Full coverage of projected financing gap possible up to at least 2020, without recourse to a new aid package from official lenders

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In their latest reviews of Greece's economic adjustment programs, both the European Commission and the IMF project a financing gap in the general government accounts to arise in the second semester of next year, amounting to ca €12.5bn over the period 2015-2016. In addition, the updated debt sustainability analysis (DSA) presented in the most recent IMF country report for Greece (June 2014) forecasts the debt ratio to reach 127.7%-of-GDP in 2020 and 117.2%-of-GDP at the end of 2022. These are somewhat higher levels than the respective targets set at the November 2012 Eurogroup (ca 124% in 2020 and substantially below 110% in 2022). It should be noted though that the latter targets assume a number of contingency (i.e., unidentified) measures corresponding to cumulative debt relief of ca 7ppts-of-GDP until 2022. Furthermore, the troika's latest projections for the Greek debt ratio do not fully incorporate a number of potential strategies currently sought for the coverage of the projected financing gap. Among others, these include, future bond issuance, internal liquidity sources and a new debt relief package expected to be agreed with official lenders before the end of this year. This note presents an updated analysis on Greek public debt, taking into consideration the last troika projections. It demonstrates that, under broadly realistic assumptions, the general government financing requirement can be covered up to (at least) 2020, without necessitating recourse to a new (3rd) financing program from official lenders. Furthermore, it shows that these strategies can broadly facilitate attainability of the debt ratio targets set at the Eurogroup of November 2012. Of course, all these assume that the agreed fiscal targets are met and the projections of the revised troika macroeconomic scenario are vindicated.

New bond issuance, internal sources and a new debt relief package can eliminate any projected funding gap, at least up to 2020

Based on the updated baseline macroeconomic scenario for Greece[1], Table A on page 4 depicts the projected evolution of the general government borrowing needs and sources of funding up to year 2020. The table incorporates: **i)** a number of strategies currently sought for the coverage of the projected financing gap over the next 12 months and beyond; **ii)** the estimated cash flow relief to be provided by a new package of debt reducing measures by the official sector, expected later this year; and **iii)** future bond issuance *i.e.*, ca. €5.6bn/annum on a *net* basis in 2014-2020 (see explanatory note to Table A). It also assumes that outstanding T-bills issuance drops to €9bn in 2017 and beyond, from ca €15bn, currently. As demonstrated by the aforementioned table (line *H*), Greece can secure adequate financing of its public borrowing requirement, without resorting to a new (3rd) financing package from the official sector. Of course, this assumes that current program targets are met and that the projections of the revised troika macroeconomic scenario are vindicated. Note that the estimated financing gap *before* incorporating available strategies for its coverage (line *E*) deviates from the respective estimate of the new troika baseline scenario (€12.6bn between H2 2015 and end-2016 as per the latest IMF report on Greece) as we assume that the Hellenic Republic will resort to new bond issuance over the respective period. Furthermore, Table A extends the projection horizon to

[1] European Commission, "*The Second Economic Adjustment Programme for Greece*", Fourth Review, April 2014; IMF Country Report No. 14/151, June 2014.

2020 *i.e.*, by four additional years compared to the respective projections shown in the latest European Commission and IMF reports. Finally, Table A *does not* incorporate the utilization of two additional funding sources. These include *a)* any remaining amount in the HFSF buffer (currently estimated at €11.3bn) post the upcoming EU-wide stress tests; and *b)* the use of idle resources available in other parts of general government for liquidity purposes. Regarding the latter, the European Commission's fourth review of Greece's second economic adjustment programme (April 2014) notes that domestic authorities have agreed to develop a plan for cash management reform to be implemented as of 1 January 2015. The plan aims to reduce the currently high segmentation of the management of various general government accounts. A first step in this reform will be to analyze the accounts held by State/central government entities in commercial banks and to close down all the unnecessary accounts, bringing the money back into the Treasury Single Account (TSA). The closure of the unnecessary accounts would take place by end-June and would bring added liquidity back to the TSA. Apparently, items *a)* and *b)* above could be utilized in tandem with the package of other strategies presented in this note in order to ensure that the government borrowing need is fully financed.

