This newsletter is a quarterly email for OPC clients from our Head, Investment Advisor Alexandros Clappas CFA. Views expressed are his own and do not constitute official OPC views unless explicitly stated. This newsletter is market commentary and does not constitute investment advice.

December 2019

Greece's "quick" recovery…

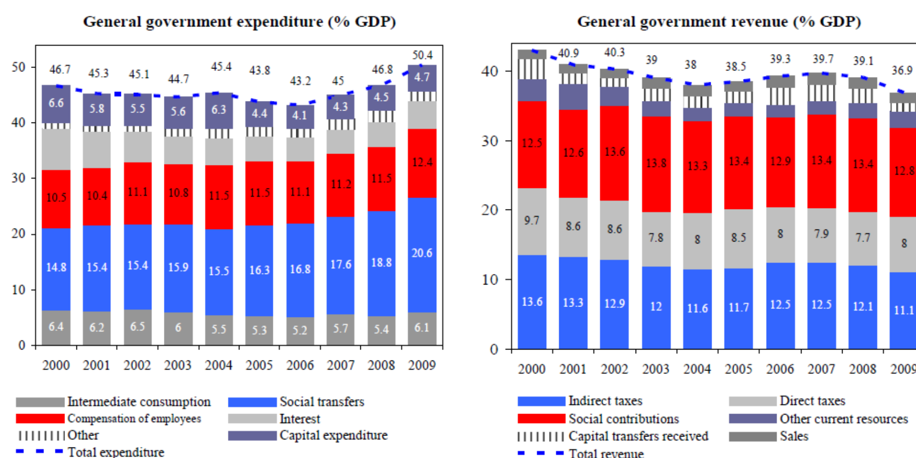
Dear Investors,

2000 to 2009

The years after accession to the European monetary union in 2001, Greece was one of the Eurozone's fastest growing economies with an average annual GDP growth rate of 4% for the period 2000 – 2009. The opening up of the Greek economy lured foreign capital as it flocked to the country in search of investment opportunities. As a result of the new currency and lower interest rates, trade with Eurozone countries increased, credit expanded facilitating growth and domestic consumption and residential investments took off. Public sector wages and pension related income also grew, as the country rewarded itself with higher income, gradually decaying the competitiveness of the export industry, while the consumption of imported goods increased. Labour costs rose faster than relative productivity gains, creating an unsustainable environment, an imbalance. An illustration of this is the current account deficit that had grown to a -15.2% peak in 2009.

Current account deficits occur when a country's imports exceed its exports. Because a country running a current account deficit consumes more than it produces, it is forced to borrow. In effect, the country is promising to pay for extra consumption today by consuming less than it produces some time in the future.

A major propeller of inefficiency was the Greek Government. From 2004 to 2009 government expenditure grew by 87%, compared to tax revenue increasing only by 31%. As a percentage of general government expenditure, wage related expenditure taking the form of social transfers, compensation to public employees and pension related expenses accumulated a 70% chunk of the total.

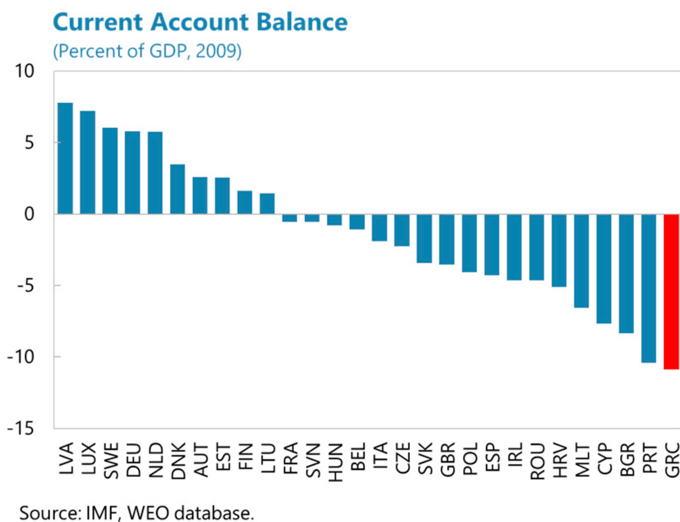


Effectively, the government was earning less but spending more, and spending on sticky items such as public servant wages and pensions, items that are probably the most difficult items of a government budget, both politically and legally, to reduce or reverse. Since the economy was not producing enough to compensate government consumption, they borrowed more and more to compensate.

Debt-to-GDP rose from 103% in 2000 to 126% in 2009. In money terms, in 2000 outstanding debt was €148 billion and it grew to €300 billion by 2009, while GDP was €142 billion in 2000 and it grew to €237 billion by 2009. In the same year GDP already turned negative, but the Government proceeded with piling on more debt, approximately €45 billion euros worth of debt. By that time, Greece had borrowed almost 75% of its debt from the international capital markets, i.e. private capital, exposing the country to a very short-tempered creditor with a very low threshold for bad management.

