5 |
| **Greece** | 16.7 | 4.3 | 21.0 |

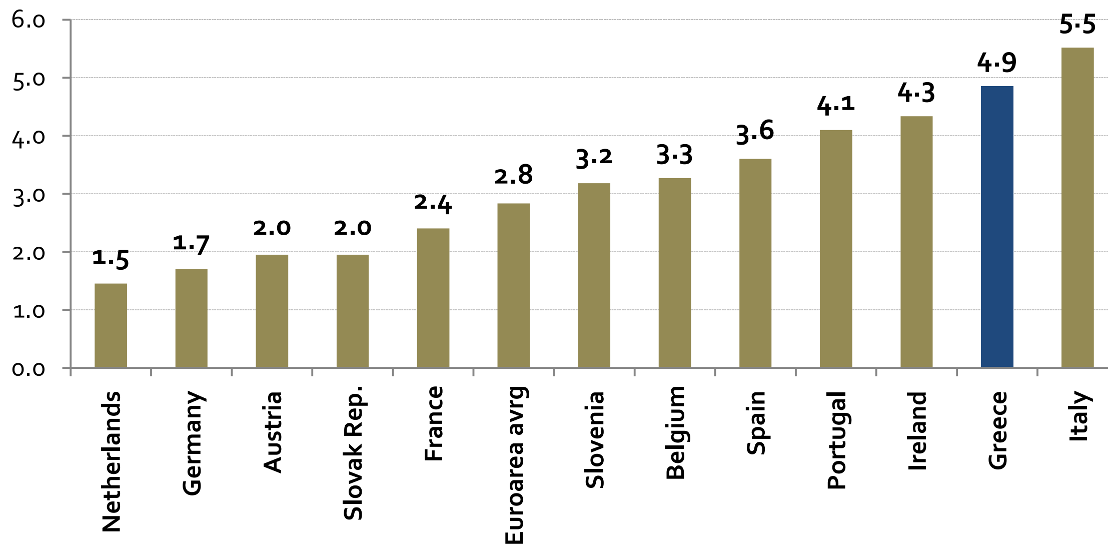
Source: BNP Paribas, Eurobank; Calculations assume 100% rollover for T-bills; do not incorporate official loan repayments

***Graph 1.2 - Nominal interest rate on public debt stock (%, period average 2013-2018)***




Source: IMF, EC, Eurobank Global Markets Research

*Graph 1.3 – Projected interest payments on general government debt (% GDP, average 2013-2018)*

