ESM short-term debt relief measures for Greece

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Rolf Strauch, ESM Member of the Management Board for Economics, Policy Strategy and Banking
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Written contribution on ESM short-term debt relief measures for Greece

1. Could you please explain how the ESM short-term measures will help Greece in making its debt sustainable and why these measures should provide comfort for investors?

Following the mandate the ESM received earlier this year, we put together proposals for short-term debt measures that we believe are workable. Together, they are an important step to improve Greek debt sustainability.

Once we have implemented all these measures, they could lead to a cumulative reduction of the Greek debt-to-GDP ratio of around 20 percentage points over the time horizon until 2060. And looking at the so-called gross financing side, the measure that the Eurogroup accepted as a benchmark for assessing debt sustainability, the cumulative positive impact of these short-term measures could be that by 2060 the GFN (gross financing needs) would be almost 5 percentage points lower for Greece.

Of course, this time horizon until 2060 is unusually long and implies great uncertainty. Therefore one has to be very careful that these are our best estimates. There is a high degree of uncertainty, market conditions can change, and therefore this has to be preliminary. But very clearly, together these measures will improve Greek debt sustainability significantly.

Looking at the proposals a bit in more detail, there are three sets of short-term measures that we proposed in line with the May Eurogroup statement.

The first set - the smoothing of the repayment profile for Greece - is related to the second programme, which was an EFSF programme. The weighted average maturity of these loans is 28 years, and this can be brought up to 32.5 years. And as a consequence, repayment humps which existed in the 2030s and 2040s – and could have been a challenge for Greece – will now be spread out, and there will be a smoother profile for Greece to repay its debt.

The second set of measures is the reduciton of interest rate risk for Greece. There are three different schemes for that second measure.

- The first is a bond exchange to recapitalise Greek banks. The EFSF and ESM provided loans to Greece for €42 billion. These loans were not disbursed in cash, but in the form of floating-rate notes. We did also did that in other countries, such as Spain and Cyprus. These notes will now be exchanged for fixed-rate bonds with a much longer maturity. And because the new bonds will be at fixed rates, Greece no longer bears the risk that interest rates will go up. Of course it also means that upfront there may be costs because from the beginning, Greece has to pay a higher long-term rate. But we are very certain that over time, in the longer run, there will be substantial savings.
- The second scheme foresees that the ESM would enter into swap arrangements. This would stabilise the ESM’s overall cost of funding and thereby also reduce the risk that Greece would have to pay high interest rates on its loans if and when rates in financial markets start rising.
- The third scheme, known as matched funding, foresees that the ESM will finance future disbursements to Greece with long-term notes, and therefore this will also stabilise the interest rate cost. This entails issuing long-term bonds that closely match the maturity of the Greek loans.

Market conditions may influence the degree to which these measures to reduce interest rate risk can be applied. The implementation phase will be 12 to 18 months.

Finally, there is the third measure in our proposal, which is the waiver of the step-up interest rate margin. This is related to a tranche of €11.3 billion of the EFSF programme (the second programme) that was used to finance debt buy-backs. On this particular tranche, if nothing happens, there would be a margin of 200 basis points, and that will be waived for the year 2017.

2. Will the short-term measures not automatically lead to higher costs for Ireland, Portugal, Spain and Cyprus who also benefitted from loans of the Euro rescue funds ESM and EFSF? Will they lead to budgetary cost for the other Euro area and ESM member states?

No. The Eurogroup set as a condition that the transactions would not have any direct cost for former programme countries. 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 of the Member States. Any costs from the three schemes to reduce the interest rate risk will be borne by Greece. As mentioned in the response to the first question, 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.

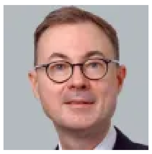
3. Will the short term measures be enough to make Greece's debt burden sustainable? Is it not already clear today that the medium to long-term measures that the euro area finance ministers talked about in their statement last May will be needed?

Medium-term measures on debt will not be agreed before the end of the ESM programme in 2018. That was also confirmed by the Eurogroup last week. These possible measures were already identified in May, so we know what might be done in the future. At the end of the programme it will be decided whether they are really needed. We will then have a new debt sustainability analysis (DSA). By then we will also know for sure whether the budgetary forecasts are confirmed. In debt sustainability analyses over such a long time horizon changes in the starting conditions can have a significant impact on the long-term prospects. Therefore it is right to decide at the end of the programme in light of reform progress and after a new DSA is produced. We will then know whether such medium-term measures are really needed.

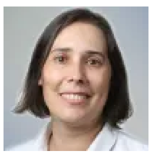
Author

Rolf Strauch
Chief Economist and Management Board Member

Contacts



Cédric Crelo
Head of Communications and Chief Spokesperson
+352 260 962 205
c.crelo@esm.europa.eu



Anabela Reis
Deputy Head of Communications and Deputy Chief Spokesperson
+352 260 962 551
a.reis@esm.europa.eu

[Juliana Dahl]
Principal Speechwriter and Principal Spokesperson
+352 260 962 654
[j.dahl@esm.europa.eu]