A new debt relief package for Greece: potential structure and implications

As explained above, the fulfillment of the medium-term fiscal targets envisaged in the present economic adjustment program in conjunction with new issuance of market debt and some additional (internal) sources would facilitate the coverage the government's borrowing requirement over the coming years and lessen the need for a new financing program from the official sector. According to our analysis, the government borrowing requirement appears broadly manageable until 2022/23, but becomes more challenging thereafter, mainly due to: a) the expiration of the 10-year grace period on principal payments on EU loans provided under both the first and the second economic adjustment programs; b) the expiration of the 10-year grace on interest payments on EFSF loans; and c) maturing post-PSI market debt. To a large extent, this issue will be addressed in the context of a new debt relief package for Greece by the official sector. In line with a number of recent official comments, this is expected to be decided later this year.[2] In an earlier study we presented the modalities of a (theoretical) debt relief package that could facilitate the fulfillment of the Greek debt ratio targets agreed at the Eurogroup of November 2012.[3] The said structure assumes that ***i)*** the average maturity of the total outstanding amount (€52.9bn) of EA loans provided under the first bailout program (GLF) is extended by 20 years to 50 years; ***ii)*** the interest rate on these loans is reduced to 0.6% fixed[4], from 3m euribor+50bps currently; and ***iii)*** a 10-year deferral of interest payments on these loans is granted. According to our analysis, this package would not only provide additional cash-flow relief to the government accounts on a multi-year basis, but it would also reduce the debt ratio *i.e.*, by ca 3ppts-of-GDP over the period 2014-2020 and by ca 7ppts-of-GDP until 2030. Table A already incorporates the projected cash-flow relief provided by such a package, while Table B depicts the projected evolution of the debt ratio under the baseline DSA scenario, *with* and *without* new debt relief. Table B replicates the *updated* baseline debt sustainability analysis (DSA) presented in the latest IMF report on Greece (and extends it to 2030)[5], while it also presents the forecasted path of the debt ratio assuming new debt relief. Graph 1 below depicts the projected evolution of the nominal effective interest rate on gross public debt under the aforementioned scenarios. Overall, the theoretical debt relief package assumed in this note would *ceteris paribus* reduce the average effective interest rate on the debt stock by 0.3ppts (from 3.2% to 2.9%) in 2014-2020 and by 0.4ppts (from 4.1% to 3.7%) in 2021-2030). This would translate into total savings of €6.6bn in 2014-2020 and ca €17.5bn over the period 2014-2030.

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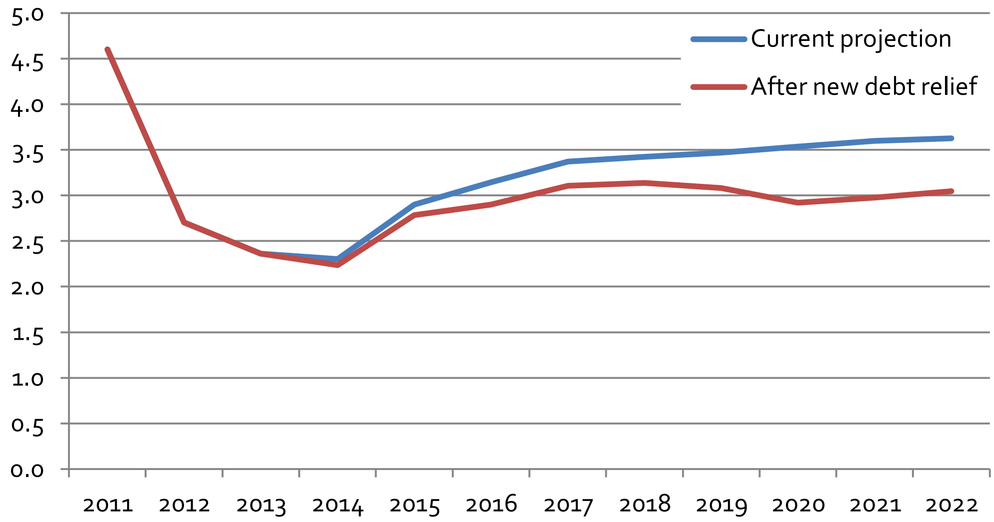
[2] E.g. Eurogroup President Jeroen Dijsselbloem said on May 5th that any final decisions on Greece's debt sustainability issue will be reached in autumn 2014, following the publication of the results of the EU-wide stress tests (expected in late October 2014) and the completion of the next troika review of Greece's adjustment program.

