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Western European Indicators and Insights

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Greece: Looking beyond the PSI.

ECB not the only ones to note the lack of Greek fiscal reforms

Perhaps developments in Greece warrant the closest potential scrutiny in coming weeks. The (relatively) new Greek Government faces clear hurdles if it is to avoid a disorderly default by March 20 when the country must redeem €14.4 bln in bonds. Some are suggesting it will be unable to do so unless the latest (€ 130 bln) bail-out package is approved, something that may only occur once the terms of both the bond exchange, known as private sector involvement (or PSI) and structural reforms to be made by Greece are agreed. If so, the so-called troika could disburse up € 90 bln in the first quarter of this year, funds that will include money towards implementing PSI, since private creditors will most likely receive € 30 bln in cash or equivalent upfront, while Greek banks will also be recapitalized by some € 30 bln.

Apparently, the debt swap talks are in their final stages, albeit still having to overcome issues such as what the new interest rate will be; whether Greek should be applied or not; and whether any haircut should apply to official money (eg ECB and IMF) as well as to that of the private sector. The latter issue is something very contentious to the ECB which is still vehemently against the principal of the PSI, in turn, causing divides between it and the IMF (which supports the bond swap). The plan is that the bond swap offer will be available to private bondholders in the first two weeks of February and the settlement will take another week, albeit it being unclear what would happen if the participation rate among bondholders is insufficient.

Disorderly default risk remains high

The plan also is that the Greek parliament will pass reform measures in the coming week. Regardless, perhaps the March 20 date is not that important as Greece could get further funds from its existing bail-out fund which has some € 45 bln left in its coffers. The problem is that for all the efforts of the Greek Government, reforms are not being enacted by a resistant civil service, whose obstinacy may only intensify ahead of the looming Greek general election. More poor data in coming weeks may serve to highlight the lack of reforms, the issue thus being whether Greek unwillingness to take its fiscal medicine will soon frustrate its bail-out partners to pull the plug on further funds (the ECB is obviously displeased with the lack of fiscal consolidation in Greece). This risk must be growing, especially if plans are being made elsewhere in the Eurozone to address the more disorderly Greek default that would ensue, plans that may allow Greece to remain in the Eurozone regardless.