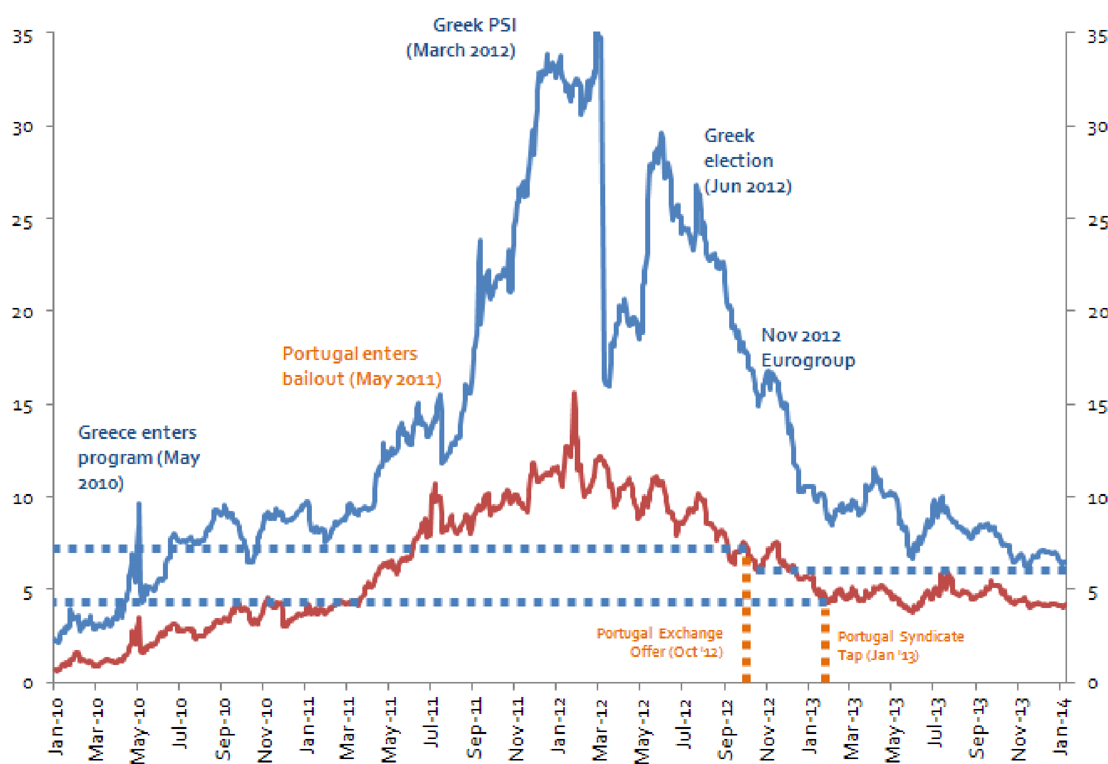



Source: IMF, EC, Eurobank Global Markets Research

**2.2 Where Greece currently stands in comparison with other program countries that have already restored market access**

Graph 2.1 below shows the evolution of the Greek and the Portuguese 10-year (generic) government bond yield spreads over the corresponding German benchmark, while the Annex section at the end of this document provides a brief summary of government bond issuance in Portugal and Ireland over the last couple of years. As the graph below demonstrates, Greece's 10-year bond yield spread (ca 600bps at the market close of January 14, 2013) currently trades around 120bps *below* the corresponding Portuguese spread on October 3, 2012, when Portugal exchanged €3.8bn of its PGB 2013 bond for a 3-year bond, but still ca 180bps over the Portuguese spread on January 23, 2013, when the country conducted a syndicated tap of its PGB 4.35%, 2017 bond for €2.5bn (Table 5.1 in Annex section).

***Graph 2.1 – Greek (blue line) and Portuguese (red line) 10yr government bond yields (%), with Greek yields shifted 1 year back in time***

