"GREECE: IS SOVEREIGN DEBT A CONSTRAINT ON GROWTH?"

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"At the end of 2014 we were so close … yet so far … for a major economic take-off!"

Executive Summary

- ❑ Supply side of the economy and structural reforms have top priority today
- ❑ Sovereign Debt is not a constraint on growth today and over the next nine years: Although high in Face value terms, it is small in Present Value terms: It has an average maturity of 17 years and very low interest rates.
- ❑ Yet, there are ways to make it even smaller in present value terms that would not cost lenders , plus condition the fiscal rigor on the GDP growth
- ❑ Three major imbalances prior to Greek crisis: Competitiveness, fiscal, pension
- ❑ Revelation of 2009 fiscal imbalance led to consecutive downgrades in credit rating, a rise in borrowing rates → EA & IMF rescue (1st adjustment program)
- ❑ After the PSI of February 2012, 2nd adjustment program. Idea of conditioning the fiscal balance on the size of economic growth, present at the time
- ❑ This was revealed in Nov. 2012, after GDP disappointed and thus a fiscal relaxation plus lower interest payments were offered to Greece
- ❑ At the end of 2014,
  - Imbalances almost cured
  - Economic growth had resumed (+0.8% in 2014), with investment finally turning positive
  - Debt was on a sustainable path, assuming growth would continue

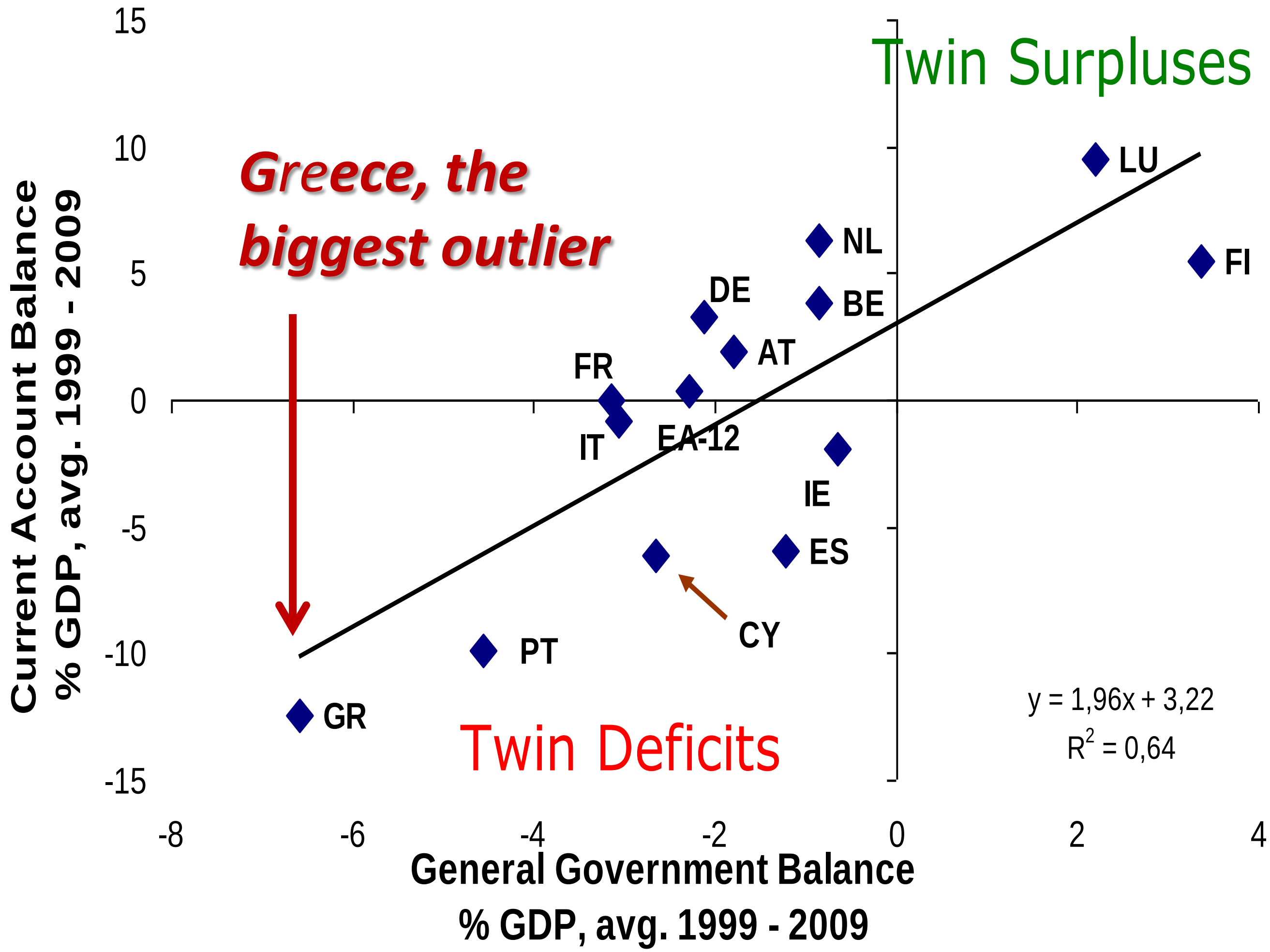
Executive Summary (continued)

