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For creditors of Greece, how little is too little?

LONDON

Private investors appear resigned to accepting losses of nearly 70%

BY LANDON THOMAS JR.

When the Greek government presents a final debt-relief proposal to its private-sector bondholders within the next week, it could mark not just the end of a torturous seven-month process between Athens and its creditors. It could also be the beginning of one of the largest debt restructurings in history.

Europe's leaders are hoping it will also be the last one — at least in their part of the world.

Euro zone finance ministers turned up the pressure on Greece to keep its budgetary promises, canceling a planned meeting in Brussels on Wednesday and deciding instead to convene by teleconference.

Jean-Claude Juncker of Luxembourg, who chairs the Eurogroup of euro zone finance ministers, said Tuesday that the format for the conference had been changed because he was still waiting to receive assurances from Greek political leaders on the implementation of budget cuts and other measures, and that other technical work remained to be done before the next bailout could be released.

European officials are intent on making Greece be seen as a special case, to assure global investors and lenders that other weak economies in the euro currency union will not eventually need their own debt write-downs. Otherwise, officials worry that a fear of other debt renegotiations will prolong the sense of

JULIEN WARNAND/EPA

Jean-Claude Juncker said European leaders sought assurances of Greek budget cuts.

uncertainty and crisis that has plagued the euro zone financial system for nearly three years.

If a majority of the Greek government's private creditors accept the deal, €100 billion, or $131 billion, of debt will be struck from Athens's pile of I.O.U.'s, which now total more than one and a half times the size of the Greek economy.

But if a large enough faction spurns the offer, a debt swap that would result in a nearly 70 percent loss for investors, the deal will fall apart. That would jeopardize the €130 billion bailout Athens hopes to receive from the so-called troika of in-

GREECE, PAGE 18

IN PORTUGAL, A WARNING FOR GREECE
Portugal is a debtor nation that has done everything asked of it to get a bailout, and yet it is still sinking in debt. *PAGE 16*

Pressure builds for Greek debt deal

GREECE, FROM PAGE 1

ternational lenders — the European Union, the European Central Bank and the International Monetary Fund.

And it would raise the prospect of default by Greece and its potential exit from the euro union, a departure whose regional consequences are hard to predict.

Also under discussion is how the European Central Bank plans to handle its holdings of €55 billion in Greek bonds. The working assumption is that the E.C.B., or possibly individual national central banks within the euro zone, might contribute to Greece's debt relief by exchanging their current Greek bonds for new ones, at cost. Under that swap, the central bank or banks would forgo profits on those bonds, but would not absorb any actual losses.

Complicating all this is the latest grim news on the Greek economy, which plunged 7 percent in the fourth quarter according to data released Tuesday. As a result, the Greek economy shrank 6.8 percent for 2011 as a whole, worse than the government's previous estimate of 6 percent.

The new figures are the latest sign that Greece may not be able to grow at a fast enough clip to pay down its debt, raising fears that even the latest terms won from investors will not be sufficient for its long-term recovery.

The final offer to Greek's private creditors is expected to be a swap for bonds that have an interest rate of around 3.5 percent — down from the 4 percent or higher rate that investors originally demanded. And those bonds are expected to carry a "cash component" that actually would no longer be pure cash but, instead, less attractive short-term bonds issued by Europe's bailout fund.

Through gritted teeth, most private creditors have said they are inclined to accept the offer. They have little choice. Greece's threat to attach so-called collective action clauses to the bonds they currently hold would force all investors to take a loss. And the holdouts on the deal would be stuck with nearly worthless bonds that offered no protection if Greece eventually needed to restructure its debt yet again.

"I think if there are no more changes, 75 to 80 percent of investors will participate," said Hans Humes of Greylock Capital in New York, who is a member of the steering committee of the Institute of International Finance, the banking group that is representing bondholders in the talks.

But Mr. Humes warned that the number of potential holdouts had increased in the past weeks, a response to the seeming take-it-or-leave-it attitude of the European leaders involved in the negotiations.

And he noted that he had been receiving calls from lawyers and bankers urging him to move from the conciliatory camp to the refusenik group, and fight

ARIS MESSINIS/AGENCE FRANCE-P

Prime Minister Lucas Papademos, right, arriving at a cabinet meeting in Athens on Tuesday. Investors must take a loss, but Greece is hoping not to alienate them entirely

the matter out in court. He said he had declined those entreaties, on the grounds that such a strategy would be fruitless. But others, he said, might still be open to a legal fight.

"If you go too far on the coupon and fiddle too much with the cash component, it just won't work," he said. "The discontent on our side is growing."

Assessing the size of the holdout camp is difficult, but analysts estimate that the number represents about €28 billion of the €207 billion in question — a figure that does not include the E.C.B.'s €50 billion position.

"I think if there are no more changes, 75 to 80 percent of investors will participate."

In this camp are holders of bonds set to mature on March 20. They are betting that Europe will not let Greece default, and that by keeping their current bonds they will be paid 100 cents on the euro.