2009 to 2010

The Global Financial Crisis of 2008 – 2009 brought a sudden drought of liquidity that was much required by countries running large deficits. In 2009, 16 out of 17 Euro Area Member States were in breach of the Maastricht Treaty criteria, i.e. 3% deficits, including Ireland, Spain and Portugal, whom were amongst the countries most affected.



A Eurostat report from April 2010 sets Greece's deficit at a staggering -13.6% (four (4) times over the Treaty limit) and Debt-GDP at 115.1% (earlier figures that were later revised up). When Eurostat, an arm of the European Commission (EC) began to take notice of the repeated adjustments to the data that came from Greece, a report was published by the EC in January of 2010 pointing to the repeated deficit and debt revisions that are extremely rare but have taken place for Greece on several occasions. The evidence against Greece's statistical agency pointed to irregularities in notifications, incorrect data, non-respect of accounting rules, lack of MOF independence, non-transparent bookkeeping, lack of accountability, data exchange by phone without documentation, to name only a few.

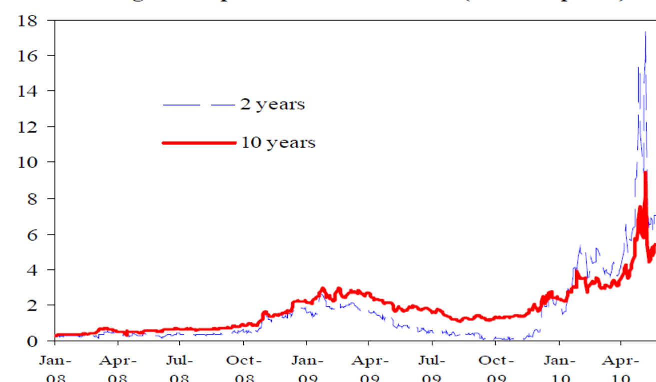
In February 2010 the Greek authorities admitted to misreporting data. Regarding the April report, Eurostat states the extent of the deviations which could reach 0.5% for GDP and 7% for Debt-GDP.

The imbalance in Greece's current account coupled with a high Debt-GDP, a mountain of government deficit and evidence of misreporting, led to the sudden eruption of the Greek Debt Crisis.

2010 - 2012

As the recession began in the fourth quarter of 2008, the country experienced six (6) quarters of negative GDP growth leading up to the signing of the first financial assistance program on the 2nd of May 2010 (First Program).

The delayed response to solving the issues the government had to face, led to a spike in the sovereign's yield curve and a vaporising chance of the crisis ending quickly.



Fears of insolvency of public finances began to affect the banking sector which was not at the origin of the crisis. As early as January 2010, the international capital markets effectively shut out Greece completely. Although banks did raise capital ratios in 2009 to 11.7% through public capital injections and their own efforts, the exposure to the sovereign was intolerable. Direct exposure through bonds was at 8% of the bank's assets by the end of 2009, with rising yields; the banks had to book losses on their balance sheets. NPL ratios started to rise alongside the worsening macro environment, which by the end of 2009 reached 7.7% and was picking up pace. At the same time, foreign capital was moving deposits out of the country as confidence in the banking system was severely undermined. The ECB had to step in as a lender of last resort, to hold off the banks from shutting down.

In order to minimise contagion, on the 11th of April 2010, the Eurogroup finance ministers reaffirmed their readiness to take determined and coordinated action, clarifying the ability to provide financing to safeguard financial stability in the eurozone area.

In order to avoid disorderly default by a EU Member State, as part of a joint effort, the European Commission, the ECB and the IMF (Troika) had agreed to provide financial assistance to Greece in the form of bilateral loans totalling €110 billion; €80 billion by the eurozone area countries and €30 billion by the IMF, to be released over the period of May 2010 to June 2013. This was the First Program known as the Greek Loan Facility.

The Memorandum of Understanding (MoU) signed by Greece in May 2010, by definition, was an agreement between the Member State concerned and the Troika, pursuant to which Greece undertook to carry out a number of precise actions (reforms) in exchange for financial assistance. The structural reforms were aimed at making the Greek economy competitive again.

This led to an economic, political and social crisis not seen ever before in a non-war period; the quantity and quality of employment, access to credit, income levels, social protection, health standards and emigration were direct effects of austerity.

As reforms became more and more politically toxic to enforce in the Greek parliament, the topic of debt forgiveness was beginning to take shape in political circles across the EU as a measure of long term debt sustainability.

