Bond sale lifts pressure on Greece, now

FRANKFURT

BY JACK EWING AND DAVID JOLLY

Greece easily sold short-term bonds Tuesday as investors reacted enthusiastically to a pledge by European Union leaders two days earlier to stand behind the country's debt.

But as investors snapped up €1.56 billion, or $2.12 billion, in high-yield debt that effectively carries an E.U. guarantee, economists warned that Greece still faced immense long-term economic and fiscal problems.

In the worst case, Greece could still default, analysts said. More likely, in coming years it will require serial bailouts by its euro-zone partners.

"Even under relatively conservative assumptions the Greek debt situation is unsustainable," said Erik F. Nielsen, the chief European economist at Goldman Sachs in London and a former official at the International Monetary Fund. "Something has to give."

Left to fend for itself, Greece would probably run out of money and default, analysts say. But other European countries are likely to conclude, however reluctantly, that continuing to support Greece is less costly than letting the country go under.

"Greece is too small to fail," said Stuart Green, economist at HSBC Bank in London. "The policy of E.U. leaders is to nip the problem in the bud with Greece before it becomes more expansive."

Investors bid €3.9 billion Tuesday for the €600 million of 52-week Treasury bills, the Greek Public Debt Management Agency said, meaning the offer was oversubscribed by 6.54 times. An auction of 26-week bills, also seeking €600 million, drew bids totaling €4.6 billion, for an oversubscription ratio of 7.67. The high demand allowed Greece to sell €780 million of bills in each auction.

The successful bond sale seemed to validate the decision by E.U. governments Sunday to provide €30 billion in

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loans if Greece was unable to raise money at a reasonable cost. The International Monetary Fund is expected to provide another €15 billion in aid.

The demand for Greek debt Tuesday also seemed to indicate that Athens would not need to ask for the help right away. "We can turn our attention with greater calm to domestic challenges and promote the necessary changes," Prime Minister George A. Papandreou said, according to Reuters.

However, the rates paid by the government — 4.85 percent for the 52-week bills and 4.55 percent for the 26-week bills — were more than double what Greece paid on Jan. 12 for similar maturities.

In addition, yields on bonds with maturities of two or more years were still at least 6 percent in Tuesday trading, meaning the government will have to pay a high price as it seeks to refinance another €40 billion of debt this year.

"There seems a strong chance that the government will eventually be forced to seek funds from the rest of the euro zone," Ben May, an economist at Capital Economics in London, wrote in a note.

And probably not just once. The need to refinance debt is only the most immediate of Greece's problems.

The aid package "is huge and it will last for this year," said Hans-Werner Sinn, president of the Ifo Institute, an economic research concern in Munich. But Mr. Sinn noted that the aid did not address other problems, like the gigantic Greek trade deficit, equivalent to 16 percent of gross domestic product. "I have no idea how this could be financed in the medium run," Mr. Sinn said.

The Greek government has based its plans to shrink the budget deficit, which is nearly 13 percent of G.D.P., on a modest economic downturn of 0.3 percent this year. The government expects growth to resume in 2011.

But economists at UBS, the Swiss bank, warn that those assumptions could be way too optimistic. UBS forecast a plunge in G.D.P. of 5 percent this year and next as cuts in public-sector wages and other austerity measures feed through into the broader economy.

If so, Greece could become caught in a vicious circle where declining output undercuts attempts to reduce the ratio of borrowing to G.D.P. The debt burden would increase at the same time the government's ability to pay was declining.

"In that case the situation is on an exploding path," Stéphane Deo, economist at UBS, said in a note last week.

Stocks fell in Greece after the auction but elsewhere were little changed. In Athens, the Athex composite index dropped 2.21 percent to close at 2,015.56 points. The euro ticked down to $1.3579 from $1.3592 late Monday in New York. The yield on Greece's benchmark 10-year government bond rose 16-hundredths of a point, to 6.8 percent.

The Euro Stoxx 50 index, a barometer for blue-chip shares in the euro zone, slipped 0.47 percent to close at 2,988.24. In London, the FTSE 100 slid 0.28 percent to 5,761.66. In Paris, the CAC 40 declined 0.46 percent to 4,031.99. In Frankfurt, the DAX closed at 6,230.83, off 0.32 percent.

On Wall Street, the Dow Jones industrial average was flat in midafternoon trading, at 11,006.42. The Standard & Poor's 500-stock index was down 0.16 percent at 1,194.60. The Nasdaq composite index was up just 0.4 percent at 2,458.96.

David Jolly reported from Paris.

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