



Re-Define Initial Commentary on the outcome of the Euro Area Leader's Summit

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We reaffirm our commitment to the euro and to do whatever is needed to ensure the financial stability of the euro area as a whole and its Member States. We also reaffirm our determination to reinforce convergence, competitiveness and governance in the euro area. Since the beginning of the sovereign debt crisis, important measures have been taken to stabilize the euro area, reform the rules and develop new stabilization tools. The recovery in the euro area is well on track and the euro is based on sound economic fundamentals. But the challenges at hand have shown the need for more far reaching measures.

The recovery in the Euro area is not well on track and in fact remains very fragile with some possibility of a double dip. Moreover, our banking system remains weak both in terms of structural maturity mis-matches in funding and capital adequacy.

We may have better economic fundamentals than some other economies at an aggregate level but our decision making has been exposed as being far too slow and has seriously dented our credibility.

Today, we agreed on the following measures:

Greece:

1. We welcome the measures undertaken by the Greek government to stabilize public finances and reform the economy as well as the new package of measures including privatisation recently adopted by the Greek Parliament. These are unprecedented, but necessary, efforts to bring the Greek economy back on a sustainable growth path. We are conscious of the efforts that the adjustment measures entail for the Greek citizens, and are convinced that these sacrifices are indispensable for economic recovery and will contribute to the future stability and welfare of the country.

2. We agree to support a new programme for Greece and, together with the IMF and the voluntary contribution of the private sector, to fully cover the financing gap. The total official financing will amount to an estimated 109 billion euro. This programme will be designed, notably through lower interest rates and extended maturities, to decisively improve the debt sustainability and refinancing profile of Greece. We call on the IMF to continue to contribute to the financing of the new Greek programme. We intend to use the EFSF as the financing vehicle for the next disbursement. We will monitor very closely the strict implementation of the programme based on the regular assessment by the Commission in liaison with the ECB and the IMF.

The program size at Euro 109 billion plus Euro 37 billion of private sector involvement (see below) is a bit larger than expected, which is good news as it builds in a bit of safety margin. The move to the EFSF was expected and will simplify matters a bit and make the Greek package consistent with the ones in Portugal and Ireland.

There is a focus on interest rate reduction and on maturity extension. There is no mention of haircuts or debt reduction so it is unlikely that the outstanding stock of Greek debt will be reduced by much, if anything.

3. We have decided to lengthen the maturity of future EFSF loans to Greece to the maximum extent possible from the current 7.5 years to a minimum of 15 years and up to 30 years with a grace period of 10 years. In this context, we will ensure adequate post programme monitoring.

We will provide EFSF loans at lending rates equivalent to those of the Balance of Payments facility (currently approx. 3.5%), close to, without going below the EFSF funding cost. We also decided to extend substantially the maturities of the existing Greek facility. This will be accompanied by a mechanism which ensures appropriate incentives to implement the programme.

The reduction in EFSF interest rates is much overdue but by itself will do little for increasing the sustainability of Greek debt. The extension of maturity is also useful, especially if it does go out to 30 years but marginal in terms of its improvement of debt sustainability. Greek problems continue to be treated as problems of liquidity when the fundamental issue is one of solvency.

4. We call for a comprehensive strategy for growth and investment in Greece. We welcome the Commission's decision to create a Task Force which will work with the Greek authorities to target the structural funds on competitiveness and growth, job creation and training. We will mobilise EU funds and institutions such as the EIB towards this goal and relaunch the Greek economy. Member States and the Commission will immediately mobilize all resources necessary in order to provide exceptional technical assistance to help Greece implement its reforms. The Commission will report on progress in this respect in October.

It is good that they at least mentioned the need for growth and investment. The absence of any reference to relaxing the co-investment requirements for structural funds that is a big obstacle to their utilization at this point is very disappointing. This is no Marshall Plan, just empty words for now, although the mention of the EIB is encouraging even though it is likely to provide mostly loans.

The technical assistance program is necessary but the announcement is not new. Plus, Greece may benefit more from technical assistance from the World Bank for state building than just by having other European Officials come in.

5. The financial sector has indicated its willingness to support Greece on a voluntary basis through a menu of options further strengthening overall sustainability. The net contribution of the private sector is estimated at 37 billion euro. Credit enhancement will be provided to underpin the quality of collateral so as to allow its continued use for access to Euro system liquidity operations by Greek banks. We will provide adequate resources to recapitalise Greek banks if needed.

Footnote: Taking into account the cost of credit enhancement for the period 2011-2014. In addition, a debt buy-back programme will contribute to 12.6 billion euro, bringing the total to 50 billion euro. For the period 2011-2019, the total net contribution of the private sector involvement is estimated at 106 billion euro.

This section is highly misleading and confusing, and very vague, perhaps deliberately so. It is hard to see what the 'net contribution' of Euro 37 billion actually means. Will payment be delayed on this Euro 37 billion of bonds? Most likely this is all it means. Will there be Euro 37 billion of losses absorbed by the private sector? Almost certainly not! Could it refer to a calculated version of a reduction in Net Present Value, I don't think so.

So this Euro 37 billion and the bigger Euro 106 referenced in the footnote refer to the total of Greek bonds in private hands that will be modified in some way or another 1) through an extension of maturity in a bond swap 2) through an agreement to roll them over and 3) through a buy back that is put at Euro 12.6 billion of the total. So, it's a bit like adding apples and oranges as we had rightly predicted the appearance of private sector involvement was always going to be much more important than the fact.

The impact of this Private Sector Involvement on the sustainability of Greek debt can only be known when the details are decided, which we believe will take some time and will almost surely disappoint heavily. So don't hold your breath. It will be a mix of maturity extension, possibly with some reduction in interest rates

and a very small amount of debt stock reduction of less than Euro 10 billion out of a total of more than Euro 350 billion of outstanding debt.