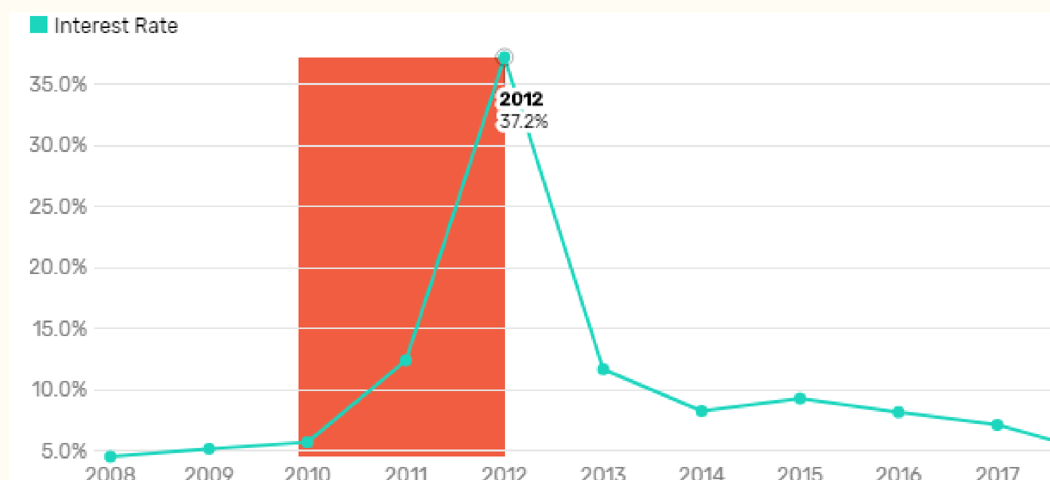
On June 6, 2011, German Finance Minister Wolfgang Schäuble wrote a letter to the ECB and the IMF proposing "*to initiate the process of involving holders of Greek bonds …through a bond swap leading to a prolongation of the outstanding Greek sovereign bonds by seven years*." Shortly afterwards, a group of major French banks issued the first detailed proposal on how a Greek bond rescheduling might look like.

2012 – 2014

Albeit a 5% GDP fiscal consolidation, a 15% reduction of GDP, unemployment at 20% there was a general motion that more had to be done for Greece's debt to be sustainable and return to capital markets.

As criticism to the First Program, the IMF noted that it did not effectively take into account the objections of one third of its board members with regards to the provision of debt restructuring in line with its usual practises and would have preferred an early debt restructuring. The ECB's reluctance to consider any form of debt restructuring in 2010 and 2011 on the grounds that it would have led to the crisis having a contagious effect on other Member States, contributed to the escalation of the Greek debt crisis.

2012 Peak Government Bond Yield



On 14 March 2012, the Eurogroup approved the Second Program for Greece for an additional €130 billion for the years 2012-2014 preconditioned on further austerity measures as well as a Private Sector Involvement (PSI) to improve the sustainability of Greece's debt, i.e. a debt haircut. The rescue package formed included an additional €19.8 billion by the IMF.

The PSI or debt restructuring demanded by the Troika had a very high passing level in order to be deemed successful and the release of the funds to be effected. After significant efforts initiated by a group of creditors, the PSI was successful in that out of a total of €205.6 billion in bonds, approximately €197 billion or 95.7% had been exchanged with new bonds of varying maturities and a write down of approximately 50% of eligible debt or €107 billion was achieved.

Table 2. Composition and estimated bond holdings of creditor committee

Steering Committee Members		Further Members of the Creditor Committee			
Allianz (Germany)	1.3	Ageas (Belgium)	1.2	MACSF (France)	na
Alpha Eurobank (Greece)	3.7	Bank of Cyprus	1.8	Marathon (USA)	na
Axa (France)	1.9	Bayern LB (Germany)	na	Marfin (Greece)	2.3
BNP Paribas (France)	5.0	BBVA (Spain)	na	Metlife (USA)	na
CNP Assurances (France)	2.0	BPCE (France)	1.2	Piraeus (Greece)	9.4
Commerzbank (Germany)	2.9	Credit Agricole (France)	0.6	RBS (UK)	1.1
Deutsche Bank (Germany)	1.6	DekaBank (Germany)	na	Société Gén. (France)	2.9
Greylock Capital (USA)	na	Dexia (Belg/Lux/Fra)	3.5	Unicredit (Italy)	0.9
Intesa San Paolo (Italy)	0.8	Emporiki (Greece)	na		
LBB BW (Germany)	1.4	Generali (Italy)	3.0		
ING (France)	1.4	Groupama (France)	2.0		
National Bank of Greece	13.7	HSBC (UK)	0.8		

Notes: In € billion. Estimates of bond holdings refer to June 2011, creditor committee composition to December 2011. *Sources*: Barclays (2011) and Institute of International Finance (http://www.iif.com/press/press+219.php).

