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MACROCOSM

Greece, Done At Last?

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Lorcan Roche Kelly

Greece comes off the threat-board as the can gets a very hard kick down the road.

While the eurogroup did not agree to give Greece zero-coupon perpetual debt -- also known as cash -- last night, they have come so close as to make no difference.

- The interest rate on the Greek Loan Facility (the series of bilateral loans to Greece as part of the first bailout in 2010) will be cut by 100 bp. This cut will likely mean that Spain and Italy will take a loss on the loans to Greece, because it pushes the rate below their own cost of funding.
- Interest payments on the EFSF's loans to Greece will be deferred for 10 years. While the interest is not being written off, deferring it does help Greece's cash position in the interim.
- The terms of both the bilateral and EFSF loans to Greece will be extended for 15 years. Average maturity of EFSF loans to Greece is currently 12.5 years so the new average will be 27.5 years. That gives Greece a great deal of funding certainty.
- Greece will also have any income from Eurosystem holdings of its debt purchased through the ECB's Securities Markets Programme (SMP) returned to it by national governments in the euro area.
- In order to further improve its debt profile, Greece will undertake a buy-back of any sovereign debt currently still in private sector hands -- yes, another Greek debt writedown. This move is not necessarily to the advantage of the Greek banking sector, which is still the largest holder of that debt.
- The buy-back is said to be priced at no higher than market prices on November 23 for the debt to be exchanged.

Overall, there is little to be unhappy about with the Greek deal. At worst, it gives the can a particularly hard kick down the road. At best, it means Greece is being given enough time to see if it is actually capable of turning its economy around.

There is now going to be a round of national parliament votes on yesterday's agreement, with disbursement due by December 13. There is little risk from the national parliament votes, although some will choose to use the opportunity to bang a political drum. For example, in Germany Michael Meister of Chancellor Angela Merkel's Christian Democratic Party

Update to strategic view

EUROPE MACRO, EUROPE BONDS: The eurogroup announced the longest kick yet of the Greek can down the road. By reducing, extending -- and yes, some pretending -- they have managed to move the Greek problem far enough into the future that it can be ignored as a fat tail risk. There will be a noisy round of parliamentary votes before deal is finalized, but there should be minimal problems there. In Spain, regional elections turned into a non-event, lifting another risk for that country.

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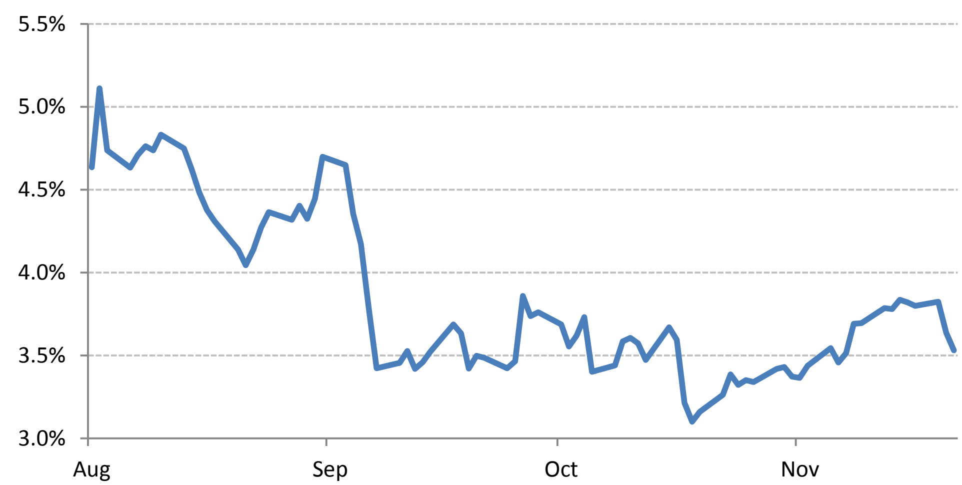
is opposing the deal. But Merkel doesn't need his vote, or that of other hard-liners in her party, as the opposition Social Democrats support the deal.

We are not going to see an end to the quarterly reviews of the Greek economy. But further strengthening of oversight by Greece's euro area partners -- full *ex ante* and *ex post* information required on all EFSF/ESM transactions to the segregation account (the account where euro-area money is paid and from where Greek debt repayments are made) -- should make them less fraught. Greece's reviews should become more like the ongoing Irish and Portuguese reviews, which never make the news anymore.

Overall, the Greek deal is a continuation of the diminution of systemic risk in the euro area, which began with ECB President Mario Draghi's July comments (see "On Draghi in London" July 26, 2012). The Greek situation has turned out as we expected (see "Bring in the Noise" September 26, 2012), even if it has taken longer than we originally envisioned. But kicking Greece into the long grass confirms that an imminent euro existential crisis is off the table.

As we have been saying, reduced tail risk means euro area sovereign debt markets should start to be priced more on country-specific risks rather than on global risk-on/risk-off mood swings. We continue to expect Spanish and French yields to keep converging, Spain toward the core and France toward the periphery (please see the chart below and "Calm Becomes Complacency" November 21, 2012).

10-year yield spread, Spain minus France



Source: Bloomberg, TrendMacro calculations

- The most recent positive development for Spain has been the results of the regional elections in Catalonia. Despite fears of a clean sweep for the pro-independence parties before the election, the results gave what can best be described as a mixed message. Even if there is no delay in forming a regional government, it seems

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the chances of an independence vote in the near future are now close to zero.

Bottom line

The eurogroup announced the longest kick yet of the Greek can down the road. By reducing, extending -- and yes, some pretending -- they have managed to move the Greek problem far enough into the future that it can be ignored as a fat tail risk. There will be a noisy round of parliamentary votes before deal is finalized, but there should be minimal problems there. In Spain, regional elections turned into a non-event, lifting another risk for that country.