Some of this group of investors includes those who own Greek credit-default swaps — insurance-like derivatives that pay off if Greece defaults. As the possibility has increased that a Greek deal will not trigger these default swaps, those investors have been loading up on the March bonds in the hope that Europe blinks and cuts Greece a check.

While Greece is likely to deploy maximum leverage in dealing with the holdouts, analysts maintain that it is in the country's interest not to alienate those investors.

"Greece has a strong interest in avoiding a large group of holdouts," said Jeromin Zettelmeyer, an economist at the European Bank for Reconstruction and Development and an expert on sovereign debt restructuring.

After all, the 70 percent haircut, or loss, will be one of the highest ever imposed on investors. It would trail only Argentina's in 2005 (76.8 percent) and, more recently, Iraq (89.4 percent) — not the kind of company a modern European country hopes to keep if it ever intends to return to the bond markets.

For that reason, Mr. Zettelmeyer said, Greece may well make a better offer to investors holding the March bonds. Those now trade at around 40 cents on the euro, twice the price of Greece's longer-term securities. Investors say that is one reason that the March bonds are trading at a premium, as word seeps into the market that those securities might receive special treatment. Whether that special break might mean more cash, or less of a haircut, will not be known until the offer letters are sent out.

What is clear is that the pressure is building for Greece to secure a deal that reduces its debt while keeping it from becoming a financial pariah. What is not clear is whether those outcomes will, in the end, prove mutually exclusive.

iness WITH REUTERS

A warning for Greece in Portugal's debt paradox

LISBON

A shrinking economy leaves Lisbon falling behind, even after bailout

BY LANDON THOMAS JR.

FRANCISCO SECO/THE ASSOCIATED PRESS

A demonstration in Lisbon against austerity measures. "Portugal's debt is just not sustainable," said David Bencek, an analyst at the Kiel Institute for the World Economy.

As a debt-plagued Greece struggles to meet Europe's strict terms for receiving its next round of bailout money, the lesson of Portugal might bear watching.

Unlike Greece, Portugal is a debtor nation that has done everything that the European Union and the International Monetary Fund have asked it to, in exchange for the bailout of €78 billion, or $116 billion at the time, that Lisbon received last May.

And yet, by the broadest measure of a country's ability to repay its debts, Portugal is going deeper into the hole.

The ratio of Portugal's debt to its overall economy, or gross domestic product, was 107 percent when it received the bailout. But the ratio has grown since then, and it is expected to reach 118 percent by next year.

That is not necessarily because Portugal's overall debt is growing, but because its economy is shrinking. And economists say the same vicious circle could be taking hold elsewhere in Europe.

Two other closely watched European countries on the debt list, Spain and Italy, now also have rising debt-to-G.D.P. ratios — even though they, like Portugal, have adopted the budget-cutting and tax-raising measures that European officials and the I.M.F. continue to prescribe.

Without economic growth, reducing debt levels becomes nearly impossible. It is akin to trying to pay down a large credit card balance after taking a pay cut. You can cut expenses, but with lower earnings, it is hard to set aside money to pay off debt.

Vitor Gaspar, the Portuguese finance minister who came to power as part of a new government last summer, is highly regarded by European economic and finance officials. He has reduced the government's budget deficit by more than one-third so far, through tough measures that include cuts in spending and wages, pension rollbacks and tax increases.

But many economists say those actions are also a reason the Portuguese economy shrank 1.5 percent in 2011 and is expected to contract 3 percent this year.

"Portugal's debt is just not sustainable," said David Bencek, an analyst at the Kiel Institute for the World Economy, a research organization in Germany. "The real economy does not have the structure to grow in the future and thus will not be able to pay back its debt in the long run."

The Portuguese public has so far generally gone along with the government's policies without the violent demonstrations that have rocked Greece, but it is starting to lose patience.

On Saturday, more than 100,000 people assembled peacefully in Palace Square in Lisbon to rally against the austerity measures and the country's 13 percent unemployment rate, while chanting, "I.M.F. doesn't call the shots here!" The head of the largest Portuguese labor union vowed to hold additional protest rallies around the country.

The I.M.F., for its part, predicts that rtugal will eventually grow enough to luce its debt to a manageable level. t even the I.M.F. warns in its recent nomic review that if growth were to appoint, Portugal's debt "would not sustainable."

Mr. Gaspar, an economist who is a former research director at the European Central Bank and a disciple of the bank's austerity-focused philosophy, insists that his country's debt is manageable. And he has no plans to ease up on austerity. He intends to cut government pension payments this year by €1.2 billion, or almost $1.6 billion at the current exchange rate, and cut the bonus payouts that public-sector workers in this country have long earned.

In discussing his record, Mr. Gaspar prefers to focus on the effect his efforts have had on the Portuguese budget deficit — the difference between what it spends and what it takes in — which fell to 5.6 percent last year, from 9.1 percent in 2010. For this year, Mr. Gaspar forecasts a decline to 4.5 percent.

"We have delivered, and our adjustment program stands out in the euro area," he said during an interview Friday in the ornate surroundings of the Finance Ministry here.

