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HOW GREECE BENEFITTED FROM EUROPEAN DEBT RELIEF

Euro area Member States have taken several steps to ease the lending terms for Greece to support its ability to service its debt burden, principally through lower financing costs and longer maturities.

The first European assistance instrument, known as the Greek Loan Facility (GLF), was amended in June 2011, when the maturity was extended by five years to a total of 10 years, the grace period was lengthened to 4.5 from three years, and the margin was lowered by 100 basis points, to 2% in the first three years and 3% thereafter. This change was superseded by the second amendment in March 2012 where maturities were extended to 15 years, the grace period raised to 10 years, and the margin reduced further to 150 basis points over the entire period.

In November 2012, the second Greek financial assistance programme included additional debt alleviation measures. Worse-than-expected macroeconomic developments, missed targets and incomplete programme implementation meant additional measures needed to be taken to reduce financing needs and to support the sustainability of Greek government debt. Therefore, the Eurogroup approved a broader set of measures on the GLF and EFSF loans:

- reduction of the GLF interest rate margin by 100 basis points;
- cancellation of the EFSF guarantee commitment fee;
- deferral of EFSF interest payments on loans under the Greek Master Financial Assistance Facility Agreement by 10 years;[3]
- return of the Securities Markets Programme (SMP) profits (when the ECB bought Greek government bonds with a discount in the secondary market and made a profit at maturity);
- extension of the GLF to 30 years and EFSF weighted average maturities to 32.5 from 17.5 years.

The low financing costs of the European facilities reduced Greece's debt servicing burden, thereby providing authorities with greater fiscal flexibility. The GLF and EFSF rates remain well below market rates. Due to the relief measures and market conditions for EFSF funding, the EFSF lending rate for Greece, which reflects the market situation, currently stands at around 1.35%. The EFSF rate compares favourably with the current IMF lending rate of 3.6%. It also remains far below the roughly 5% rates that Greece has had to pay for corresponding maturities over the past decade and current market rates. Financing at EFSF and GLF rates therefore entails an important support component, because they are alternatives to other, more costly sources of financing.

The measures correspond to substantial economic debt relief, with effects that transcend the enhanced fiscal room for manoeuvre provided to Greece. Considering these maturity extensions and interest rate deferrals over the entire debt servicing profile from a net present value (NPV) perspective shows a reduction in the overall debt burden and reveals implicit savings. The NPV approach consists of discounting the difference between the future cash flows of the loans benefitting from lower financing costs and debt relief measures and the cash flows of the same loans had they not benefitted from the relief measures.[4] Stretching out principal repayment schedules over such an extended period of time, along with interest payment deferral, imply that these payments account for substantially less in NPV terms when assessed from the Greek side taking into account the financial market perspective.[5]

3 Not applied to Private Sector Involvement (PSI) and bond interest facilities, which correspond to roughly 25% of the overall EFSF loan to Greece.

4 For the calculation of the interest Greece would have paid in the markets, the historical 10-year German bund rate plus a theoretical market spread of Greece at the starting date of each EFSF loan tranche is used. For the calculation of the interest applicable to the EFSF loans to Greece, projections of the EFSF cost of funding are based on the estimate of the funding volumes that the EFSF has to achieve in the future. The NPV gain is derived from the difference between these two flows of interest payments. The discount curve is derived from the German bund plus the theoretical market spread for Greece as of calculation date.

5 It should be noted that this does not entail any financial loss or write-down from an EFSF perspective. The EFSF is fully repaid; Greece has to cover any financing costs related to the agreed interest rate deferral in line with the amendment of the Master Financial Assistance Facility Agreement.

The economic reduction of the debt burden and implicit savings from the various relief measures described above leads to NPV savings equivalent to 49% of Greece's 2013 GDP. The overall figure comprises an NPV reduction for the EFSF facilities of 34% of GDP, of which 7% of GDP can be attributed to the extension of maturities and interest rate deferral, and 27% of GDP can be attributed to the savings from the financing at EFSF rates compared to market rates for Greece. To this number, one can add the impact of the extension of maturities and the lowering of the margin for the GLF. This adds another 10% of GDP in NPV reduction. Finally, the return of SMP profits adds up to 5% of GDP. This overall NPV savings figure as a percentage of GDP and its breakdown is based on theoretical assumptions of the interests Greece would have paid in the markets, compared to estimates of the future EFSF cost of funding.

From a Greek perspective, the debt relief measures taken by its European creditors provide a substantive benefit in fiscal space and overall payment profile. It cannot be argued that the debt level is unsustainable by merely looking at the aggregate nominal debt to GDP ratio. A proper sustainability analysis must consider the structure of Greek debt. Payment obligations over the years until 2023 are minimal. Thereafter, the repayment is stretched out over several decades which, combined with favourable lending rates, results in an overall high but sustainable debt – provided that Greece continues its reform agenda.