Euronomics: A fresh look at Greek debt sustainability

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15 April 2021

Greece has come a long way in the decade that followed the sovereign debt crisis, restoring sustainability to public finances, regaining market confidence, strengthening the banking sector, and improving its economic competitiveness. Though the financial burden of the current pandemic has raised debt levels and long-term risks, we are not going through another debt crisis. Greek and European Union (EU) efforts can ensure Greece's current debt sustainability despite the remaining, long-term challenges.

Greece emerged from the past debt crisis more resilient. It conducted a number of reforms, including making the public administration more efficient, simplifying licensing, streamlining procedures, and facilitating trade. As a result, the Greek economy was structurally more resilient at the start of the pandemic than it was prior to the sovereign debt crisis. Past consolidation efforts, though quite painful, enabled the country to enter the pandemic with a very healthy budgetary position. This allowed the government to combat the effects of the current crisis with countermeasures amounting to approximately 9.4% and 6.5% of GDP in 2020 and 2021, respectively.

A new debt sustainability environment

The structure of Greek debt has much improved. This is due in large part to the ESM's and its predecessor, the EFSF's, very favourable lending terms and the liability management exercises under the ESM programme. The ESM holds around 55% of Greece's public debt and the weighted remaining maturity of the ESM/EFSF loans is 31 years - much longer than that of the remaining debt stock. Due to the low interest rate on these loans - thanks to the ESM's own low, AAA rated cost of funding over that period - Greece's annual costs for servicing these loans is lower than expected for its total debt level.

Like many other countries, Greece is benefitting from a secular decline in interest rates resulting in very favourable financing conditions. Historically low interest rates have reduced the debt service burden both as a share of overall expenditure and compared to taxation. In many respects, this is a new world for debt sustainability analyses. As we have been arguing for some time, the focus is less on the stock of debt - often measured as the debt-to-GDP ratio - but rather on budgetary flows and roll-over risks. The general decline in interest rates and the compression of risk premia has diminished the effective interest rate on Greek government debt from 7.3% in 2000 to around 1.5% in 2020. Greece is locking in current low interest rates by further extending the maturity of its issuance and through interest rate swaps.

In contrast to its situation during the financial crisis, Greece now has broader access to the European Central Bank's (ECB) monetary policy measures. This further reduces the country's debt servicing costs. Greece sovereign debt is now not only eligible as collateral for its main refinancing operations, but also in the ECB's current bond purchasing programme, the Pandemic Emergency Purchase Programme (PEPP).

Effective interest rate