66 26/4/2011

Lessons for Greece in earlier crises

Inside the Markets

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REUTERS

LONDON As speculation about a Greek restructuring intensifies, investors could do worse than to look at how emerging economies have faced down debt crises.

With €300 billion, or $428.3 billion, in outstanding public debt, a Greek workout would be unprecedented. Past credit crises suggest that restructuring, in tandem with a sufficiently rigorous fiscal overhaul, could draw a decisive line under Greece's economic troubles.

Still, successful emerging-market restructurings may not be easily replicated in Greece.

"One lesson from emerging markets is that if debt restructuring is unavoidable, it's better to do it sooner than later," said Athanasios Vamvakidis, the European head of G-10 FX strategy at Bank of America Merrill Lynch. "But in the case of significant contagion risks and large contingent liabilities from the financial sector, it may be better to wait."

A year after securing a €110 billion bailout from the International Monetary Fund and its European partners, Greece is missing fiscal targets set for its rescue. Many investors think Greece should seek to renegotiate debt, which is expected to hit 160 percent of gross domestic product next year.

A wide-ranging voluntary restructuring program like the Brady Plan could ostensibly be a template for a solution for Greece and other indebted euro zone members like Portugal.

Started in 1989 to help mostly Latin American countries break from a circle of crippling debt costs and severe contraction, the Brady Plan allowed creditors to swap defaulted bank loans for a choice of new bonds, usually collateralized by U.S. Treasury bonds.

With Greece, the European Union could offer to swap sovereign bonds for new debt issued by its collective bailout vehicle, the European Financial Stability Fund or, from mid-2013, the European Stability Mechanism.

Even if the terms entice enough creditors, the restructuring may not be sufficient to help drive a Greek recovery. More than half the 17 debtor countries that took part in the Brady program between 1989 and 1997 are now investment grade, but most of those are major commodity exporters that took at least a decade to attain that credit status.

Greece's diverse investor base is another hurdle.

"Greek debt is spread amongst a high number of investors, compared with emerging markets, where you could negotiate with the largest holders," said Kommer van Trigt, a portfolio manager at the Dutch firm Robeco.

The presence of the European Union as a backstop offers creditors little incentive to take part in a restructuring.

"An incentive to take part in the Brady Plan was that it regularized payments on debt that many developing economies had simply stopped servicing," said Phil Poole, HSBC Global Asset Management's global head of macro and investment strategy.

Should enough creditors be persuaded to take part in a restructuring, the European Union would also have to avoid fanning market fears over debt issued by peripheral euro zone countries.

Emerging markets have long labored under the shadow of contagion risk: Mexico's declaration in 1982 that it could no longer service its foreign loans set off a wider debt crisis for Latin America, while the collapse of the Thai baht in 1997 sent Asia into a tailspin.

But the size of Greek debt, together with the country's inclusion in the euro zone imply that contagion from a Greek credit event would surpass anything previously seen.

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Any restructuring that includes a "haircut" or forced losses on the principal would hit bondholders that include European banks and pension funds, as well as the European Central Bank. Euro zone banks hold about €154 billion in Greek debt, according to data from Bank for International Settlements.

If restructuring is initiated, the European Union would have to provide some form of guarantee on euro zone bank deposits to prevent the run on banks seen in Argentina in 2001, when its attempt to exchange distressed debt ended in the largest sovereign default, at more than $90 billion.

Even if policy makers are willing to pay the price, Greece's inclusion in the single currency could mean that a debt workout would not have the same effect on growth as it has for emerging economies.

"In emerging economies, restructuring took place with exchange rate collapse and this helped the countries regain competitiveness. Devaluation is not an option for Greece," said Mr. Vamvakidis, who worked at the I.M.F. from 1997 to 2010.

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