Explainer on ESM short-term debt relief measures for Greece

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Short-term debt relief measures for Greece: explainer

1. **When was it decided that Greece would receive short-term debt relief measures?**

In its statement of 25 May 2016, the Eurogroup mandated the ESM to work on a first set of debt relief measures, referred to as short-term measures.
The ministers said that these measures would be implemented after the closure of the first review and before the end of the current ESM programme (the third programme). On 5 December 2016, the ESM presented detailed plans for the short-term measures to the Eurogroup.
On January 23, the governing bodies of the ESM and of the EFSF completed the approval process of the measures. The measures were successfully implemented over the course of 2017.

2. **Will there be further measures in the future?**

In its statement of 25 May 2016, the Eurogroup also mentioned a possible second set of measures, if needed, following the successful implementation of the third

programme by Greece. These are called medium-term measures.
For the long term, the Eurogroup has agreed to a contingency mechanism to ensure long-run debt sustainability in case a more adverse economic scenario materialises in the country.

3. **What are the guiding principles for additional debt relief?**

The Eurogroup laid down guiding principles for additional debt relief in its statement of May 2016. It excluded any nominal haircuts, and further decided that the measures must: facilitate market access for Greece to replace publicly financed debt with privately financed debt; smooth the repayment profile; incentivise the country's adjustment process (even after the ESM programme ends); and ensure flexibility to accommodate uncertain economic growth and interest rate developments in the future.

4. **What do the short-term measures consist of?**

There are three sets of short-term measures:
* smoothing Greece's repayment profile;
* reducing interest rate risk;
* waiving the step-up interest rate margin for 2017.

5. **How does the smoothing of the repayment profile work?**

The smoothing of the repayment profile refers to Greece's second programme, with the EFSF. The maximum weighted average maturity of the loans in this programme was agreed to be 32.5 years. Due to several factors, such as the return of bonds by Greece to the EFSF in February 2015, it dropped to approximately 28 years. The maturity has now been brought back up to the maximum of 32.5 years, and the repayment scheduled re-profiled, to avoid a number of repayment humps in the 2030s and 2040s.

6. **What about the second measure, the reduction of interest rate risk?**

There are three different schemes for the second measure.

The first is a *bond exchange*. To recapitalise banks, the EFSF/ESM provided loans to Greece worth a total of €42.7 billion. These loans were not disbursed in cash, but in the form of floating-rate notes. Greece used the notes to recapitalise banks.

The ESM is now exchanging these bonds for fixed-rate notes, which it is then buying back for cash. This significantly reduces the interest rate risk that Greece bears. The ESM has raised all the funds that are needed for the bond exchange through issuing longer-dated bonds.

The second scheme foresees the ESM entering into *swap arrangements*. This scheme aims at stabilising the ESM's overall cost of funding and reducing the risk that Greece would have to pay a higher interest rate on its loans when market rates start rising.

A swap is a financial contract that enables two counterparties to exchange the cash flow on two different securities, for instance, fixed-rate payments for floating-rate payments.
The ESM has now put the swap programme in place, and will continue to be active in the derivatives markets to maintain it.

The third scheme, known as *matched funding*, foresees the ESM charging a fixed rate on part of future disbursements to Greece. This would entail issuing long-term bonds that closely match the maturity of the Greek loans. This scheme will be implemented in 2018.

Market conditions may influence the degree to which the ESM can implement any of these three schemes.

7. **And the third measure, the waiver of the step-up interest margin?**

The *waiver of the step-up interest rate margin* applies to the €11.3 billion instalment of the EFSF programme (second programme) used to finance a debt buy-back. A margin of 2% had originally been foreseen for 2017 onwards. This margin was waived, and has not been charged for the year 2017.

8. **What savings will the measures bring for Greece?**

When implemented in full, these measures should lead to a cumulative reduction of Greece's debt-to-GDP ratio of around 25 percentage points until 2060, according to ESM estimates in a baseline scenario. It is also expected that Greece's gross financing needs will fall by around six percentage points over the same time horizon. The bond exchange and the interest rate swaps make up the largest part of this reduction. Second-round effects on Greece's refinancing rates would be an additional benefit. The short-term measures will improve Greece's debt

sustainability.
However, caution is warranted. The impact of some of the measures hinges on several factors beyond the ESM's control. These include the interest rate environment and the availability of other market participants to conclude some transactions.

9. **Are there any costs to the measures, and who will pay them?**

The adjusted repayment profile is expected to bear no cost. The cost of the waiver of the step-up margin will consist of the foregone profit for the EFSF and its shareholders.
Any costs from the three schemes to reduce the interest rate risk will be borne by Greece. This is particularly the case for the bond exchange and the interest rate swaps. Such short-term costs are more than compensated by the long-term benefits of the operation for Greece.

10. **Are there any costs for other euro area member states, and particularly the four former programme countries?**

No. The Eurogroup set as a condition that the transactions would not have any direct cost for other programme countries.

11. **Are there any costs for Greek banks from the bond exchange?**

The scheme is expected to be neutral for Greek banks and needed their consent for implementation.

12. **What is the impact on the EFSF/ESM funding strategy?**

The funding strategy remains unchanged. ESM and EFSF will remain present as an issuer in benchmark sizes along the entire yield curve.
For internal purposes, the ESM has created a portfolio that will contain the proceeds of all the operations required to fund the short-term measures, known as the 'Greek Compartment'. This will enable us to isolate these costs, and pass them on directly to Greece, so that other beneficiary countries don't bear any extra cost.

13. **Why did the Eurogroup decide to look into debt relief measures for Greece?**

The measures seek to address a general concern that future debt payments will pose an undue burden on public finances and thus stifle the Greek economy. Gross Financing Needs (GFN), the total amount of money a country spends in one year on interest rates payments and repaying maturing debt, is the benchmark used to

measure this burden.
The Eurogroup has agreed that, under a baseline economic scenario, Greece’s GFN should remain below 15% of GDP during the post-programme period for the medium term, and below 20% of GDP after that.

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