



Market Access is Receding for Greek Debt

Nicolas Véron assesses the market impact of the dilemma faced by European creditors over Greece's failure to implement its promised reforms.

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Steve Weisman: More turmoil over the situation in Greece. Nicolas Véron, visiting fellow at the Peterson Institute for International economics is here to discuss the latest developments. This is Steve Weisman at the institute. Nicolas there's renewed talk that Greece is going to have to restructure its debts. What's new in the last couple weeks?

Nicolas Véron: Depending on your perspective, much is new or not much is new. Much is new in terms of, we now know that the Greek economy and the Greek government are not going to deliver on all the milestones that had been agreed upon a year ago, which was the first assistance program. So we have to go for plan B.

Steve Weisman: Is that because Greece has had trouble implementing all these austerity measures?

Nicolas Véron: Yes it's austerity measures, it's state reform, it's legislative reform and it's also the reaction of the economy. So basically things aren't going as well as initially planned.

Steve Weisman: But just to be clear, Greece has done a lot -- but maybe not as much as promised but also there were other factors like the economy?

Nicolas Véron: Yes, but I think the first other aspect is Greece wasn't able to deliver the sort of fiscal cleaning up as was agreed last year. So basically, prime facie, the Greek government not having done all that it had committed to. And this is certainly how it will be interpreted in some corners of Europe. Now you may say the economic context also hasn't been that favorable and that has made reform more difficult.

Steve Weisman: Did Greece try, and the program was too draconian or unrealistic?

Nicolas Véron: I think you know Greece did try. Greece did do a number of things that were not easy. At the same time there is a feeling that Greece -- and when I say Greece I should say the Greek public opinion, government, elites, whoever it is, as the business community sees it -- it doesn't matter [to Greece] if national honor or national survival [is at stake]. You reimburse everything, and I think [that] is where situation is complicated. You have the feeling that the government sees it as a natural development that at some point this will need to be renegotiated, and possibly refinanced. And this is what makes this situation particularly difficult to handle.

Steve Weisman: When you say 'reimburse' you mean reimbursing creditors?

Nicolas Véron: Yes.

Steve Weisman: What are creditors prepared to do?

Nicolas Véron: Germany is in a difficult situation because, on the one hand, they have told their public opinions, this is enough, they will get reimbursed, and the German taxpayer will make a profit because the interest rate is about the financing rate of the German government. And at the same time basically the rest of the players are saying, well, facts have moved on the ground. We need to evolve and adapt our position and find a new deal with the Greeks for the boat not to be rocked.

So you see very violent undercurrents in Germany. Some people saying “Well no way Greeks will have to restructure” instead of, “If it’s not able to repay it in the terms that had been initially agreed...” And then you have perhaps cooler voices saying: “Look what are our alternatives? If we restructure the Greek debt, what sort of shockwaves will it create in the financial system? What will it mean for our own banks? What will it mean for the eurzone? And you have this debate going on in Germany with a fairly high pitch these days.

Steve Weisman: I read the phrase “soft restructuring” in the paper. Is there such a thing?

Nicolas Véron: There have been instances in the past of extensions of maturity and basically tinkering at the edges of the terms of the debt in order to make it more easy to reimburse. The textbook example is Uruguay a couple of years ago, which did basically gain a lot from this -- or so the conventional wisdom has it, because it has this extension of maturities and the renegotiation of terms of the agreement. And then they basically didn’t cut their access to the market place. I think there is a consensus among informed people that this is not going to work in Greece because the problems are just too big, it’s a debt burden, and it’s too big. So if you go for soft options, whatever they are, voluntarily restructuring, or reprofiling or this sort of thing, you’re not going to change the equation to a sufficient extent that it would make what is not now not credible, that it would make it creditable.

Steve Weisman: So a much more serious restructuring would appear to be inevitable? What factor would that have on banks in France, Germany and other parts of Europe?

Nicolas Véron: I don’t really believe it’s inevitable, because the other option is that the eurozone countries and the IMF could extend additional credit. This is probably what is going to happen because...

Steve Weisman: To kick the can down the road?

Nicolas Véron: Kick the can down the road, to use the proverbial expression, and overcome the German resistance to basically bailing out a bailout if you want to put it in negative terms because [the other] options are worse. And here’s the reasoning of the European central bank and a number of member states: it is to say, well, if we go for a hard restructuring of Greece now, given the fragility of the European banking system, given the state of uncertainty in a number of European countries, given the fact that Spain looks like it’s out of the woods right now, but it remains fragile, it could create contagion that we’re really not able to manage.

And there is no way to model this. So it could be a leap of faith. And if it goes wrong it would be catastrophic and that’s the reason why these players are saying “Look, lets be reasonable, we don’t want to go for the catastrophic scenario, so we’ll have to pinch our nose and extend a new credit to Greece in some form or another to make sure that this catastrophic development doesn’t happen in spite of the bad news about repayment.”

Steve Weisman: Greece was supposed to be able to go to the market in 2012 next year. What does all this mean for Greece's ability to do that?

Nicolas Véron: Indeed that is the core issue, Steve. The big question is when, and how and whether Greece will be able to go back to the marketplace in a normal condition of a solvent borrower. And perhaps the right way to look at the issue -- policy makers in the past twelve months had been fixated on this question: "How do we make Greek debt attractive again for investors?" Maybe they would have taken different policy stances including the discussion about restructuring.

Now I think more and more people are recognizing that this return to the marketplace will probably not happen in 2012, and this creates a short fall estimated between thirty and fifty billion euros, which creates the need for refinancing. When will Greece go back to the market? This is not a process which is conducive to reestablishing trust. So if the investors see that when Greece isn't able to repay, basically it gets another line of credit from public authorities, they're probably inclined to say, well, we'll continue watching this game but we don't want to be part of it for the moment. Now there are additional dimensions, one being what Carmen Reinhart or others would call financial repression.

There will probably be some governments basically strong-arming their banks, national banks, private banks of course headquartered in their countries, to refinance the Greek debt that they hold. This may be part of the equation. But we're not going to see a sound return to the marketplace as a normal solvent issuer any time soon. And it is unfortunately possible that we'll need some restructuring of the Greek debt held by public institutions. Eurozone members, state, IMF, some time down the road before Greece can return to the marketplace. And of course the more we wait, the more this restructuring will result in losses to the public sector, eurozone member states, IMF, as opposed to losses of the private sector.

Steve Weisman: Thank you Nicolas.

Nicolas Véron: Thank you very much Steve.