An important part of the success in the write down was attributed to bondholders that were banks or institutional investors susceptible to pressures by regulators and governments. Another part also came down to a change in domestic Greek law that occurred on the eve of the offer that made the voluntary offer compulsory as long as 2/3 majority of bondholders accepted the exchange, in stark contrast to the status quo which required a 90% majority to accept the offer. This was applied to local-law bonds only and not for English Law bonds.

By the time the exchange offer circulated, the credit rating agency Moody's downgraded Greece's rating from A3 to a rating C, 12 notches in just twenty (20) months.

Since the 60% outstanding bondholders were major banks with other issues to deal with, it became clear that the best option was to exchange the potential bankrupt bond with a 15% "cash" like option, as the new bonds provided were backed by EFSF paper. The Official Sector; the ECB and national central banks, was ultimately the largest holder of Greek debt and was excluded from the debt exchange.

The PSI set a new world record in terms of debt volume restructured and aggregate creditor losses and it all happened in record timing; all the meanwhile, a few months earlier, European policymakers strongly denied any such possibility, of a sovereign default in Europe.

The holders of the €6.4 billion that did not accept the exchange and were under English law, held out and were paid in full. This discrepancy amongst creditors, laws and enforceability of restructuring creates a challenge amongst future participation rates of possible debt exchange programs as one can argue certain holders were unfairly treated.

2014 - 2018

Each financial assistance programme had five (5) to six (6) scheduled reviews which included reform milestones to be reached before fund dispersion was permitted. Upon the 5th and final review of the Second Program, the Troika teams were interrupted in early December 2014 when snap parliamentary elections had been called after three (3) unsuccessful reform votes in Hellenic Parliament.

The elections saw the success of SYRIZA, an opposition party to austerity measures. The Greek government then requested 4-month extensions to the Second Program deadline, in order to renegotiate debt restructuring and austerity measures on behalf of the Greek people. On June 27th the Greek Prime Minister Alexis Tsipras announced a referendum on the austerity measures. He falsely promised that a "no" vote would give Greece more leverage to negotiate a 30% debt forgiveness with the EU.

Agreement on the 5th review could not be found and the programme expired on 30 June 2015 with an outstanding loan of €130.9 billion weighted average maturity of 42.5 years. A €1.5 billion repayment amount due on the same date was not paid to the IMF whom later cited “the amount was not received”. Both sides later on called it a delay and not an official default.

Two days later, the IMF warned that Greece needed 60 billion euros in new aid.

The IMF, as a strong proponent of debt relief, told creditors, now mostly the Official Sector EU funds, to take write-downs on more than 300 billion euros which Greece owed to them.

On July 5, Greek voters said "no" to austerity measures and sent a run on the banks. At the peak of the crisis in June, Emergency Liquidity Funding (ELA) was provided for an amount reaching €86.8 billion in order to keep the banks from closing entirely. Greece sustained extensive economic damage during the two (2) weeks surrounding the vote. Banks enforced capital controls and restricted ATM withdrawals to sixty (60) euros per day. It threatened the tourism industry at the height of the season, with fourteen (14) million tourists visiting the country.

On July 15, the Greek parliament passed austerity measures, despite the referendum result, in order to receive financial assistance under a Third Program through the ESM. The austerity measures agreed were said to be more stringent than the entire First and Second Programs combined. It included stricter pension reform, broadening of the tax base and full legal independence of the ELSTAT. Additionally, significant promises were made against privatisation efforts, descaling the union power against collective bargaining and other labour market reforms that have met strong social opposition. The passing of the reforms gave way to loans of €86 billion for macroeconomic adjustments and bank recapitalisation, as well as a promise of at least some debt forgiveness in the future.

Greek banks recapitalised through a combination of private and governmental funds. Of the total amount of funds, only €61.9 billion was finally disbursed.

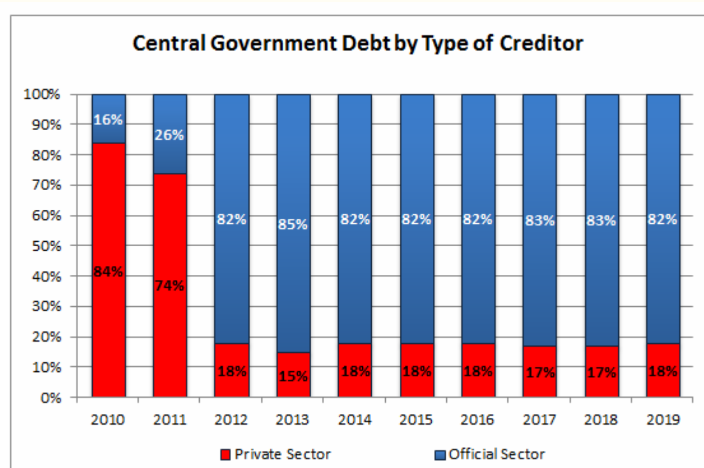
It should be mentioned that ironically the capital controls imposed reduced tax evasion and increased government revenues by almost €1 billion.