- In November 2014, little remained to close the final review of the 2nd Program:
  - At the Eurogroup meeting of December 8, 2014, EU Commission stated: "*Greece has done more than enough to close the review and a lot more than any other Program country*"
  - IMF, on the other hand, wanted the pension reform of 2015 front-loaded before the possible elections. ECB followed the IMF lead → Review got an extension to end-February 2015
- New government wasted precious time →brought economy back to recession
  - Made a policy of a nominal Debt haircut central to its campaign without exploring equivalent alternatives that were politically feasible
  - Ignored the issue of moral hazard, which was central to EA thinking throughout the crisis and followed a strategy based on the perception that EA instability gets generated from Grexit alone, not from moral hazard
  - Generated uncertainty inside Greece through its "constructive ambiguity" – a misnomer for lack of strategy & action - and ignored the supply side
  - Hence, it brought a new recession and trapped itself into a corner, obliged now to take worse fiscal measures than those envisaged in Nov. 2014, even with a much smaller primary surplus target for 2015, otherwise risking capital controls, a demise of the economy & its own political demise

Serious macroeconomic imbalances prior to the crisis

Besides the fiscal & external imbalances, there is a serious pension system imbalance

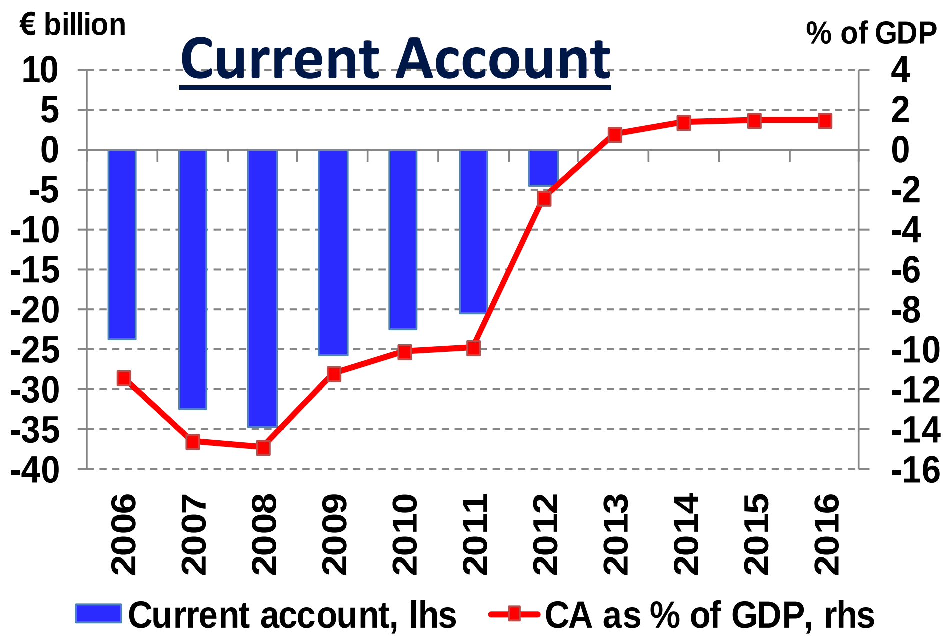
- **On the other hand, private debt not as serious as in other EA countries**
- **The current account imbalance reflects deeper competitiveness problems, not yet fully cured**

