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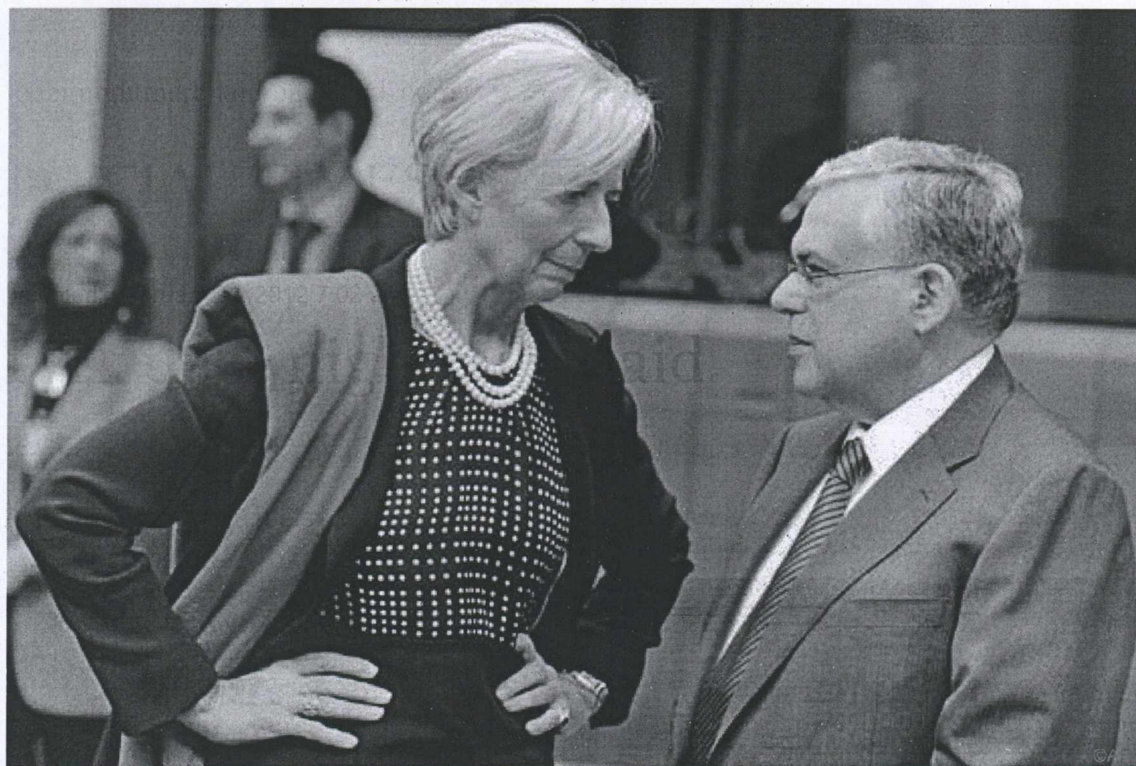
Greek debt nightmare laid bare

By Peter Spiegel in Brussels



Christine Lagarde and Greek PM Lucas Papademos

A "strictly confidential" report on Greece's debt projections prepared for eurozone finance ministers reveals Athens' rescue programme is way off track and suggests the Greek government may need another bail-out once a second rescue – set to be agreed on Monday night – runs out.

The 10-page debt sustainability analysis, distributed to eurozone officials last week but obtained by the Financial Times on Monday night, found that even under the most optimistic scenario, the austerity measures being imposed on Athens risk a recession so deep that Greece will not be able to climb out of the debt hole over the course of a new three-year, €170bn bail-out.

It warned that two of the new bail-out's main principles might be self-defeating. Forcing austerity on Greece could cause debt levels to rise by severely weakening the economy while its €200bn debt restructuring could prevent Greece from ever returning to the financial markets by scaring off future private investors.

"Prolonged financial support on appropriate terms by the official sector may be necessary," the report said.

The report made clear why the fight over the new Greek bail-out has been so intense. A German-led group of creditor countries – including the Netherlands and Finland – has expressed extreme reluctance to go through with the deal since they received the report.

A "tailored downside scenario" in the report suggests Greek debt could fall far more slowly than hoped, to only 160 per cent of economic output by 2020 – well below the target of 120 per cent set by the International Monetary Fund. Under such a scenario, Greece would need about €245bn in bail-out aid, far more than the €170bn under the "baseline" projections eurozone ministers were using in all-night negotiations in Brussels on Monday.

"The Greek authorities may not be able to deliver structural reforms and policy adjustments at the pace envisioned in the baseline," the pessimistic scenario warned. "Greater wage flexibility may in practice be resisted by economic agents; product and service market liberalisation may continue to be plagued by strong opposition from vested interests; and business environment reforms may also remain bogged down in bureaucratic delays."

Even under a more favourable scenario, Greece could need an additional €50bn by the end of the decade on top of the €136bn in new funds until 2014 being debated by finance ministers on Monday night. That "baseline" scenario includes projections that the Greek economy stops shrinking next year and returns to 2.3 per cent growth in 2014.

Details of what has gone off course in the report are long and daunting. A recapitalisation of Greek banks, originally projected to cost €30bn, will now cost €50bn. A Greek privatisation plan, originally to raise €50bn, will now be delayed by five years and bring in only €30bn by 2020.

The report also paints a troubling outlook for the debt restructuring, expected to begin this week. The deal involves a debt swap, where private investors trade in existing Greek bonds for a package that includes €30bn in bonds issued by the eurozone's rescue fund and €70bn in new, long-term Greek bonds.

The analysis says the swap, co-financed by Greece and the rescue fund, essentially creates a class of privileged investors who will chase off new bond investors when Greece attempts to return to the bond market.

"It is now uncertain whether market access can be restored in the immediate post-programme years," the report warned.

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