There will be an effort to sell Net Present Value Reductions, but at negative and low levels of growth that Greece is expected to continue to see, an NPV reduction when interest coupons are close to 4% and growth rates below that will not result in any significant increase in debt sustainability. Greek debt continues to be unsustainable, private sector involvement or not.

The reference to 'voluntary' private sector involvement means that there is no chance that the PSI will be substantial in terms of real burden sharing. Nor will it be able to reduce Greek debt stock by much.

And giving credit enhancements for what is likely to be only a minimal degree of sacrifices by private bondholders will come either at the cost of EU tax payers or by undermining Greek debt sustainability so making the whole exercise almost utterly pointless. The devil once again lies in the detail of whether the credit enhancements are simply to allow the ECB to continue to accept the bonds as collateral or whether they are meant as a carrot to encourage bondholders to exchange their debts. These might as well require similar levels of credit enhancements implying a like-for like swap to say the new bonds are different from, but equally attractive as the old bonds.

Private sector involvement:

6. As far as our general approach to private sector involvement in the euro area is concerned, we would like to make it clear that Greece requires an exceptional and unique solution.

It's a useful statement to reinforce that there is a buffer between Greece, where the situation is really bad and other states such as Portugal and Ireland where it is merely bad. This can help minimize the possibility of contagion to Ireland and Portugal.

7. All other euro countries solemnly reaffirm their inflexible determination to honour fully their own individual sovereign signature and all their commitments to sustainable fiscal conditions and structural reforms. The euro area Heads of State or Government fully support this determination as the credibility of all their sovereign signatures is a decisive element for ensuring financial stability in the euro area as a whole.

This does not mean anything.

Stabilization tools:

8. To improve the effectiveness of the EFSF and of the ESM and address contagion, we agree to increase their flexibility linked to appropriate conditionality, allowing them to:

- act on the basis of a precautionary programme;
- finance recapitalisation of financial institutions through loans to governments including in non-programme countries;
- intervene in the secondary markets on the basis of an ECB analysis recognizing the existence of exceptional financial market circumstances and risks to financial stability and on the basis of a decision by mutual agreement of the EFSF/ESM Member States, to avoid contagion.

We will initiate the necessary procedures for the implementation of these decisions as soon as possible.

Phew, finally. From the outset, we have been strong proponents of allowing both the EFSF and the ESM to give guarantees, provide precautionary credit lines, buy sovereign debt in the secondary market and recapitalize banks all with low and proportionate conditionality. This only goes half the way. It will first need to be approved by national parliaments; it does not allow the EFSF to issue guarantees, allows secondary market purchases only under exceptional circumstances and does little to make conditionality proportional. And it says nothing about whether these will be extended to the ESM, an essential step in our view.

9. Where appropriate, a collateral arrangement will be put in place so as to cover the risk arising to euro area Member States from their guarantees to the EFSF.

This is a sop to Finland and maybe the Netherlands but with little overall impact on the nature of the deal.

Fiscal consolidation and growth in the euro area:

10. We are determined to continue to provide support to countries under programmes until they have regained market access, provided they successfully implement those programmes. We welcome Ireland and Portugal's resolve to strictly implement their programmes and reiterate our strong commitment to the success of these programmes. The EFSF lending rates and maturities we agreed upon for Greece will be applied also for Portugal and Ireland. In this context, we note Ireland's willingness to participate constructively in the discussions on the Common Consolidated Corporate Tax Base draft directive (CCCTB) and in the structured discussions on tax policy issues in the framework of the Euro+ Pact framework.

Good that they are finally making long overdue concessions on the EFSF lending to Ireland and Portugal. Also good that Ireland may be willing to engage constructively in the CCTB discussions.

11. All euro area Member States will adhere strictly to the agreed fiscal targets, improve competitiveness and address macro-economic imbalances. Public deficits in all countries except those under a programme will be brought below 3% by 2013 at the latest. In this context, we welcome the budgetary package recently presented by the Italian government which will enable it to bring the deficit below 3% in 2012 and to achieve balance budget in 2014. We also welcome the ambitious reforms undertaken by Spain in the fiscal, financial and structural area. As a follow up to the results of bank stress tests, Member States will provide backstops to banks as appropriate.

Nothing of substance here, just some more words we have already heard.

12. We will implement the recommendations adopted in June for reforms that will enhance our growth. We invite the Commission and the EIB to enhance the synergies between loan programmes and EU funds in all countries under EU/IMF assistance. We support all efforts to improve their capacity to absorb EU funds in order to stimulate growth and employment, including through a temporary increase in co-financing rates.

There is another reference to growth and this time also to employment which is good if they will actually do something about this. The references to improving the capacity to absorb structural funds and more coherence with loan programs are also good and new. The reference to an increase in co-financing rates is encouraging and may help release additional funds to Greece, which has no money to match the EU's contribution of structural funds.

Economic governance:

13. We call for the rapid finalization of the legislative package on the strengthening of the Stability and Growth Pact and the new macro-economic surveillance. Euro area members will fully support the Polish Presidency in order to reach agreement with the European Parliament on voting rules in the preventive arm of the Pact.

14. We commit to introduce by the end of 2012 national fiscal frameworks as foreseen in the fiscal frameworks directive.

15. We agree that reliance on external credit ratings in the EU regulatory framework should be reduced, taking into account the Commission's recent proposals in that direction, and we look forward to the Commission proposals on credit ratings agencies.

16. We invite the President of the European Council, in close consultation with the President of the Commission and the President of the Euro group, to make concrete proposals by October on how to improve working methods and enhance crisis management in the euro area.

Nothing new here except some mild references to reducing the role of credit rating agencies.