[3] Greece Macro Monitor of October 31, 2013 *("Debt forgiveness is not a necessary precondition for restoring debt sustainability")*. For a more analytical treatment on the topic see the following link:
http://www.eurobank.gr/Uploads/Reports/GREECE%20Macro%20Monitor%20-%20October%2031%202013.pdf

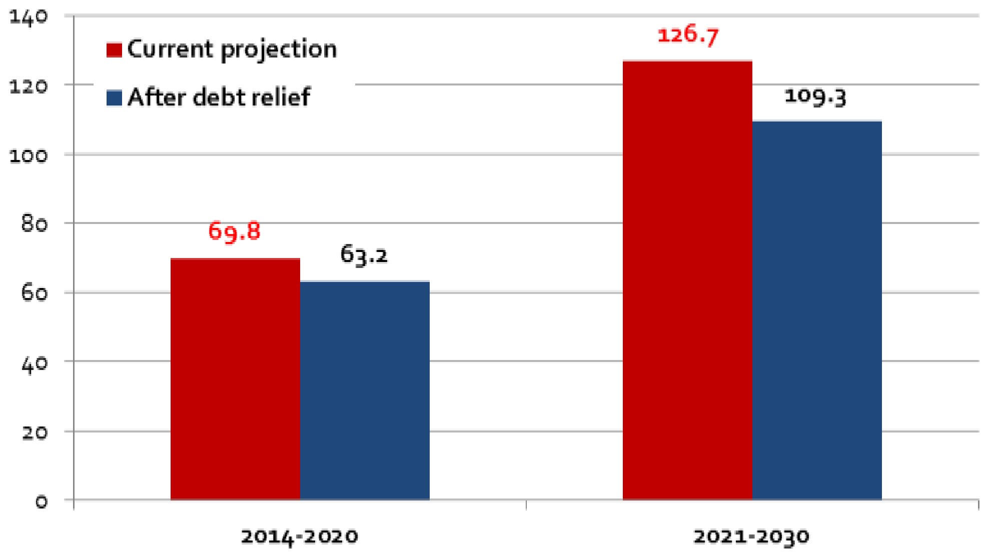
[4] The specific interest rate has been chosen so as to deliver a reduction in the public debt ratio over the period 2014-2022, which is broadly consistent with the respective targets set at the November 2012 Eurogroup.
[5] IMF Country Report No. 14/151, June 2014.

Graph 1 – Greece: projected path of nominal effective interest rate on public debt *with* and *without* new debt relief (%)



Source: Source: EC (April 2014); IMF (June 2014) and Eurobank Global Markets Research

Graph 2 – Greece: projected interest payments *with* and *without* new debt relief (EURbn)



Source: Source: EC (April 2014); IMF (June 2014) and Eurobank Global Markets Research

Table A - Greece: General government borrowing needs & funding sources (EURbn)

