The Economist

Greece and its creditors

A bank bail-out by another name?

Banks would do rather too well out of a proposed rollover

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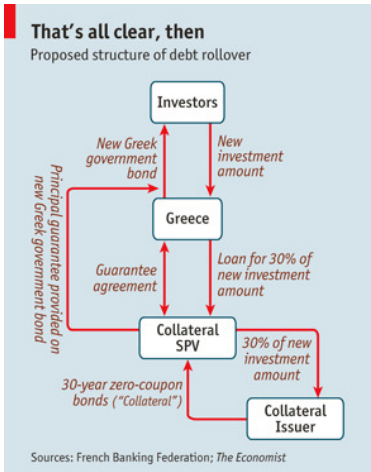
IMMEDIATE worries about a Greek debt default were allayed on June 29th, with the passage of a first vote in the Greek parliament on an austerity plan. Not before fear had spread well beyond the Aegean. The interest rates demanded by investors to hold Spanish and Italian government debt rose to their highest levels in seven months on June 27th, before slipping back. On June 29th America's Federal Reserve extended a promise to provide dollars to other major central banks.

The pressure to put together a second bail-out package for Greece remains intense. A proposal from the French banking sector this week on rolling over privately held Greek debt is supposed to clear the way. Not all the details are clear but the plan seems to do too little to help Greece, and too much to help the banks.

The proposal is intended to achieve two inconsistent objectives. The first is to ensure that private creditors contribute to a Greek bail-out, to satisfy German demands that taxpayers should not have to bear all the burden of another euro-zone rescue. The second is to ensure that participation in the plan is seen as voluntary by the ratings agencies, thereby avoiding a declaration of default.

The French plan proposes giving private creditors two options. One is to ask banks to reinvest almost all of the proceeds of Greek bonds that mature between now and June 2014 in new five-year bonds. This would delay a reckoning by a few years.



The second proposal—and the one preferred by banks—is far more complicated (see chart) and is designed to improve the creditworthiness of Greek bonds. Take a deep breath; here's how it would work. As Greek bonds mature over the next three years, the country would repay holders. Banks would pocket 30% of the cash and "voluntarily" buy new, 30-year Greek debt with the rest. Greece in turn would pass on about 20% of the original bonds' value (or 30% of the amount being rolled over) to a special-purpose vehicle (SPV) that would buy AAA-rated bonds maturing in 30 years. If Greece defaults, these bonds would be used as collateral to repay banks the principal they loaned.

In the circumstances, the deal is a good one for banks. It reduces the potential loss they might suffer were Greece to default and lets them take some money out now. It also rewards them with interest payments that may rise to 8% if the Greek economy rebounds. "It seems sensible for the banks to be taking a bet like this on a Greek recovery", says Alex Tsirigotis, an analyst at Mediobanca. "If they don't take the bet, they face the potential of losses in the magnitude of 50% anyway."

For Greece, the bargain is far less compelling. The 30-year plan does nothing to reduce Greece's debt burden and could complicate any eventual restructuring. Since Greece would pay interest on all of its borrowings, but could use only part of them, its cash interest rate over 30 years would be about 10-11%. Some rescue.

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