EUROPEAN DEBT RELIEF BENEFITS GREECE

Euro area countries have taken many steps to ease Greece's overall repayment burden.

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 a longer repayment period. Nominal haircuts on the debt have not been undertaken.

First Greek programme (no EFSF or ESM involvement)

In the first programme, euro area countries cut borrowing rates, and put off and extended the repayment period.

When Greece first asked for financial assistance from the EU, there was no lender of last resort for governments yet. Under that programme, known as the Greek Loan Facility (GLF), euro area countries lent Greece €52.9 billion on a bilateral basis, and the IMF another €20.1 billion.

Begun in April 2010, the programme was amended in June 2011:

- the maturity was extended by five to 10 years,
- the grace period was lengthened to 4.5 from three years,
- the margin was lowered by 100 basis points, to 2% in the first three years and 3% thereafter.

This change was replaced by the second amendment in March 2012:

- maturities were extended to 15 years,
- the grace period raised to 10 years,
- the margin was further reduced to 150 basis points over the entire period.

Second Greek programme (EFSF involvement)

In the second, they adopt another similar set of measures.

The EFSF, Europe's temporary rescue fund, had already been in operation for nearly two years when the second Greek assistance programme began in March 2012. In November of that year, this second programme introduced additional debt alleviation measures. Worse-than-expected macroeconomic developments, missed targets, and prolonged policy uncertainty 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.

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

Third Greek programme (ESM programme)

In August 2015, Europe's permanent rescue fund, the ESM, launched the third programme for Greece. As of 31 December 2015, it had disbursed €21.4 billion to Greece under this programme of up to €86 billion total agreed financial assistance. This programme was needed to help Greece tackle worsening macroeconomic conditions and a serious deterioration in the banking sector. The weighted average maturity of the loans to Greece was fixed at 32.5 years and lending rates were, as in all programmes, based on the ESM's low cost of funding.

In 2015, the ESM took on the third programme for Greece.

Low financing costs

The low financing costs of the European facilities reduced Greece's debt servicing burden, thereby providing authorities with greater fiscal flexibility. The GLF, the EFSF, and ESM rates are well below market rates for Greece. The EFSF and ESM lending rates (excluding fees) stood at 1.57% and 0.72%, respectively, as of end-December 2015. The EFSF and ESM rates compare favourably with the 2015 IMF lending rate of around 3.8%.[4] They also remain far below the roughly 5% rates that Greece had to pay for corresponding maturities before the crisis and its current market rates. Financing at the EFSF, ESM, and GLF rates therefore entails an important support component compared to other sources of financing.

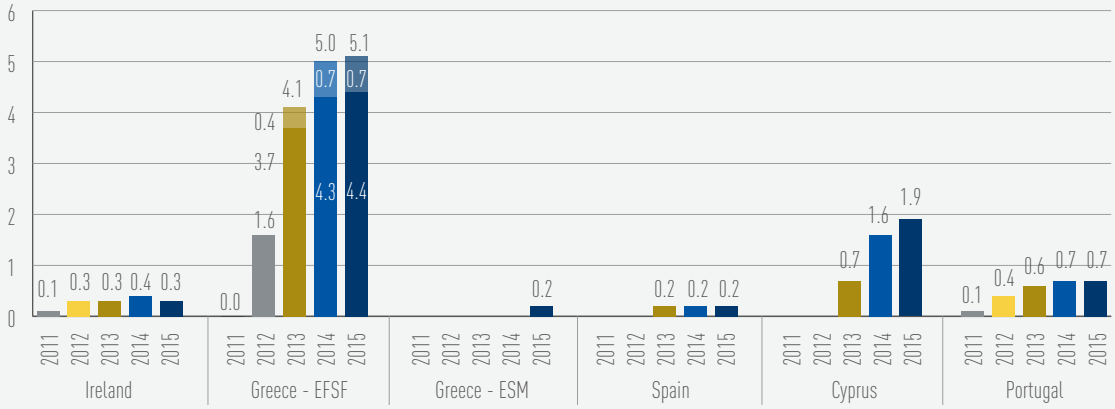
The low financing costs of the European facilities create fiscal space.

As far as EFSF/ESM financial assistance is concerned, the simplest way to estimate the savings achieved over the past years is to compare the effective interest rate payments on EFSF/ESM loans with the interest rate that these countries would have paid had they been able to cover their financing needs in the market in the absence of disruption. The proposed approach values every single disbursement in the past at the average market 10-year bond yield in a year.[5]

[4] For 2016, the implicit interest rate is projected to reach 3.10% by end-December 2016, assuming no new disbursements.

