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Brief Thoughts on Debt Proposal for Greece

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The EU and private sector offering for Greece will likely fall short of providing requisite relief and lifting pressures on neighboring nations. Our recent piece “Solving the Greek Crisis” was designed to identify specific steps to solve the Greek crisis as well as provide a path toward regional stability.¹ In this piece we re-examine these thoughts within the context of the recent proposal.

The present program falls short, due to:

- The debt relief offered by the private sector is only 21%. This is on the low end of the 20% to 40% reduction we previously identified as requisite for success. In order for relief on the lower end of the spectrum to spark success, a more active reform and privatization program by the Greek authorities should be put into action.
- The program envisions that 90% of private sector institutions with Greek exposure will participate in the proposed plan. This will likely prove a bit of a stretch, as many of the largest banks in the world with Greek exposure have yet to support the private sector offer.² Additionally, a portion of the bank debt was likely already sold into the secondary market to participants less willing to voluntarily restructure claims.
- The program contemplates the purchase of 30-year zero coupon bonds to collateralize restructured bonds. This approach mimics a scheme used in many Brady Plan debt restructuring agreements. Unfortunately, the cost of purchasing zero-coupon bonds today is substantially higher, due to low global interest rates. In other words, the cost of securitizing a bond 30 years into the future increases, as interest rates fall. Today, the cost of purchasing a 30-year EU zero-coupon bond is roughly 35 cents for every EUR. In contrast, the price of collateral during the Brady days was a relatively scant 7 to 9.5 cents. Likewise, resources spent on the purchase of collateral divert funds from addressing Greece’s overall financing need.
- The plan contemplates a EUR20.6 billion loss for European banks. This is slightly low based on our original estimate of a EUR23.2 to EUR46.4 billion loss depending on the extent of debt reduction.

In sum, the program represents a step in the right direction. The private sector under the leadership of the Institute of International Finance and public sector efforts seem to be responding to the market pressures. Nonetheless, a deeper approach will prove requisite for restoring growth in Greece and thwarting the risk of contagion.

¹ Goodman, Lawrence, “Solving the Greek Crisis” – Center for Financial Stability, Inc., June 24, 2011.

² See “Financial Institutions in Support” in [Greece Financing Offer](#) – Institute of International Finance, July 21, 2011



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