Europe Flash

Eurogroup meeting Feb 20: a new bailout agreed for Greece, but downside risks remain

The eurogroup reached a preliminary agreement early in the morning on the second bailout to Greece. The agreement includes the following:

1. Requirements for Greece

- Greece accepts a larger role for the troika, which will have a permanent delegation in the country.
- An escrow account is created to ensure Greece gives priority to debt repayment. The amounts needed will be put there three months in advance. Greece will take legal measures within the next two months to give priority to the repayment of debt and interest before any other spending. It will eventually have to enshrine this in the Constitution.

2. Private sector involvement

- The haircut is increased from 50% to 53.5%. Probably this will be accompanied by a reduction of coupons until 2020 and an increase in the coupons beyond 2020. Losses for private investors in NPV terms could reach levels of about 75% (we need to wait for more details about the transaction to calculate it better)
- The success of PSI is a necessary condition for the programme to be finally approved. The bond exchange should be finished by early March (probably around the 10th of March).

3. Official sector involvement

- The total amount provided by the official sector is limited to 130 bn euro, unchanged from previous commitments, including a significant participation by the IMF.
- The ECB (as expected) and national central banks (this is new) will contribute with the profits derived from their Greek bond holdings. This will reduce Greek debt by 2.8pp of GDP (ECB) and 1.4pp (1.8pp) by 2020. Details will be agreed in the next few days.
- Lower interests rates will be applied, retroactively, to the official debt (through the EFSF). The new margin of these loans will be limited to 150bp.

4. Debt sustainability

- With all these mechanisms, debt is assumed to hit 120.5% of GDP by 2020, as in previous exercises. In our view, it sounds a bit optimistic, but it should pave the way for further IMF participation.
- An alternative scenario has been leaked to the press whereby debt would restart growing rapidly if Greece does not comply with its commitments of deficit reduction, reforms and privatizations. This has been likely done to stress the high risks involved around this package and to put pressure on Greece. At Jan 30 summit there were no significant agreements on the issues at stake.

Evaluation

- The fact that an agreement has been reached is positive, as its successful completion would solve the Greek "issue" at least in the short term, providing some time to set up measures to stop an eventual contagion to other countries.
- However, the risks are varied:
  1. Elections in Greece in April brings out a parliament without majority (high)
  2. PSI participation (low, with CACs and probably a CDS swap default)
  3. Greece fails to take the agreed measures in the short-term (low)
  4. Some member states do not support the agreement (low)
  5. Greece does not fulfil the program targets in the next quarters (high)

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