	2012	2013	2014	2015	2016	2014-2016	2017	2018	2019	2020	2017-2020
A. Gross borrowing need (I.1 + I.2 + I.3)	**109.3**	**37.3**	**31.1**	**21.3**	**8.7**	**61.1**	**15.7**	**7.4**	**16.9**	**16.3**	**56.3**
I.1 Government cash deficit	**10.1**	**7.5**	**3.3**	2.2	1.2	**6.7**	**1.4**	**1.6**	**1.4**	**1.6**	**6.0**
I.2 Amortization (I.2.1 + I.2.2 + I.2.3)	**9.4**	**16.2**	**25.3**	**16.6**	**7.5**	**49.4**	**14.3**	**5.8**	**15.5**	**14.7**	**50.3**
I.2.1 Bonds and loans (after PSI & DBB)	12.8	11.0	17.9	8.0	4.4	30.3	6.9	3.3	11.9	7.4	29.5
I.2.2 Short-term (net)	-3.4	3.4	0.0	0.0	0.0	0.0	6.0	0.0	0.0	0.0	6.0
I.2.3 Official creditors (1.2.3.1 +1.2.3.2)	0.0	1.7	7.4	8.6	3.1	19.1	1.4	2.5	3.6	7.3	14.8
1.2.3.1 IMF	*0.0*	*1.7*	*7.4*	*8.6*	*3.1*	*19.1*	*1.4*	*2.5*	*3.6*	*4.5*	*12.0*
1.2.3.2 EU	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*2.8*	*2.8*
I.3 Other (I.3.1 + I.3.2 +...+ I.3.6)	**89.7**	**13.6**	**2.5**	**2.5**	**0.0**	**5.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
I.3.1 Bank recap	41.0	7.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
I.3.2 Cash upfront for PSI (sweetener & accrued interest)	34.6	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
I.3.3 Cash upfront for debt buyback (DBB)	11.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
I.3.4 Arrears clearance	0.5	5.5	2.0	2.5	0.0	4.5	0.0	0.0	0.0	0.0	0.0
I.3.5 Cash buffer	1.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
I.3.6 ESM capital	0.9	0.9	0.5	0.0	0.0	0.5	0.0	0.0	0.0	0.0	0.0
B. Financing source (II.1+II.2+II.3)	**0.3**	**3.7**	**9.0**	**9.2**	**10.1**	**28.3**	**14.3**	**6.6**	**17.4**	**14.3**	**52.5**
II.1 Market access	0.0	0.0	5.0	5.0	5.0	**15.0**	10.0	2.5	13.1	10.0	**35.6**
Market access on a net basis i.e., after substracting bond issuance to rollover debt issued from 2014 onwards	*0.0*	*0.0*	*5.0*	*5.0*	*5.0*	*15.0*	*10.0*	*2.5*	*7.0*	*5.0*	*24.5*
II.2 Privatisation revenue	0.0	1.0	1.5	2.2	3.4	7.1	2.9	3.0	3.4	3.6	12.9
II.3 ANFA & ESM profits	0.3	2.7	2.5	2.0	1.7	6.2	1.4	1.1	0.9	0.7	4.0
C. Net financing needs (A.-B.)	**108.9**	**33.6**	**22.1**	**12.1**	**-1.4**	**32.8**	**1.4**	**0.8**	**-0.5**	**2.0**	**3.8**
D. Official loan disbursements (III.1+III.2)	**109.9**	**32.1**	**20.7**	**7.2**	**1.8**	**29.7**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
III.1 EU	*108.2*	*25.3*	*10.2*	*0.0*	*0.0*	*10.2*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*
III.2 IMF	*1.6*	*6.8*	*10.5*	*7.2*	*1.8*	*19.5*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*
E. Financing gap (D.-C.) ***"-" indicates deficit ; "+" indicates surplus***			**-1.4**	**-4.9**	**3.2**	**-3.1**	**-1.4**	**-0.8**	**0.5**	**-2.0**	**-3.8**
F. Strategies to cover financing gap with internal sources other than bond issuance (IV.1 + IV.2 + IV.3 + IV.4)			**3.3**	**3.7**	**-2.0**	**5.0**	**1.2**	**1.5**	**0.5**	**1.8**	**5.0**
IV.1 Rollover of 5-yr gvnt bond owned by ETEAN (=€ *1.5bn- €0.43bn)*			1.1						-1.1		
IV.2 Purchase by Pireaus Bank & Alpha Bank of preference shares from the State (€*1.7bn)*			1.7								
IV.3 Use of subsector deposits through repo transactions				3.0	-3.0						
IV.4 New debt relief package/assumed cash flow relief			0.5	0.7	1.0		1.2	1.5	1.6	1.8	
G. Financing gap after utilisation of internal sources & debt relief package (E.+F.) ***"-" indicates deficit ; "+" indicates surplus***			**1.8**	**-1.2**	**1.2**		**-0.2**	**0.7**	**1.0**	**-0.2**	
H. Cumulative financing gap after utilisation of internal sources & debt relief package "-" indicates deficit ; "+" indicates surplus			**1.8**	**0.6**	**1.8**		**1.6**	**2.3**	**3.3**	**3.0**	

Source: EC (April 2014); IMF (June 2014); Eurobank Global Markets Research

Explanatory notes to Table A

Line I.1 "Government cash deficit" depicts the General Government balance in cash (*non*accrual) basis.

Line I.2.1 "Bonds and loans (after PSI and DBB)" incorporates the expected maturities of existing debt (bonds and loans) as well as the maturities of newly-issued bonds, as per the assumptions presented in the corresponding explanatory note for ***Line II.2*** below.

Line I.2.2 "Short-term (net)" depicts the corresponding maturities of T-bills (on a net basis); here we assume that the total outstanding amount of T-bills declines to ca €9bn in 2017 onwards from ca €15bn, currently.

Line 1.2.3.2 "EU" - There is currently a 10-year grace period on principal payments on all EU loans provided to Greece under the first and the second (current) bailout programs.

Line II.1 "Market access" - For simplicity, we assume here that market access over the period 2014-2020 is conducted via issuance of 5-year fixed coupon bonds, carrying (an average-weighted) coupon of ca 3.6%.

Line II.2 "Privatisation revenue" - In the context of the last (4th) program review, targeted privatization revenue for FY-2014 has been revised downwards by €1.2bn; while the respective targets for the fiscal years 2015 and 2016 have been raised by €0.2bn and €1.4bn.