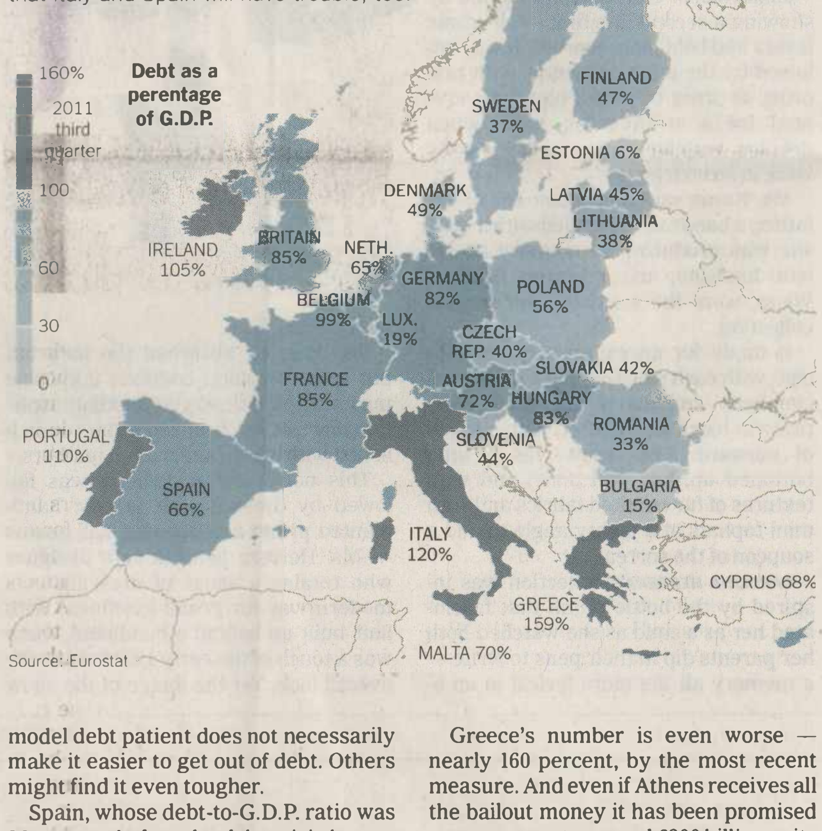
Once Portugal's budget overhaul takes hold, Mr. Gaspar predicts, the country's economy will grow more than 2 percent from 2014 on, and the debt will fall accordingly.

Mr. Gaspar has won plaudits from European leaders and the I.M.F., which are eager to champion an exemplar of economic revamping in contrast to the unspooling Greek disaster. In fact, Portugal is deemed such a model that the European Union and the I.M.F. are widely expected to come up with more money for Portugal next year if necessary — as was suggested in an overheard exchange between Mr. Gaspar and the German finance minister at a meeting last week in Brussels.

But as Portugal's slowly rising debt-to-G.D.P. ratio indicates, being Europe's model debt patient does not necessarily make it easier to get out of debt. Others might find it even tougher.

Depths of indebtedness

Even though Portugal's government is acting prudently to manage its debts, a weak economy makes it difficult to repay them, raising fears that Italy and Spain will have trouble, too.



Spain, whose debt-to-G.D.P. ratio was 36 percent before the debt crisis began, is projected to stand at more than double that — 84 percent — by 2013. Italy, whose ratio was already at 105 percent in 2009, is expected to reach 126 percent by next year.

Greece's number is even worse — nearly 160 percent, by the most recent measure. And even if Athens receives all the bailout money it has been promised — a sum sure to exceed €200 billion — its debt-to-G.D.P. ratio is still expected to be onerous, 120 percent, in 2020. That grim outlook even factors in the big write-down of its debt that Greece is now trying to negotiate with its private creditors and the E.C.B.

If Portugal and other European debtors find it increasingly difficult to pay off their creditors because of slow growth or no growth, some experts predict that they, too, might eventually need to negotiate debt write-downs. That was how things played out in Latin America in the 1980s, once it became clear that the I.M.F.'s relentless austerity push was impeding the growth that countries needed to pay down debt.

Economists accept that during the initial stage of a major spending adjustment program, the debt-to-G.D.P. ratio will spike as economic growth suffers. The bet, however, is that over time the economy will pick up enough that the country starts to generate a primary surplus — that is, a budget in the black, once debt payments are excluded.

But there are many who believe that just as Greece's debt picture is fundamentally untenable, so is Portugal's.

According to calculations by Mr. Bencek, the economist, Portugal would need to produce a primary surplus of about 10 percent of G.D.P. in the coming years to reduce its debt ratio to a permanently serviceable level. That, he said, would require a degree of cuts in spending far beyond what Mr. Gaspar and his team have already been able to achieve.

As even the current cuts bite ever deeper, many Portuguese are asking whether it might not be better for their government to try negotiating easier terms with its lenders.

"Portugal would save €3 billion a year if it restructured its debt," said Pedro Lains, an economic historian and a blogger at the University of Lisbon.

Mr. Lains spoke not only as a theorist. His salary at the government-run university has been cut 30 percent.