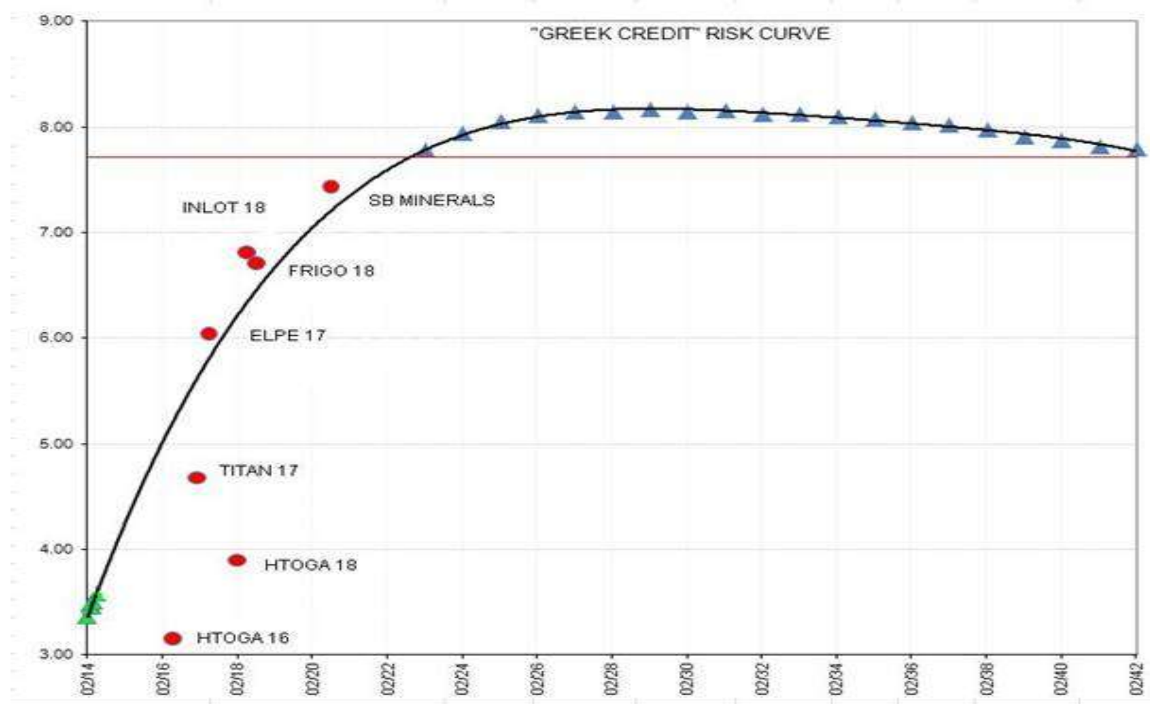



From Graphs 2.1 & 2.2, one could conceivably see Greece being in a position to re-approach financial markets at some point later this year, with a relatively small government bond issue; say, a new 5yr bond for a notional amount between €2 and €2.5bn. This would require a further significant compression of Greek bond yield spreads in the period ahead (by 150-200bps or so in the 10-year maturity segment, if the most recent Portuguese issuance history has any relevance for Greece. In our view, the latter scenario could materialize if the recent positive trends continue in the months ahead.[17] Potential drivers of such a positive trajectory could include, among other, (i) a fresh stream of higher-frequency domestic macro and financial indicators supporting expectations of a shift into positive GDP growth as early as this year; (ii) the completion of the current (4$^{th}$) troika review in the not too distant future (say by mid-February); (iii) confirmation by Eurostat in late April of a primary surplus in Greece's 2013 general government accounts (Eurobank Research baseline scenario); and (iv) the initiation of official discussions on a new debt relief package (OSI) for Greece shortly after Eurostat's next EDP report. As a final note to this section, Graph 3 below depicts the current shape of a "Greek credit risk curve", which in the absence of intermediate Greek government bond (GGB) maturities is fitted with a number of Greek corporate names. Apparently, the graph provides only a very rough proxy of where a new 5-year GGB issue would trade today, but the key point here is that a further significant spread compression is needed in the following months so as to enable Greece to re-approach financial markets as early as this year.

[17] The 10-year Greek/German bond yield spread recently broke below 600bps, to currently trade at a 3 ½ year low.

***Graph 2.2 – Greece vs. Portugal: 10 year government bond spot yield spreads (in bps)***

***Graph 3 - Greek Credit Risk Curve***
***Green triangles T-Bills, Blue Triangles GGBs, Red Circles Greek Corporates***



# Annex

**Recent history of government bond issuance in Ireland and Portugal**

## Portugal

*On October 3, 2012,* Portugal exchanged €3.8bn of its PGB 2013 bond for a 3-year bond (PGB 2015). The yield to maturity of the new bond at the day of the announcement of the exchange was 5.12%.
*On January 23, 2013,* Portugal conducted a syndicated tap of its PGB 4.35%, 2017 bond for €2.5bn. The tap produced a yield of 4.89%, for a spread of 4.29% over the corresponding German benchmark.
*On May 7, 2013,* Portugal conducted a syndicated new issue of a 10-year bond (PGB 5.67%, Feb 2024) for €3bn at a yield of 5.67%.
*On December 3, 2013,* Portugal exchanged €6.64bn worth of bonds. The move aimed to reduce debt service costs due in the next two years, by pushing back repayments of (i) €837mn of bonds maturing in June 2014; (ii) €1.64bn of bonds due in October 2014; and (iii) €4.17bn of bonds due in October 2015. In their place, investors received ca €2.68bn of notes due in October 2017 and €3.97bn of June 2018 bonds. The exchange came at a yield of 4.50% for the 2017 bonds (PGB 4.35%, 10/2017) and 4.75% for the 2018 bonds (PGB 4.45%, 6/2018). At that time the PGB 4.95%, 2023 bond was trading at 5.83%, with the corresponding yield spread over the German benchmark trading at 4.11%.
*On January 9, 2014,* Portugal accessed international markets with a very successful tap of €3.25bn of its PGB 4.75% June 2019 bond (investor orders placed exceeded €11bn). The tap produced a yield of 4.65% and covered nearly a third of the country's annual bond issue target.

Portugal aims exit from its €78bn bailout program in mid-2014.