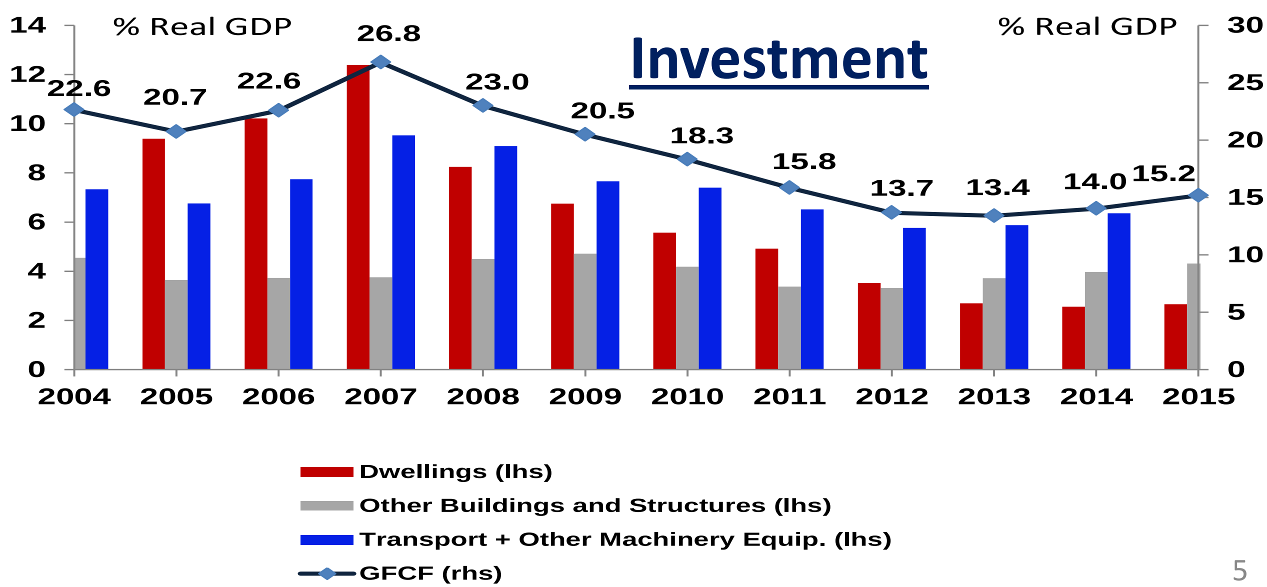


Source: European Commission

State of Play at the End of 2014

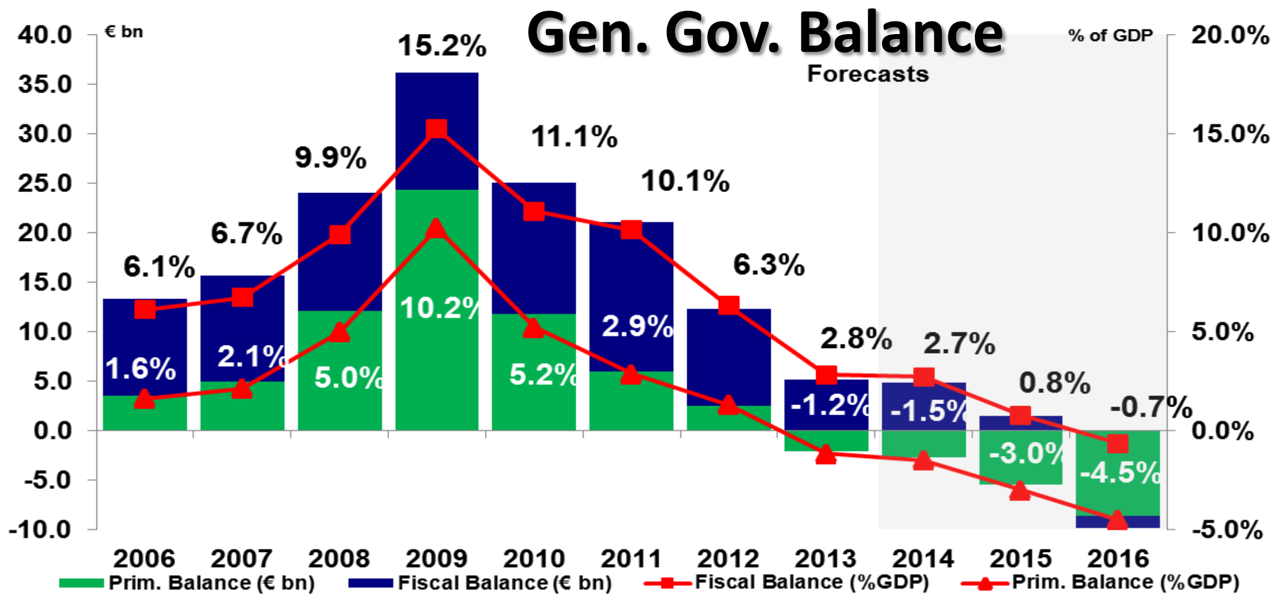
- **Foundations of an extrovert and competitive economy via reforms:**
  - ✓Competitiveness rankings↑
  - ✓Current account in surplus after years of deficits, yet exports still anemic
  - ✓2014 growth of 0.7%, after a cumulative drop of ca 26%, yet now in a new recession
  - ✓FDI in 2013 and 2014 exceeded 2007 level
  - ✓Privatizations picked up momentum
  - ✓Investment in machinery & equipment up
- **A new Growth strategy based on 3 pillars: institutions, education, competitiveness**

