Agreement on Greece: key points

- The second review of Greece's financing programme is about to conclude. The European Stability Mechanism (ESM) is preparing to pay out EUR 8.5 bn to the Greek authorities, after all parties agreed that they had completely fulfilled their side of the agreement.
- As to debt relief measures, the Europeans essentially held to the framework of the May 2016 agreement: measures will not be adopted until the financing programme ends in mid-2018, and the size of debt relief is still unknown. The Europeans spelled out the procedure as clearly as possible.
- The IMF signed on to this procedure, although without making any fundamental concessions. It will recommend a new funding arrangement for Greece, but the IMF will not make any pay outs until Greece and its creditors reach an agreement on debt relief.
- The Europeans acknowledge that the next step for Greece is to prepare to return to the financial markets.

A recovery slow in the making

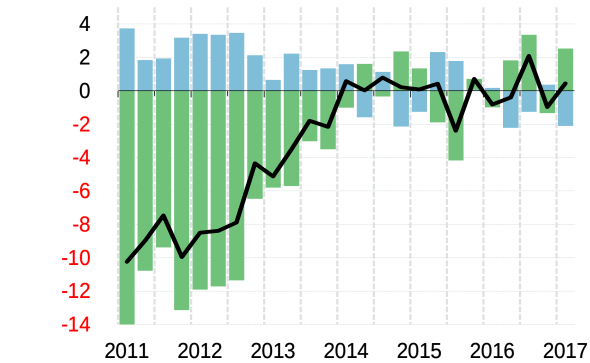

Chart Source: Eurostat

As usual, the eurozone finance ministers drew out the suspense until the very last moment before reaching an agreement with Greece and the IMF on 15 June 2017 that will conclude the second review of the current financing programme, which was initially scheduled to end in late 2016. The key points are highlighted below:

The horizon is clear in the short term

➢ **The Greek authorities have completely fulfilled their side of the bailout agreement.** Eurogroup members welcomed all of the measures taken by the Greek authorities in recent months to reach an agreement. All of the preconditions required by the Europeans and/or the IMF have been met, notably measures to strengthen Greece's fiscal position once the European financing programme ends (see Agreement in sight?[1]). Other measures aim to reduce the stock of non-performing loans in the banking system and to start up the Hellenic privatisation and investment fund.

➢ Under these conditions, **the European Stability Mechanism (ESM) is preparing to pay out the third tranche of the bailout of EUR 8.5 billion**. This is more than enough to cover the Greek government's upcoming debt repayments, including nearly EUR 7 billion to the ECB, the IMF and private investors. Excluding short-term financing, Greece will not have any other major repayment dates before July 2018, when it must reimburse about EUR 2 billion in securities held by the ECB[2]. This means there are unlikely to be any new tensions before the end of the current programme.

Doubts remain about debt sustainability in the longer term

➢ For months, the main point of disagreement between the Europeans and the IMF has been the medium-term strategy, and the sustainability of Greek public debt after the current financing programme ends. To this end, **the main innovation in yesterday's agreement concerns a French proposal to adopt a "growth adjustment mechanism"**. Under this mechanism, loans granted by the European Financial Stability Facility (EFSF) would be more or less automatically reprofiled based on the country's growth (bigger adjustments would be made if growth is weaker than expected). The EuroWorking Group, a Eurogroup task force, has been assigned to work on this subject. This measure would be no small matter if it helped

[1] Ecoweek of 14 April 2017

[2] Securities purchased by the ECB as part of the Securities Market Program (SMP) and that were excluded from debt restructuring in 2012.

keep the Europeans and Greeks from returning to the negotiating table too quickly after reaching a debt restructuring agreement.

➢ As for the rest, **the Europeans continue to act within the framework of the May 2016 agreement and press release** (which we described in detail in "Greece: missed opportunity"[3]). **Yet the press release is careful to describe in detail the future procedure,** including the conditions the Europeans would use to evaluate the sustainability of Greek debt, and the precise measures they are prepared to take in mid-2018, after the current programme ends.

➢ They set a target for **Greece to generate a primary surplus of 3.5% of GDP for at least 5 years, i.e. through 2022**, which is one of the scenarios adopted by the European Commission in its report on the programme's first review. There are no other official targets, but apparently a surplus equal to or slightly higher than 2% of GDP would suffice to meet the Europeans' criteria. Under these conditions, the Europeans continue to calculate the gross annual financing needs of the Greek state at less than 15% of GDP in the medium term, and 20% of GDP thereafter[4]. To cover this, they envision a series of measures already described in spring 2016, including handing over the profits of the ECB's Securities Markets Programme (SMP), the rescheduling of EFSF loans and the elimination of interest margins…

➢ **These restructuring measures will not be adopted before the current programme ends in mid-2018, and will be precisely calibrated at that time,** based on the debt assumptions and projections made in advance by the European institutions. Consequently, they cannot be quantified today.

Tentative agreement with the IMF

➢ Since the Europeans cannot do more in the short term (especially just a few months prior to German elections), **the IMF decided to give its stamp of approval to the agreement, although it did not make any fundamental concessions.** IMF staff will recommend that the Board of Directors adopt an "Agreement-in-Principle" to open a new arrangement with Greece, that will not result in any financial pay outs until Greece and the Europeans reach a debt restructuring agreement that satisfies the IMF. This arrangement probably will not be operational for a year. The IMF is apparently considering a very low amount (possibly about EUR 2 bn), and would take the form of a precautionary credit line, a drawing facility designed to help states who use it to maintain or, as is Greece's case, to return to the capital markets.

Several questions remain unanswered

➢ Will this agreement allow Greek public debt securities to be eligible for the ECB's securities purchasing programme (QE), as the Greek authorities strongly hope? Nothing could be less certain, especially since it provides very few elements that the ECB could use to determine the sustainability of public debt[5].

➢ Even so, the Eurogroup acknowledged that the next step for Greece would be to prepare to return to the capital markets, and it pledged to support this effort. The programme's next pay outs should take into account this goal, and enable the country to build a liquidity buffer.

➢ Unfortunately, postponing a veritable debt relief agreement is clearly hampering this goal, not only because it maintains uncertainty over the Greek government's future financing needs, but also because it shows that the Europeans and the IMF still have not reached a consensus on a common medium to long term economic and fiscal scenario for Greece, which potential investors could rely on making decisions.

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[3] Conjoncture of July-August 2016, BNP Paribas. Part three describes the agreement and the respective debt sustainability analyses by the IMF and the European Commission.

[4] Greece's financing needs will increase in the very long term, as current European financing, which is not very costly, is steadily replaced with market financing. This is why the IMF considers that without major debt restructuring, Greek debt would return to an almost uncontrollable upward trajectory by about 2030. This is also why the Europeans insist that in addition to the debt relief agreement promised for mid-2018, they would be prepared to consider further measures under an unfavourable scenario.

[5] The ECB, like the IMF, but in a parallel and totally independent manner, let it be known that for Greek government securities to be eligible for its Public Securities Purchasing Program (PSPP), it would first have to be in a position to analyse the sustainability of Greek public debt in a favourable manner.

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