***Table 5.1 – Portugal: Recent history of government bond issuance***

| PORTUGAL | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| Date | Event | Issue | Issue Size (Bio EUR) | Issue Yield | German Benchmark Yield | Government Yield Spread | Portugal 10year (PGB 4.95 2023) | German Benchmark Yield | Government Yield Spread | Portugal 5s-10s spread |
| 3-Oct-12 | Debt Exchange | PGB 2015 | 3.8 | 5.12% | 0.10% | 5.02% | 8.64% | 1.45% | 7.19% | |
| 23-Jan-13 | Syndicated Tap | PGB 4.35 2017 | 2.5 | 4.89% | 0.60% | 4.29% | 5.75% | 1.55% | 4.20% | 0.85% |
| 7-May-13 | New Issue | PGB 5.65 2024 | 3 | 5.67% | 1.30% | 4.37% | 5.50% | 1.30% | 4.20% | 1.38% |
| 3-Dec-13 | Debt Exchange | PGB 4.35 2017 | 6.6 | 4.50% | 0.41% | 4.09% | 5.83% | 1.73% | 4.11% | 1.08% |
| | | PGB 4.45 2018 | | 4.75% | 0.68% | 4.07% | | | | |
| 9-Jan-14 | Market access (Tap) | PGB 4.75 2019 | 3.25 | 4.65% | 0.90% | 3.75% | 5.36% | 1.92% | 3.45% | 0.71% |

Source: Portuguese debt management office, Eurobank Global Markets Research

## Ireland

In 2012, Irish debt management office's (NTMA) engagements with the debt markets included: bond switches (€4.6bn); the issuance of conventional bonds (€4.2 bn); and the issuance of a new debt instrument, Irish Amortizing Bonds, tailored to meet the needs of the domestic pensions industry (€1.0bn). In more detail,
*Bond Switches in 2012*
In January 2012, investors switched €3.53bn of the 2014 bond into a new 2015 bond, while in July 2012 holders of the 2013 and 2014 bonds switched €1.04bn into a new 2017 bond and the existing 5% October 2020 bond.
*New Issuance in 2012*
New 5.5% October 2017 and the existing 5% October 2020 bonds. This was Ireland's first long-term debt issuance since September 2010. Investors committed €4.19bn to these bonds at a yield of 5.9 % for the 2017 paper and a yield of 6.1% for the 2020. The weighted average yield on the combined transaction was 5.95%.
*On January, 8 2013* the NTMA raised €2.5bn via a syndicated tap of its 5.5% October 2017 bond. The funds were raised at a yield of 3.32%.
*On March 13, 2013* the NTMA launched its second syndicated transaction of the year. This raised €5bn through the sale of a new benchmark bond maturing in March 2023. The funds were raised at a yield of 4.15%. The sale was the NTMA's first new 10-year issuance since January 2010.

Ireland exited its €85bn EU/IMF bailout program in November 2013.

***Table 5.2 – Ireland: Recent history of government bond issuance***

| IRELAND | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| Date | Event | Issue | Issue Size (Bio EUR) | Issue Yield | German Benchmark Yield | Government Yield Spread | Irish 10 Year Yield | German Benchmark Yield | Governmen t Yield Spread | Irish 5s10s |
| 25-Jan-12 | Exchange Offer | IRISH TSY 4.5% 2015 | 3.53 | 5.00% | 0.42% | 4.58% | 7.20% | 1.95% | 5.25% | 1.30% |
| 26-Jul-12 | Exchange Offer/New Issue and Tap | IRISH TSY 5.5% 2017 (new issue) | 5.23 | 5.90% | 0.35% | 5.55% | 6.10% | 1.32% | 4.78% | 1.00% |
| | | IRISH TSY 5% 2020 (tap of existing) | | 6.10% | 0.96% | 5.14% | 6.10% | 1.32% | 4.78% | 1.00% |
| 8-Jan-13 | Syndicated Tap | IRISH TSY 5.5% 2017 | 2.5 | 3.32% | 0.49% | 2.83% | 4.97% | 1.50% | 3.47% | 1.10% |
| 13-Mar-13 | New Issue | Irish 3.9% 2023 | 5 | 4.15% | 1.48% | 2.67% | 4.15% | 1.48% | 2.67% | 1.15% |

Source: Irish debt management office, Eurobank Global Markets Research

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