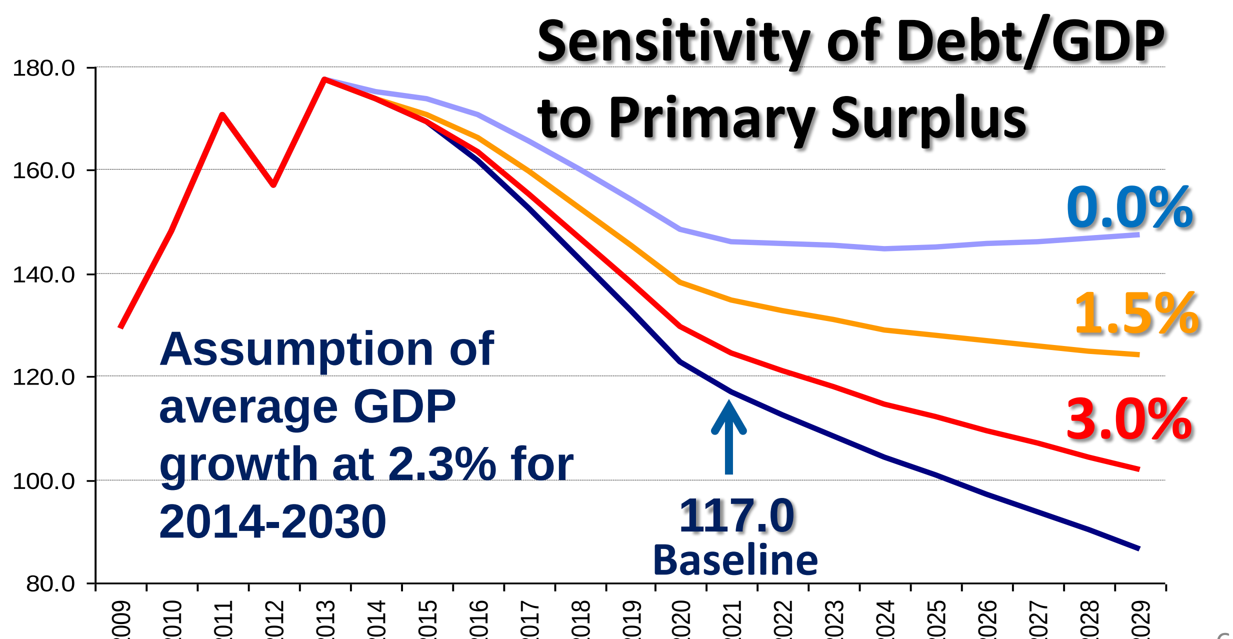




State of Play prior to January Elections

- **Enormous fiscal consolidation since 2009** when Gen. government expenses were **€128.2 bn** and Gen. government revenues **€91.9 bn**. In the budget of 2015, the corresponding expenses and revenues were both projected at ≈€80bn.
- **Debt sustainability on track**, Average Maturity from 6 years to 17 years, interest rates low
- Soon out of the MoU, into ECCL with Euro Area, and a precautionary agreement with the IMF

