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Greek bail-out: drowning not waving

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The nail-biting is so familiar. For days, markets have fixated on political posturing in Athens, weighing up whether Greece will agree to sufficient additional austerity to allow its lenders to advance a second rescue package. Now, the odds seem to be rising, helping the euro gain ground against the dollar. In particular, unconfirmed suggestions that €60bn-ish of Greek bonds held by the European Central Bank could be swapped with the European Financial Stability Fund (which would then lend Greece additional funds to repurchase them) have encouraged optimism. The mechanics may look complex, but a swap arrangement could improve the chances that an accompanying "voluntary" debt restructuring (or PSI deal) between Greece and its private sector creditors will proceed. The ECB, which bought the bonds at a discount, had been insisting on repayment in full.

But even if these deals are done, investors should brace for an equally familiar fallout. First, there will be relief that messy default has been avoided and, secondly, realisation that little has been solved. Short-term, markets will fret about the extent of voluntary participation in the debt restructuring, and whether holdout bondholders can be corralled. Longer-term, Greece may benefit little. Its debt dynamics will remain horrible: the agreed aim of the PSI deal is to push debt to gross domestic product down to 120 per cent by 2020, from about 160 per cent at present (compared with 82 per cent for European Union overall).

More fundamentally, the economy is now expected to shrink about 3 per cent this year, after contracting 6 per cent in 2011. But the fiscal deficit last year was around 9 per cent, well above lenders' 7.5 per cent target. So even if extra austerity is agreed, worries about slippage will remain. The politics won't go away, either: national elections are due in April.

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