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Western European Indicators and Insights

June 14, 2011

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GREECE: Further downgrade.

S&P on Monday cut the Greek long-term sovereign credit rating by three notches to CCC. Explaining its actions, the ratings agency said Greece is increasingly likely to restructure its debt in a manner that, under the conditions of any package of additional funding provided by Greece's official creditors, would result in one or more defaults under its criteria. S&P said the recovery rate for investors holding Greek bonds would remain in the 30 per cent to 50 per cent range.

Any roll-over may constitute a default?

Indeed, it is notable that S&P, echoing the verdict of fellow rating agencies such as Fitch, is suggesting that the kind of private sector involvement in any fresh Greek bail-out – either with a bond swap or by extending maturities on existing bonds – would constitute a default, as the terms would likely be less favorable than the debt being refinanced. The chances of the latter have increased given the apparent willingness of French banks to accept a roll-over of their Greek bond holdings. Regardless, it seems as if the spat between Germany and the ECB regarding the extent/form of private sector involvement (the former wanting more than the voluntary roll-over than the latter would accept) is becoming irrelevant as both would be regarded as defaults, at least by the ratings agencies.

Bigger hole in bail-out

As a result, this may put a bigger hole in funding of the circa-€ 170 bln bail-out that Greece seemingly requires now that it cannot return to funding itself from 2012. Admittedly, some € 60 bln will be available from the remnants of the existing bail-out put together just over a year ago. It was hoped that the rest would be plugged by around € 30 bln coming from Greek asset sales and a further € 30 bln from reduced financing costs caused by some for of debt roll-over (the rest from new lending).

However, that arithmetic looks less reliable, with a further cause for concern being the extent to which any Greek asset sales can actually be relied upon given the opposition already evident in Greece. In addition, the limited restructuring that Greece may be forced into would do little to make its fiscal finances look that much more sustainable. Perhaps the latter makes it more likely that a Greek default will be avoided at this juncture. Regardless these factors make the task of cobbling together a bail-out while will politically acceptable to all parties and one that is economically viable that much harder by the time of the scheduled summit of EU leaders on June 23-24. The hope will be that