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Jitters grow as Greece primes itself for debt test

LONDON

Investors' worries mount over ability of Athens to put its house in order

BY LANDON THOMAS JR.

As Greece gears up for perhaps its most critical bond issue ever, investors are growing increasingly concerned about the government's ability to raise cash and reassure a skeptical market about its plans to restructure the economy and curb public spending.

For weeks now the government has been sounding out investors about plans to raise about €3 billion, or $4 billion, through an issue of 10-year bonds. Analysts and bankers are expecting the issue to come sometime next week, after the government announces a new raft of fiscal changes.

But with the feel-good effect of the European Union's public backing of Greece this month wearing off — and worries about the health of Greek banks and the country's credit rating spreading — it now seems apparent that investors will demand a high return for the risk of assuming Greek debt.

Investors say that under the current circumstances, any Greek bond issue would need to carry an interest rate of around 7 percent to be successful. That is almost a percentage point more than the rate investors received in the previous Greek bond sale, in January, and a full 3 percentage points more than Greece's borrowing cost before the current crisis.

That Greece may have to raise funds at such a high premium — comparable German bonds, the European benchmark for safety, currently pay 3.1 percent — underscores the severity of the crisis.

The wide differential, or spread, also indicates investor skepticism about the Greek government's ability to meet E.U. demands to lower its budget deficit from 12.7 percent of gross domestic product to under 9 percent this year.

"Even if they bring the deficit to zero, with interest rates at 6.5 percent and a growth rate of zero at best, Greece's debt ratio remains on an explosive path," said Miranda Xafa, a former executive board member at the International Monetary Fund.

"I just don't think they can raise funds from the market now," she said. "They need to borrow at lower rates."

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Concerns about Greece sent the euro lower against the dollar Thursday. In late European trading it was down 0.1 percent at $1.3529.

Also on Thursday, the chairman of the U.S. Federal Reserve, Ben S. Bernanke, said the Fed would be examining the controversial credit default swaps that Greece arranged with Goldman Sachs to lower the apparent size of its debt.

Adding to investor anxiety was the prospect of another round of rating downgrades for Greek debt.

On Wednesday, Standard & Poor's surprised the market by warning of a possible double-notch downgrade in Greece's debt rating, to BBB-minus from BBB-plus. The rating agency cited the risk that any fiscal retrenchment would sharply reduce Greece's prospects for economic growth — confirmation of a widely held view that the government's forecast of 0.3 percent economic growth for 2010 is too optimistic.

The threat of ratings reversals, a downgrade of Greek banks by Fitch, and strikes that shut down most of Athens on Wednesday have precipitated another spike in the price of Greek credit default swaps, which investors buy as insurance against default. Investors are now demanding a risk premium of 392 basis points, the most in two weeks. That means someone who holds Greek debt would have to pay $392,000 to insure $10 million in debt against default for a year.

One sign of Greece's diminished fund-raising expectations has been the quiet postponement of a widely advertised visit to the United States and Asia to interest new investors in Greek debt.

Because of lack of demand, "that trip is no longer in the cards," said an investment banker who was briefed on the government's fund-raising strategy. He declined to be identified because he was involved in the financing.

A spokeswoman for the Greek Finance Ministry did not respond to a request for a comment.

The rise in investor skepticism has led Greece to adopt a new financing strategy. Instead of selling debt through public auctions, where the danger of a failed offering could further unnerve markets, it has gone directly to institutional investors, sounding them out in one-on-one meetings, mostly in London.

But as for the timing and details of the sales, the Finance Ministry has been careful not to show its hand. Large investors and banks in Athens and London that would ordinarily be the main market for Greek debt remain mostly in the dark about the specifics of the fund-raising.

"I have heard nothing," said Anthimos Thomopoulos, the chief financial officer of the largest Greek bank, National Bank of Greece.

Bankers and analysts in Athens say there is a debate within the Finance Ministry as to whether the government should go to the market now, or wait until a new menu of changes — like more taxes and further public sector wage cuts — is announced, in the hope that such measures would result in lower financing costs.

But a more dire view is already taking hold, according to some bankers: Investors are looking less to what changes the government announces than to what shape a bailout will take.

REUTERS

An anti-government march took place Wednesday in Athens to protest proposed cuts as the government tries to mend its finances.

Greece has €20 billion of debt coming due in April and May, and €53 billion for all of the year. It seems unlikely that such a quantity can be raised from investors — many of which are conservative pension funds and insurance companies that are already nursing losses from an €8 billion bond issue in January that has been hit by the recent market downturn.

An I.M.F. staff member is already in Athens — the second trip there since the beginning of the year — along with officials from the European Commission. Olli Rehn, the economic and monetary affairs commissioner of the European Union, will visit Athens on Monday.

So far, the European Union has remained steadfast, publicly, in saying that Greece will put its own house in order. But the I.M.F.'s increasing role — together with the possibility that Greece may need the type of immediate financial lifeline that the European Union may not be able to provide — is increasing the odds of some form of official I.M.F. participation.

"Europe needs to swallow its pride and admit that it has neither the funds nor the expertise to deal with this," said Ms. Xafa, the former I.M.F. board member.