The Greek capital market ecosystem was picking up with financing work progressing from the drought period of 2012 – 2015. Corporate issuers began tapping the international capital markets during 2016 onwards.

In 2016 General Government Debt as a percentage of GDP peaked at 180%.

GREEK ECONOMY										
1.	**Main Economic Indicators**	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**
	Nominal GDP (in mil.€)	226.031	207.028	191.204	180.654	178.656	177.258	176.488	180.218	184.714
	Percentage change of real GDP	-5,4%	-9,1%	-7,3%	-3,2%	0,7%	-0,3%	-0,2%	1,4%	1,9%
	Harmonized CPI(Annual average rate of change (%)	4,7%	3,1%	1,0%	-0,9%	-1,4%	-1,1%	0,0%	1,1%	0,8%
	Unemployment rate(% average seasonally adjusted)	12,7%	17,9%	24,5%	27,5%	26,6%	25,0%	23,6%	21,5%	19,3%
2.	**Public Finance & Debt**	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**
	General Government Debt (in mil.€)	330.372	356.003	305.096	320.509	319.629	311.729	315.009	317.484	334.721
	General Government Debt (% of GDP)	146,2%	172,0%	159,6%	177,4%	178,9%	175,9%	178,5%	176,2%	181,2%
	General Government Primary Deficit (-) / Surplus(+) (% of GDP)	-5,2%	-3,0%	-3,7%	-8,4%	0,3%	-2,1%	3,7%	3,8%	4,3%
	General Government Deficit (-)/ Surplus(+) (% of GDP)	-11,1%	-10,2%	-8,8%	-12,4%	-3,6%	-5,6%	0,5%	0,7%	1,0%
EUROZONE										
	-	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**
	Percentage change of real GDP	2,1%	1,5%	-0,9%	-0,3%	1,1%	2,1%	2,0%	2,4%	1,9%
	Harmonized CPI(Annual average rate of change(%)	1,6%	2,7%	2,5%	1,4%	0,4%	0,2%	0,2%	1,5%	1,7%
	Unemployment rate	10,2%	10,2%	11,4%	12,0%	11,6%	10,9%	10,0%	9,1%	8,2%

The Greek government bond yield curve was not normal after the PSI effort. The liquidity and structure was not approachable for a sovereign of the size of Greece. The PDMA, then in 2017, put in place an effort to tackle this problem. It consolidated the legacy curve into five (5) benchmark bonds. The curve was more efficient and liquid as it provided ground for future new issues. As yields began to fall, the curve performed extremely well and paved the way for more issuers to benchmark the sovereign curve and enter the debt markets.



More good news followed as initial investors in the Greek curve took profits and a rotation took place whereby the even driven hedge funds reduced their positions and more real money asset managers entered the market. This really was an indication that investors took note of the progress and the potential recovery happening in Greece. Some 17,000 instructions had been received out of which 13,000 came from investors that had less than €100,000 of debt from countries such as France and Germany making a clear point that confidence in Greece had recovered.

2018

Greece successfully concluded its Third Program on 20 August 2018, ending the eight (8)-year austerity period, after receiving loans from the ESM, EFSF, IMF and euro area countries. This marked the end of the largest sovereign assistance package in history, comprising of three (3) distinct programes. Thanks to the unprecedented financial support, the Private Sector debt forgiveness of €107 billion, the Official Sector debt relaxation by smoothening circa 25% debt-GDP and very favourable terms on existing loans, Greece was able to modernise its economy and regain investor trust.

Exiting the program and eight (8) years of austerity, Greece had the following to show for:

- Reducing the number of public employees by 25%;
- Public sector wages dropping by 30%;
- GDP lowered by 25%;
- NPLs highest in EU at 47.2% gross loans;
- Debt-GDP at 180%;
- Weighed average cost of funding at 1.4%;
- Weighed maturity of funding – twenty (20) years.

The Greek economy returned to growth, the government budget was in surplus and the current account close to balance even in the face of higher oil import prices. Greece had been brought back from the brink of economic disaster while still had many more to deal with.

2019

The European Parliamentary elections in May brought New Democracy a ground-breaking win of 33% of the votes to SYRIZA's 23%. Prime Minister Alexis Tsipras called for a general election which ended with a landslide victory for New Democracy and leader Kyriakos Mitsotakis with 39.85% of votes and a majority of 158 seats in the Hellenic Parliament.

A short five (5) month period in the new government had allowed for structural pro-business changes such as the corporate tax rate to be reduced from 28% to 24% with a plan to get to 20%, dividend tax reduced from 10% to 5%, with plans for privatisation of the electricity grid and energy sector reform with shift to renewables.

