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# The Arithmetic Adds Up to a Greek Restructuring

By CHARLES FORELLE

There is one word that must not be uttered in this town: Restructuring.

When it comes to the €110 billion they've pledged to Greece, officials of the European Union and the International Monetary Fund insist that a debt default by the bedraggled country is beyond contemplation.

"Let's be very concrete and precise," EU President Herman Van Rompuy said last week. The Greek package "does not include any provisions for debt restructuring."

But even if Mr. Van Rompuy won't talk about it, private economists sure will.

"At this point, it is very clear that restructuring is the only option," says Lena Komileva of Tullett Prebon in London.

"Almost certainly, the Greek debt will have to be restructured in 12 to 24 months," says Eswar Prasad, a former IMF official now at Cornell University.

And Josef Ackermann, the chief executive of Deutsche Bank, said earlier this month he thought it "doubtful" that Greece would be able to repay all its borrowings.

Why all the dour faces?

The Greek government had €273.4 billion in debt at the end of last year, equivalent to 115.1% of the country's gross domestic product. That ratio will rise sharply through 2012, since a yawning budget gap adds more to the tab each year. There are few signs that the stagnant Greek economy will grow anywhere near fast enough to catch up.

The EU and IMF's plan, which involves €80 billion in loans from the 15 other euro-zone countries and €30 billion from the IMF, is to keep Greece afloat for a few years while the country enacts giant cuts and fiscal changes. Those, it is hoped, will make Greece more attractive to private creditors, and the country can be eased back into capital markets.

If Greece's efforts can pare the budget gap enough, "then the debt-to-GDP ratio will start to recede and there won't be questions of sustainability," said John Lipsky, the IMF's No. 2 official, in a conference call the day the bailout was announced.

The private sector is more pessimistic, for two main reasons.

First, the cuts are brutal, and it may be difficult for Greece's leaders to sustain them. The plan, particularly this year and next, calls for big hikes in taxes and sharp cuts in wages and payments for the many civil servants.

Second, even if everything goes well, the sobering math favors a restructuring.

Greece in 2009 ran a primary deficit of €20 billion, which is to say that even excluding interest paid on its debt, the government was €20 billion in the hole. Like a consumer with living expenses greater than his salary, Greece needed to borrow just to keep the lights on—stopping credit-card payments wouldn't solve the problem.

A default now "would be a recipe for significant disorder," Mr. Lipsky said.

But the EU-IMF program trims the primary deficit. By 2012, according to IMF estimates, the primary deficit will have turned into a surplus of €2.4 billion. At that point, Greece is borrowing only to deal with existing debt.

The cost of that debt is soaring. In 2012, Greece will be spending €17.1 billion on interest, up from €11.9 billion last year. In 2014, when Greece's debt is projected to peak at €353.8 billion, it will pay €20.4 billion in interest to creditors. That's not far off what it will spend on government wages.

But that strengthens the Greek case to reduce the interest burden. High interest payments and no primary deficit "are the exact circumstances," wrote Citibank's Willem Buiter in an analysis earlier this month, "that make a default individually rational for the debtor."

In 2012 or 2013, with debt nearly 150% of GDP, "the notion of paying off banks in Western Europe is not going to go off very well" in Greece, says Cornell's Mr. Prasad. Especially since "you are going to have to squeeze social expenditures so much."

Ms. Komileva says Greece faces a "crisis of solvency." That's made clear by investors' ho-hum reaction to the European Central Bank's pledge to purchase

Greek and other sovereign debt from the markets. The yield on Greek 10-year bonds Thursday was 7.82%, down from pre-bailout levels but still more than five percentage points above Germany's yield.

Insolvent borrowers, Ms. Komileva says, have three options: get capital from a lender of last resort, improve their own performance or reduce their liabilities through restructuring. Greece has already tried the first two, she says, but they "haven't resolved the cause of the insolvency: lack of growth" and dire public finances.

Another issue posed by Greece's mounting debt: It will, eventually, still need access to large amounts of private financing. Of course, that's what triggered Greece's present problem.

In 2014, after years of painful cuts, the IMF projects Greece will need to borrow €70.7 billion and will have €265 billion in debt to the private sector—about where it was in 2009. Except that it will also owe €85 billion to the EU and the IMF.

Mr. Prasad, who worked at the IMF for 16 years, says the Greek program has bought the country a year before restructuring. But that year is "very important," he says.

For one, it forces the Greeks to make serious reform steps toward reform. It gives creditors time to prepare for a default. And it gives other weak euro-zone countries time to work on their finances.

"Spain and Portugal," Mr. Prasad says, "have been given a very clear signal that they have a year."

**Write to** Charles Forelle at charles.forelle@wsj.com