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"The common currency protects Europe from 1930's-style competitive devaluations, which is the last thing Europe would need now. Although the Eurozone's architecture is lacking in a number of respects, the euro can work, if it is seen to work for all its people and regions."

ESM designs and implements short-term debt relief measures for Greece

ESM launches short-term measures to reduce interest rate risk for Greece.

The ESM launched a series of short-term measures in 2017 designed to improve debt sustainability for Greece. These so-called short-term measures were agreed by the euro area finance ministers, the Eurogroup, on 5 December 2016 and by the Boards of Directors of the EFSF and ESM on 23 January 2017.

The measures will cut Greece's gross financing needs by almost five percentage points by 2060.

When implemented in full, these short-term measures could reduce Greece's debt-to-GDP ratio by around 20 percentage points and gross financing needs (GFN) by almost five percentage points in 2060. These estimates are based on the baseline assumptions of the European institutions in December 2016, and should be taken with caution given the high uncertainty attached to the long horizon of the analysis.

The Eurogroup also approved further measures in principle, if required.

In its statement of 25 May 2016, the Eurogroup mentioned a possible second set of medium-term measures, following Greece's successful conclusion of the ESM programme in August 2018, if needed. The Eurogroup has also agreed a contingency mechanism to ensure long-run debt sustainability, if needed. The possible medium- and long-term measures can be phased in progressively if necessary to meet the agreed benchmark for GFN.

Overview of the short-term measures

Measure 1: Smoothing the EFSF repayment profile under the current weighted average maturity

Under the EFSF Master Financial Facility Agreement with Greece, the maximum weighted average maturity was set at 32.5 years. By 2016, however, the final weighted average maturity dropped to 28.2 years mainly due to a €10.9 billion early repayment in February 2015. With this measure, the maturity will now be brought back up to 32.5 years. This measure spreads out over several years a number of repayment humps that would have been due in the 2030s and 2040s, thereby mitigating Greece's refinancing risk. In addition, it facilitates debt service payments on non-EFSF/ESM Greek debt by smoothing the overall Greek debt profile (Figure 12).

Measure 2: Using the EFSF/ESM funding strategy to reduce interest rate risk without incurring any additional costs to former programme countries

In consultation with its Members, the ESM designed three non-mutually exclusive short-term schemes to improve debt sustainability. The proposed schemes provide the largest possible benefit for Greece without subjecting former programme countries to additional costs.

- **Scheme 1: Bond exchange.** To recapitalise banks, the EFSF/ESM provided loans to Greece worth €42.7 billion. The stability funds disbursed these loans in the form of floating-rate notes. Under this scheme, the EFSF/ESM will exchange most of these floating rate notes with fixed interest rate instruments and extend their maturities. To do so, the ESM will issue long-term fixed-rate notes through cashless transactions, which will be held by the banks temporarily, as well as bonds, thereby funding in stages the repurchase of the bank-held floating rate notes.

- **Scheme 2: Swap arrangements.** Swapping floating for fixed interest rate cash flows reduces the variability of interest rates associated with ESM loans. By fixing the interest rate for part of the ESM loan, Greece will have more certainty and predictability on the future stream of interest rates it must pay. The magnitude of the benefits will vary depending on the rate, the maturity, and the size of the swap transactions that the ESM can execute on the market.

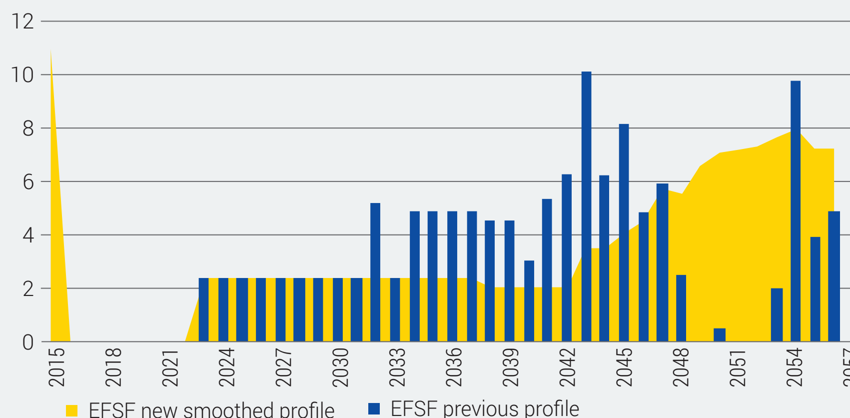
- **Scheme 3: Matched funding.** The ESM will charge a fixed rather than a floating rate on part of future disbursements to Greece. Under the current programme assumptions, the ESM expects to disburse a further €30 billion to Greece until mid-2018. With matched funding, the ESM will issue long-term fixed-rate bond issuances that closely match the maturity of the Greek loans.

The implementation of these three schemes is subject to market conditions. The ESM will assess the feasibility and benefits of transactions for Greek debt sustainability on an ongoing basis.

Figure 12

Indicative EFSF loan re-profiling under the current weighted average maturity

(in € billion)



Source: ESM calculations

Measure 3: Waiving the step-up interest rate margin related to the debt buy-back tranche of the second Greek programme for the year 2017

In December 2012, the EFSF provided €11.3 billion to finance Greece's debt buy-back operations. This instalment was charged with a 0 basis point margin but provided for a step-up margin of 200 basis points as of 1 January 2017. The third short-term debt measure waives this step-up margin for the year 2017.

Impact of the short-term measures

The bond exchange and interest rate swaps will provide Greece with the most relief.

All short-term debt measures have a positive effect on Greek debt dynamics. The short-term measures are expected to reduce the overall debt-to-GDP ratio by 20 percentage points in 2060 and the GFN ratio by five percentage points.[2] The bond exchange under scheme 1 (back-to-back extension) should deliver the greatest benefits as it affects the largest portion of Greek debt. This scheme will reduce both the debt-to-GDP and the GFN-to-GDP ratios by 2060. The other two measures have a broadly similar effect; both could yield a reduction of the debt-to-GDP level of around seven percentage points by 2060. They each lower the GFN ratio by 1.5 percentage points over that time period.

The debt measures will also help the Greek government secure more favourable market lending rates.

The smoothing of the EFSF repayment profiles lowers the debt ratio by more than three percentage points and the GFN ratio by almost one percentage point by 2060. The cancellation of the 2017 debt buy-back instalment step-up margin has the least impact; it decreases 2017 interest payments by around €220 million. Matched funding of future ESM disbursements will bring additional benefits for long-term Greek dynamics. Finally, these measures will have a knock-on effect; they will help the Greek government secure more favourable market lending rates.

Seen from a net present value perspective, the short-term measures reduce Greece's overall debt burden by some 8.7% of Greek GDP.

From a net present value (NPV) perspective, the short-term measures also reduce the overall debt burden by around 8.7% of Greek GDP. The NPV approach consists of discounting the difference between the future cash flows of the EFSF and ESM loans before and after the short-term measures. The discount factor reflects the weighted average cost of financing total Greek debt. The NPV gains increase if the second round effect of the short-term measures – lower market refinancing rates for Greece – are taken into consideration. The final overall impact of these measures, however, depends on the size and timing of market transactions and the combination of schemes. In addition, the effects are sensitive to the assumptions underlying the debt sustainability analysis.

[2] The estimated impact of the short-term measures is based on the baseline DSA assumptions of the European institutions in December 2016.