2020 onwards

IMF PREDICTIONS

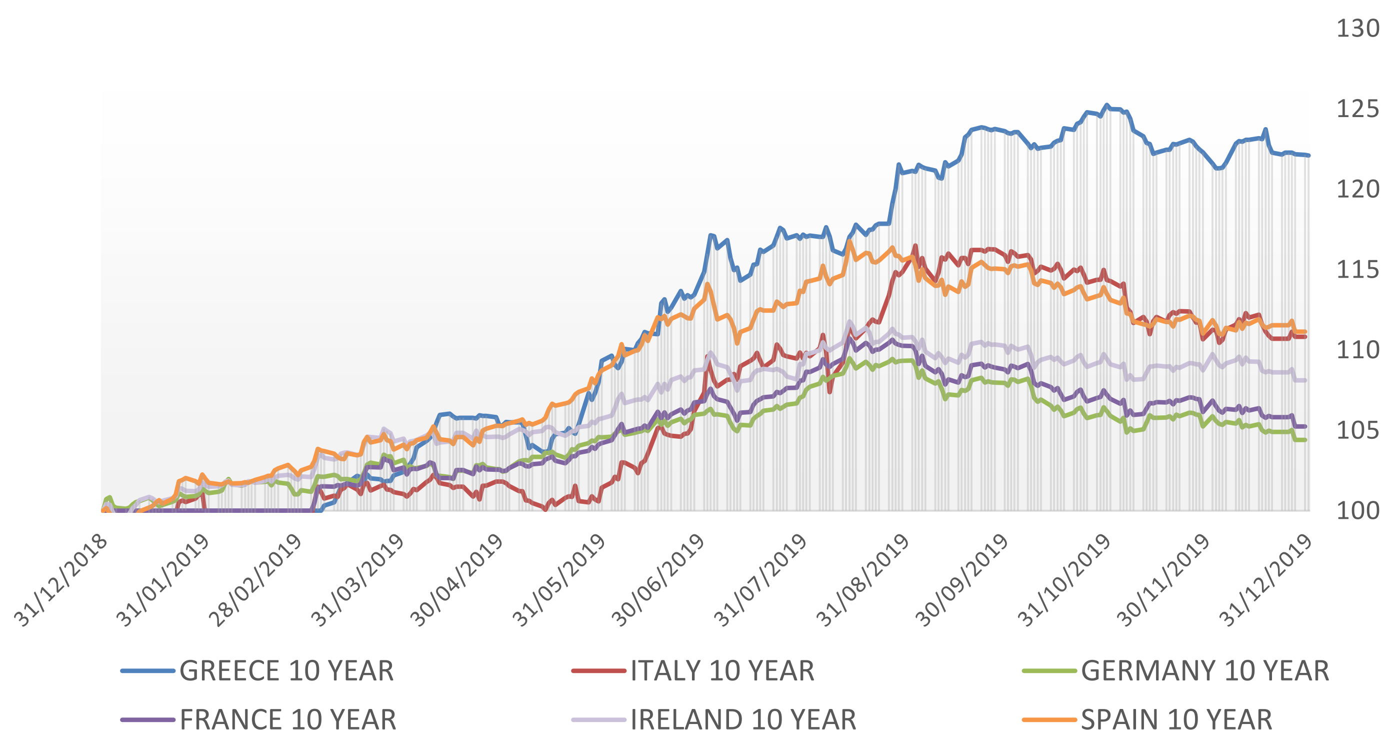
	2017	2018	2019	2020	2021	2022	2023	2024
		(proj.)						
Real GDP	1.5	2.1	2.4	2.2	1.6	1.2	1.2	1.2
Unemployment	21.5	19.6	18.5	17.5	16.2	15	14.3	13.6
Public Debt	179.3	183.3	174.2	167.3	160.9	153.8	147.2	143.2

Greek banks are working closely with the government and investors in order to reduce the large stockpile of NPLs (at 35% of gross loans) already reduced by €30 billion from the peak €100 billion with write offs and sales. Additionally, asset securitisation schemes, similar to an Italian model are being worked on, dubbed Hercules which is expected to onboard half of NPLs i.e. around €30 billion worth. The scheme includes a securitisation model with banks holding a senior tranche participation effectively removing the NPLs from the balance sheet, but nonetheless, participating in the performance of the asset, as will the government with a contribution.

Moreover, Hellenic banks have brought in so-called mega servicers including Intrum to offload more NPLs, a deal originating with Piraeus Bank, now at a colossal €41 billion worth of gross loans to service from retail to complex industrial.

As a testament of the recovery underway, the Greek ten (10) year bond performed spectacularly well in 2019 compared to its EU – peers. The chart shows the return of all bonds with price indexed at 100.