Line IV.1 "Rollover of 5-yr gvnt bond owned by ETEAN" – ETEAN is an extra-budgetary fund whose main objective is to give guarantees to SMEs so that the latter can have access to financing. In 2009, the government issued bonds to ETEAN (total notional amount of ca €1.5bn), but fewer guarantees have been called than expected initially. This will allow the government to cancel about €430mn of these bonds when they mature i.e., in August 2014 (see *European Commission, The Second Economic Adjustment for Greece Fourth Review – April 2014*).

Line IV.2 "Purchase by Pireaus Bank & Alpha Bank of preference shares from the State (€1.7bn)" - In 2009 Greece issued the so-called pillar I bonds to capitalize Greek banks in kind. In exchange for these bonds, the Greek State was given preference shares in the banks that required the recapitalisation. In the course of the on-going recapitalization, two banks have raised higher amounts from the markets in order to buy back the state preference shares. This reduced the government financing needs for May 2014, when the pillar I bonds matured.

Line IV.3 "Use of subsector deposits through repo transactions" - While the State cash reserves run relatively low, other general government entities dispose of sizable cash reserves. As part of the program, a mechanism will be put in place to enable the State to use idle resources available in other parts of general government to cover part of its financing needs. As a first step, the authorities are setting up a repo framework using state government assets as collateral to draw on excess liquidity in general government subsectors for up to €3 bn. This framework will be implemented as part of a prior action and although the repos will be short-term, they can be rolled over as needed (see *European Commission, The Second Economic Adjustment for Greece Fourth Review – April 2014*).

Line IV.4 - ***"New debt relief package/assumed cash flow relief"*** depicts the ensuing decline in the Government borrowing requirement resulting from an assumed (new) debt relief package involving: **a)** 20-year maturity extension on EU bilateral loans (GLF) given to Greece in the context of the 1st adjustment program (total notional €52.9bn); **b)** 10-year grace on interest payments on GLF loans; and **c)** further interest rate reduction on GLF loans to 0.6% fixed, from 3m euribor + 50bps, currently.

Table B – Greece: Debt sustainability analysis (with and without new debt relief)

	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Gross public debt (% GDP) - baseline	170.2	157.2	175.1	174.2	171.0	160.5	152.0	144.6	135.3	127.7
Gross public debt (% GDP) - after debt relief	**170.2**	**157.2**	**175.1**	**174.1**	**170.6**	**159.9**	**151.0**	**143.1**	**133.2**	**125.0**
Memorandoum items										
Real GDP Growth	-7.2	-7.0	-3.9	0.6	2.9	3.7	3.5	3.3	3.6	2.6
GDP deflator inflation	1.2	-0.3	-2.1	-0.7	0.4	1.1	1.3	1.4	1.8	1.8
Primary fiscal balance (% GDP)	-2.4	-1.3	0.8	1.5	3.0	4.5	4.5	4.2	4.2	4.2
Nominal interest rate on debt (%)	4.6	2.7	2.4	2.3	2.9	3.1	3.4	3.4	3.5	3.5
Nominal interest rate on debt (%) - after debt relief	4.6	2.7	2.4	2.2	2.8	2.9	3.1	3.1	3.1	2.9
Nominal GDP (EURbn)	208.5	193.3	182.1	181.9	187.9	197.1	206.6	216.5	228.2	238.5

	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030
Gross public debt (% GDP) - baseline	121.8	117.2	113.0	109.3	106.0	102.5	99.2	96.1	93.0	89.8
Gross public debt (% GDP) - after debt relief	118.4	113.1	108.4	104.2	100.6	96.7	93.1	89.7	86.4	83.0
Memorandoum items										
Real GDP Growth	2.0	1.9	1.9	1.9	1.9	1.9	1.9	1.9	1.9	1.9
GDP deflator inflation	1.9	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0
Primary fiscal balance (% GDP)	4.0	4.0	4.0	4.0	4.0	4.0	4.0	4.0	4.0	4.0
Nominal interest rate on debt (%)	3.6	3.6	3.6	3.8	4.0	4.1	4.3	4.6	4.7	4.7
Nominal interest rate on debt (%) - after debt relief	3.0	3.0	3.2	3.4	3.7	3.8	4.0	4.4	4.5	4.5
Nominal GDP (EURbn)	247.9	257.6	267.8	278.3	289.3	300.7	312.5	324.8	337.6	350.9

Source: EC (April 2014); IMF (June 2014) and Eurobank Global Markets Research

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