Greece is investment grade again - why it matters to keep it

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Greece has achieved an important milestone in its recovery from a painful debt crisis more than a decade ago. After 13 years, Greece regained investment grade in its credit rating from Standard & Poor's Global Ratings (S&P).

In this blog post, we show why this achievement matters to Greece and markets, how citizens stand to benefit, and why Greece must continue with its reforms to secure its hard-won gains.

Back in 2010, Greece lost its investment grade status and went through three adjustment programmes. The European Financial Stability Facility (EFSF) co-financed the second one with the International Monetary Fund and the European Stability Mechanism (ESM) financed the third one.[1] The macro and fiscal imbalances in the economy and the financial sector's weaknesses triggered a sovereign debt crisis, cutting Greece's access to capital markets and putting the Greek people through considerable hardships.

With a combination of financial assistance and the commitment to reform, Greece successfully concluded the third and final financial assistance programme on 20 August 2018. This marked the end of the largest sovereign assistance package in history, comprising three distinct programmes.

The 20 October S&P rating decision was the third upgrade to investment grade for Greece this year, but the first from one of the three largest credit rating agencies.[2]

What Greece did to win back investment grade

The return to investment grade is an important step recognising Greece's prudent fiscal policies and its efforts to modernise the country through the implementation of a determined and challenging package of reforms. These reforms were launched with the introduction of the EFSF/ESM financial support programmes, and their scope covered, among others, public administration, the judicial system, as well as the restructuring of its banking sector and the reduction of non-performing loans.

In the last few years, the country's fiscal and economic performance exceeded expectations, surpassing most of its euro area peers.

The completion of the banks' restructuring and the implementation of an important reform package designed under the last ESM programme, as well as the EU Recovery and Resilience Plan (RRP) and the investments launched under the RRP, led to stronger economic growth and to accelerated debt reduction.

The ESM supported Greece along the way by financing it at AAA - the highest investment grade level available - funding costs, considerably below the market rate for 10-year Greek bonds, which peaked at 30% at the height of the crisis.

This financial lifeline gave the country time to make the necessary adjustments and lay the foundations for future growth. The ESM secured low and hedged interest rates for the coming decades thanks to the favourable debt structure provided by the ESM debt, with the first instalment to be paid back only in 2034 and a final maturity by 2060.[3]

Keeping investment grade

Recovering the investment grade rating is only the first step. To strengthen and maintain such status, Greece needs to complete the country's modernisation and keep its reform momentum as the new government's agenda suggests.

Therefore, it would be important to complete structural reforms, including those initiated but not yet fully implemented under the EU's enhanced surveillance framework and the RRP. Take, for example, reforms related to the banking sector and the management of public assets.

Greece, through the Hellenic Financial Stability Fund, a financial institution created in July 2010 with the aim of contributing to maintaining the financial stability of the Greek banking system, helped strengthen its domestic banks' corporate governance and risk management. The country has started returning banks to the private sector following recapitalisations made in the wake of the debt crisis. The privatisations must continue, focussing on attracting strong strategic shareholders.

Through the Hellenic Corporation of Assets and Participations, a public institution introduced during the ESM programme, Greece has also sought to modernise some state-owned enterprises through efficient management, while also minimising interference in their corporate governance. Some of these enterprises are now reporting profits for the first time in years. Better-managed state-owned enterprises positively impact growth and can offer better services to citizens and corporates.

The completion of all these reforms is crucial to creating a modern environment for Greece to retain its investment-grade status and attract foreign and strategic long-term investors.

Why investment grade is a matter of trust

Greece's recent upgrades to investment grade were welcomed by financial markets. They normalise the use of Greek government bonds as collateral in the European Central Bank's (ECB) refinancing operations, and more importantly drive down the cost of credit, benefiting the country's citizens, which is particularly welcome at a time of sticky inflation with higher interest rates.

Financial markets make an important distinction between low-risk and high-risk bond issuers:[4] the lower the risk, the more investors trust such issuers.

The higher the rating, the further into investment grade territory, and the easier and cheaper it is for Greece to borrow from the markets. If Greece can borrow more cheaply, so too can Greek corporates and households.

The sovereign rating and funding costs often serve as a benchmark for private funding raised by banks and corporates in the country. In fact, sovereign ratings are often considered a cap for national banks and corporates.

Thus, the upgrade will also allow the private sector to benefit from reduced and less volatile costs of funding. This means that businesses could become more profitable, resilient, and stable. The reduced cost of funding for banks can translate for households to lower interest payments, more spending power, and reduced cost of access to credit.

The upgrade to investment grade also increases the pool of potential investors who can buy Greece's bonds. The higher rating can unlock a broader investor base from which the country was excluded for 13 years. For example, many of the world's largest international pension and investment funds cannot buy anything below investment grade.[5]

This new status also allows the country's inclusion in more global market indices, which strengthens Greece's financial market access. Many large international investors build their sovereign bond portfolios with reference to international indices: being part of these can boost demand for Greek government bonds.

As an investment grade country, Greece can now attract more foreign capital with a positive impact on the economy and its growth capacity.

Another effect of the investment grade status is that it allows the ECB to treat Greece like all other euro area countries in its refinancing and monetary policy operations. The ECB accepts as collateral those bonds that are rated investment grade by one of the four largest rating agencies.

The ECB granted exemption provisions to Greek government bonds after the country lost its investment grade status. Thanks to the upgrades to investment grade, Greek bonds' inclusion in such operations becomes normalised and no longer subject to the ECB's exemption decision.

Conclusion

The promotion to investment grade is a great achievement and a game changer but requires continuous efforts to be maintained and improved further. Greece now needs to build a track-record and retain investors' confidence in being a strong and stable investment grade country. Only this way can Greece maximise the benefits and secure them for its citizens in the long term. So, Greece must keep the reform momentum, preserve its prudent fiscal position, and continue the path of its modernisation.

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Further reading

Euronomics: A fresh look at Greek debt sustainability

Greece

[Lessons from Financial Assistance to Greece - Independent Evaluation Report]

Footnotes

[1] The first adjustment programme, the Greek Loan Facility, consisted in bilateral loans from euro area member states and the International Monetary Fund.

[2] On 4 August and 8 September respectively, Scope Ratings and DBRS Morningstar upgraded Greece to investment grade.

[3] On EFSF loans, which have a final maturity until 2070, Greece paid the first scheduled principal instalment in 2023.

[4] Financial markets refer to low-risk bonds as investment grade bonds, while they call high-yield bonds or junk bonds sub-investment or speculative grade.

[5] Historically, the term investment grade derives from the investment practice of some large US investors, which assigned BBB minus as the hard investment threshold for their portfolios. The term became commonly used since the 1960s.

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