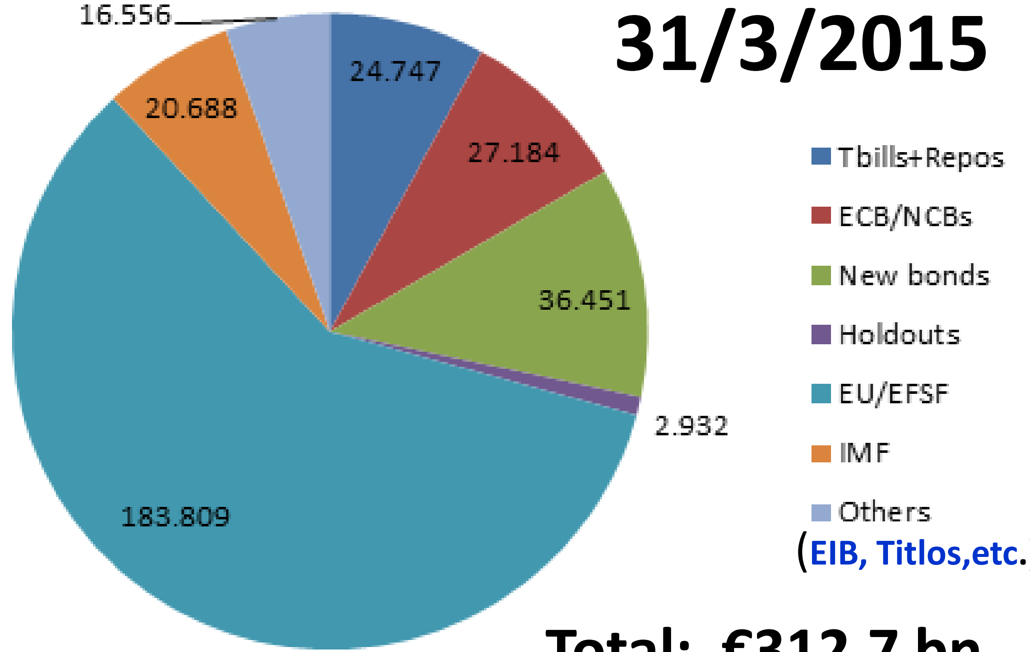




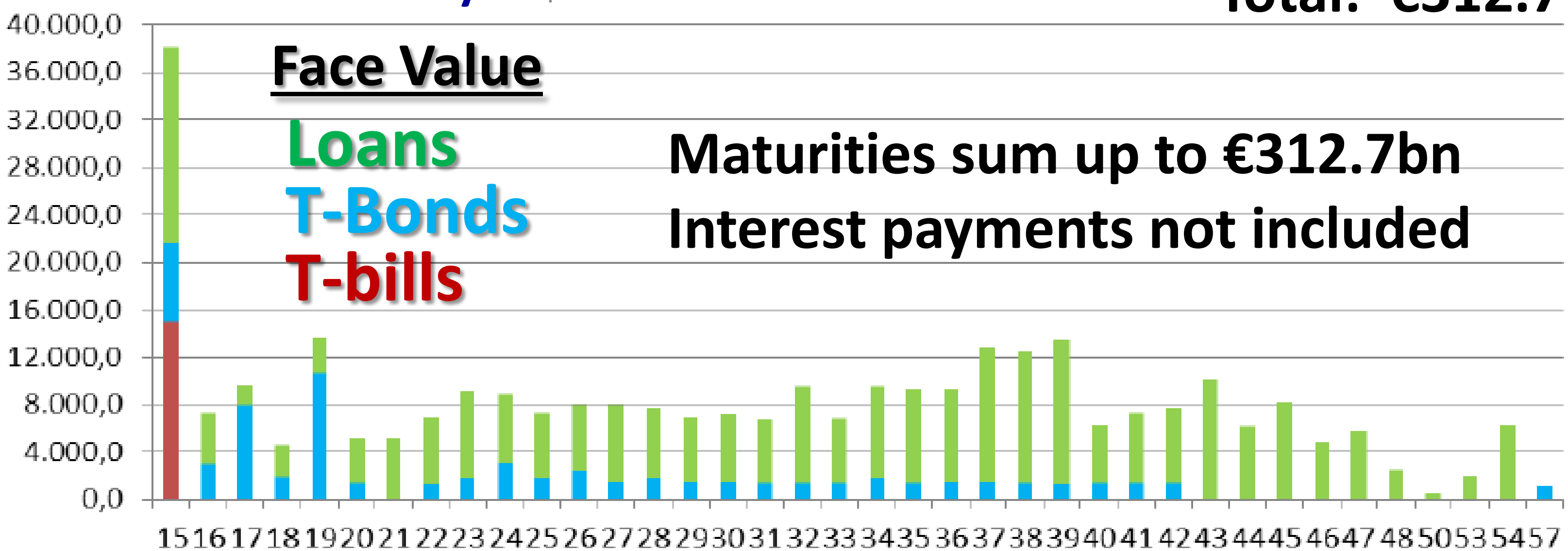
Greek Central Gov. Debt Composition

- EFSF loans worth €130.9bn or 42% of the total debt stock: Interest rate of 1.6%
- Greek Loan Facility (GLF) worth €52.9bn or 17% of the total stock: Interest rate of 0.7%
- Annual interest payments of ca. €5.5bn until 2022 with an extra ca. €1.5bn deferred
- Gen. Gov. debt smaller by ca. €8bn

31/3/2015



Total: €312.7 bn



How to reduce the Present Value of Debt

<u>Eurogroup statement</u> (November 27th 2012):

*"Euro area Member States will consider further measures and assistance, including inter alia **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, when Greece reaches an annual primary surplus, as envisaged in the current MoU, conditional on full implementation of all conditions contained in the programme, rin order to ensure that by the end of the IMF programme in 2016, Greece can reach a debt-to-GDP atio in that year of 175% and in 2020 of 124% of GDP, and in 2022 a debt-to-GDP ratio substantially lower than 110%."*

- ***<u>Fixing interest rates</u>**:* The EFSF interest rate cost, currently at 1.6%, could be fixed for a period of 30-50 years (10 year EFSF rate currently close to 1%). The GLF interest rate should be fixed for a period of 10-15 years at current levels (0.7%+hedging cost) between 2015-2030.
- ***<u>Maturity extensions</u>*** EFSF and GLF loans can be extended to 50 years.
- ***Extension of the grace period for the EFSF interest deferral*** to, say, 2030 so that debt/GDP is below 80% - ***Forgiveness?***
- ***Sweetener Interest Rate Deferral:*** €96.1bn coming from the Master FAFA, €29.7bn from the PSI LM Facility (Sweetener) and €4.9bn from the Accrued Interest Facility → annual savings of €550 mn. - ***Forgiveness?***

Concluding Remarks

- Once the country is out of the present difficulties, it can begin exploring innovative ways to reduce its debt burden
- Conditioning the targeted fiscal balance on the state of the economy is an idea worth exploring during the upcoming Debt Sustainability Analysis
- Exploring the use of financial instruments along the debt-equity swap category is another avenue
- Those ideas are floating around for a long time but never became concrete proposals partly because of politics and the presence of moral hazard