Greece 10 year returned 23% in 2019 …



And the stock market did not do so bad either…

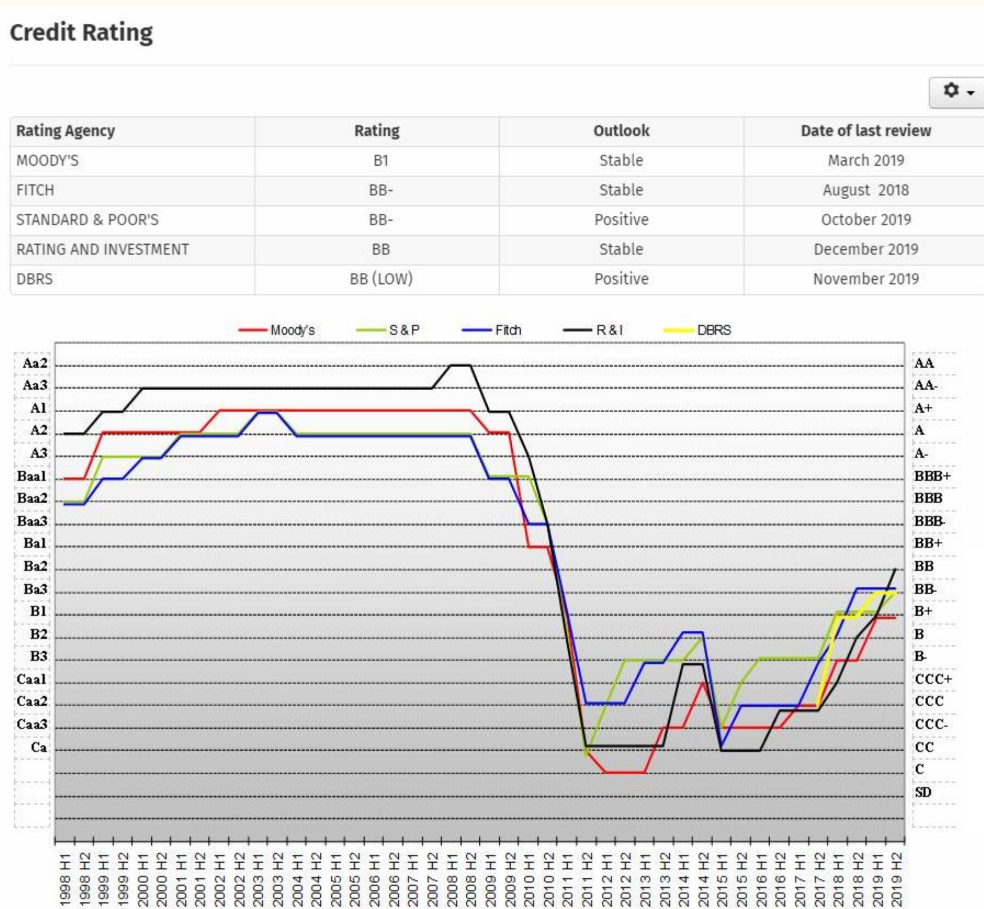
Athens Stock Exchange returned 50% in 2019…

Region: Primary Indices Only | Period: YTD 12/31/18 - 12/30/19 | Total Return | Currency: EUR

Movers | All

Groups (94)	Return
Primary Equity Indices	
Best Performing	
1) Athex Composite Share Pr	50.10%
2) RTS Index	48.47%
3) S&P/NZX 50 Index Gross	34.65%
4) S&P/NZX 20 Index	32.91%
5) ISEQAll-Share	32.41%
6) S&P 500 INDEX	32.34%
7) SWISS MARKET INDEX	31.32%
8) BUCHAREST BET INDEX	31.23%
9) BRAZIL IBOVESPA INDEX	29.73%
10) FTSE MIB INDEX	29.20%
Worst Performing	
11) SOFIX INDEX	-5.52%
12) MSM30 Index	-6.70%
13) MSE Top 20 Index	-11.11%
14) S&P MERVAL TR ARS	-11.36%
15) S&P/CLX IPSA (CLP) TR	-13.11%
16) NIGERIA STCK EXC ALL SHR	-13.97%
17) Laos Composite Index	-14.31%
18) BLOM STOCK INDEX	-18.03%
19) GSE Composite Index	-20.92%
20) Lusaka Stock Exchange Al	-26.47%