[5] The market interest rate is capped at a maximum of 6.4%, which represents the highest rate at which euro area countries issued a bond over the past eight years. This cap is imposed because secondary bond markets do not provide reliable pricing information at times of distress given very high rates.

Figure 20: Potential budgetary savings from EFSF/ESM low cost of financing
(in % GDP)



Source: ESM

The EFSF and ESM pass on their low financing costs to the borrowing country.

Figure 20 shows the savings for Greece and the other countries benefitting from EFSF/ESM financial assistance. Savings are presented as a percentage of GDP. The deferral of interest payments granted to Greece on EFSF loans is depicted in light colour. The figure shows that all countries benefitted from low interest rates, though the financial advantage is by far the largest for Greece given the massive size of the financial support. Benefits increased in all cases with the disbursement of the programme. They have slightly decreased recently for Ireland in view of its improved financing conditions. However this effect is expected to be temporary, when the more expensive loans provided initially under EFSF mature.([6]) The deferral of interest rates, which was only granted to Greece in view of its special debt challenges, provides an additional advantage in current budgetary savings, representing a total 5.1% of GDP in 2015. The deferred payments will, however, become due after 2022.

Effective reduction of the debt burden

Greece benefits in the long run through a more sustainable debt burden.

The measures correspond to substantial economic debt relief. Considering the 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. The NPV approach consists of discounting the difference between the future cash flows of the loans with lower financing costs and debt relief measures and the cash flows of such loans had they not benefitted from the relief measures. 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 for Greece from a financial market perspective.([7])

The reduction of the debt burden in NPV terms and savings from the various relief measures described above leads to NPV savings equivalent to 51% of Greece's 2015 GDP. Excluding ANFA and SMP profits, the debt relief for Greece in NPV terms rep-

([6]) See also the section on lending in Chapter 2.

([7]) It should be noted that this does not entail any financial loss or writedown 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.

resents 40% of outstanding debt to European official creditors; this, however, implies no reduction in nominal debt and therefore no cost for the European taxpayer.

The overall savings figure comprises first an NPV reduction for the EFSF facilities of 32% of GDP, of which 3% of GDP can be attributed to the extension of maturities and interest rate deferral, and 29% of GDP can be attributed to the savings from the low financing rate. The ESM disbursed facilities as of end of 2015 created another NPV reduction of 5% of GDP thanks to favourable financing rates. To these numbers, one can add the impact of the extension of maturities and the lowering of the margin for the GLF. This generated another 9% NPV savings of GDP. Finally, the return of SMP profits added up to 5% of GDP.

This overall NPV savings figure and its breakdown is based on assumptions of the interest Greece would have to pay on the market, compared to estimates of the future EFSF cost of funding.[8] Figure 21 summarises the breakdown of overall savings.

The ESM calculates those NPV gains at 51% of Greek 2015 GDP.

Debt repayment

The debt relief measures taken by its European creditors represent a substantial benefit in fiscal space and overall payment profile for Greece. Payment obligations are minimal until 2023. Thereafter, the repayments stretch out over several decades. The favourable lending rates and the lengthy repayment periods were considered adequate at the time to safeguard the sustainability of Greek debt provided that Greece continued its reform agenda.

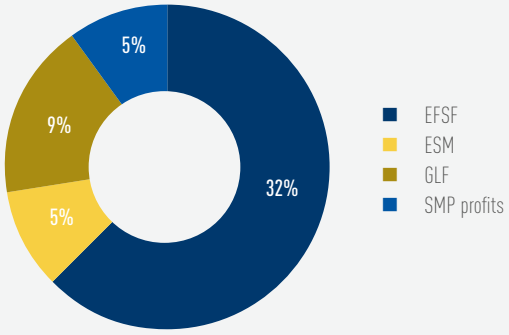
Views on how to best assess debt sustainability are evolving. There is a growing consensus in line with the EFSF/ESM view that debt sustainability depends not only on the overall amount of liabilities, but also on the underlying debt structure, in particular its maturity. On this score, key to debt sustainability are:

- a downward sloping path for the overall debt stock, and
- a sufficiently modest level of annual gross financing needs, a metric which reflects the fiscal stance and debt service flows.

To assess the sustainability of debt, one must consider more than its overall amount.

[8] Estimates of future EFSF and ESM cost of funding are based on expected interest rates (forward rates) derived from market data which are applied to future EFSF and ESM funding volumes. The rates Greece would have to pay on the market are based on the EFSF and ESM cost of funding plus estimates of spreads.

Figure 21: Long-run net present value savings for Greece from European financial support (in % gross domestic product)



Source: ESM