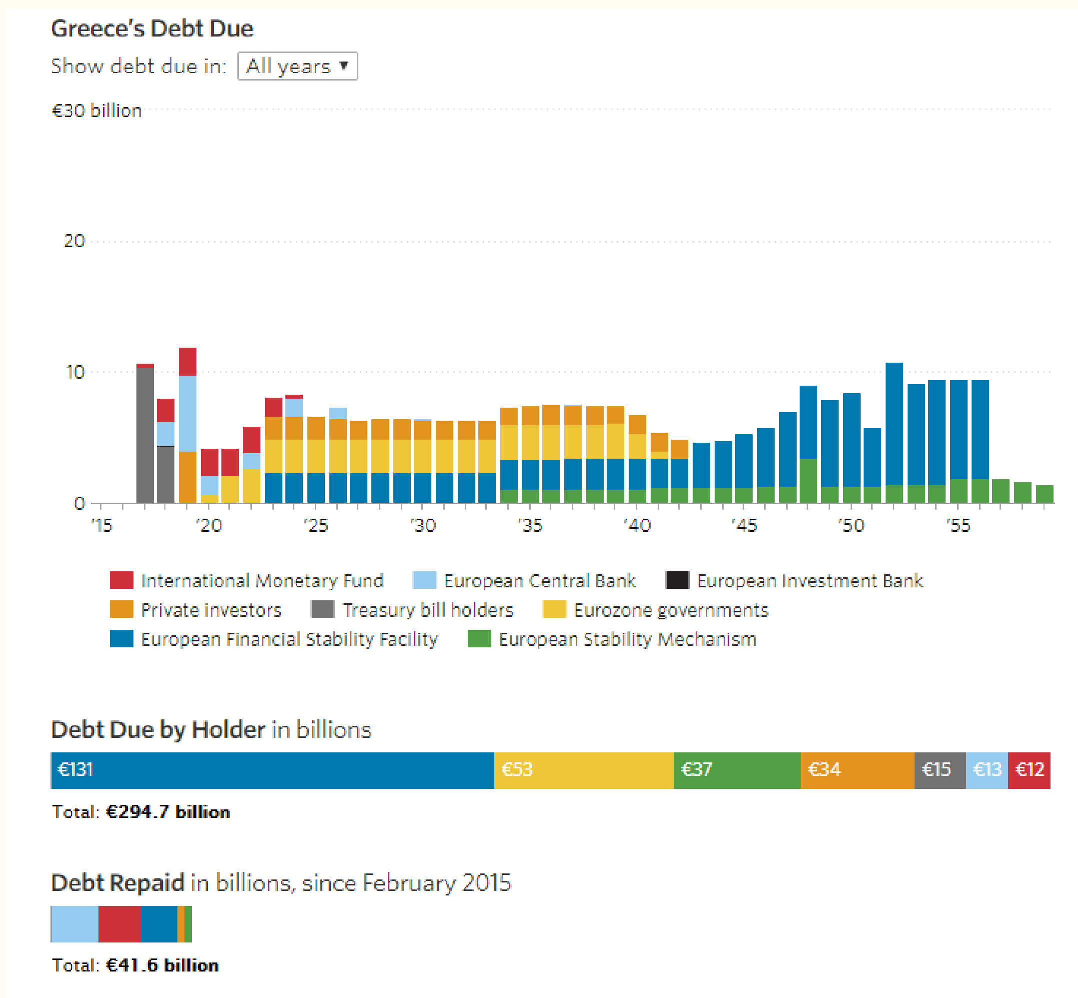
Credit ratings have upgraded Greece many notches since the peak of the crisis…



Credit Rating

Rating Agency	Rating	Outlook	Date of last review
MOODY'S	B1	Stable	March 2019
FITCH	BB-	Stable	August 2018
STANDARD & POOR'S	BB-	Positive	October 2019
RATING AND INVESTMENT	BB	Stable	December 2019
DBRS	BB (LOW)	Positive	November 2019

The whole debt picture by Wall Street Journal



In conclusion

The austerity measures relied primarily on expenditure cuts. Studies of past consolidation have shown that expenditure-based consolidation has more chance of success than increases in tax revenues.

The private sector relies on a stable medium-term environment in order to work around competitive forces and direct efforts of efficiency. Tax revenue increases were, in Greece's case, a crucial part of the austerity measures, but could have been less directed towards production, as these would be detrimental to competitiveness. A focus on tax evasion should have been front and centre as it was a crucial ingredient of the fiscal derailing

"The Greek tragedy contains more than its fair share of irony. Perhaps the biggest irony of all is that in the drafting of the Maastricht Treaty on Economic and Monetary Union in the late 1990s, it was Germany that insisted on the "no bailout" clause. A Greek default in 2010 would have avoided Greece's fiscal troubles cascading into an existential moment for the European Union. This is something many, including myself, proposed. But Germany and France did not want that. They feared that the damage it would do to the German and French banks that had gorged themselves on high-yielding Greek debt would further endanger a fragile global financial system. More debt was heaped onto already impossible-to-repay levels of debt. Greece's economic sustainability was sacrificed on the altar of European financial stability. Once a country is in a fiscal mess, there are economic benefits to a default. The object is not to punish creditors, but to allow a country to quickly return to the capital markets. The shame of default often leads to new political leadership, which gives credibility to new fiscal commitments."
Symeon Mavridis - Department of Social Administration and Political Science, University of Thrace, 11 October 2017

Alexandros Clappas, CFA

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