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## GREEK DEBT SWAP: A SIGNIFICANT STEP FORWARD, BUT FAR FROM THE END OF THE CRISIS

Greece has announced the results of its debt restructuring offer. The country achieved a participation rate high enough to allow it impose the terms of the restructuring on dissenting bondholders through collective action clauses (CACs). The debt swap will reduce Greek sovereign debt by around €100 billion. This is an important step, but there is still a long road ahead, not only for Greece, but for its private and official creditors as well.

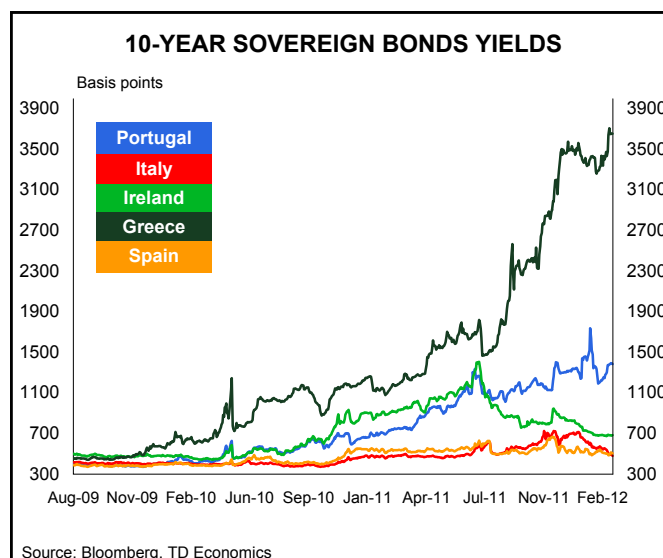
These are some of the details on the exchange results so far:

- 85.8% of Greek-law bondholders will tender their bonds, equivalent to approximately €152 billion face value. This is well above the 66 % majority required to activate CACs.
- 69% of foreign-law bonds chose to participate, equivalent to approximately €20 billion face value.
- Use of CACs will bring the participation rate to 95.7%, or approximately €197 billion. However, the participation deadline on foreign-law bonds has been extended until March 23rd 2012, which leaves the door open for a higher final take-up.

Following the announcement by Greek authorities, euro zone finance ministers held a conference call in which they decided to proceed with the disbursement of the euro area's contribution to the PSI operation in the form of EFSF bonds – i.e. the cash sweeteners – for the settlement of the Greek-law bonds, as well as the accrued interest on the exchanged bonds. They also noted that the necessary conditions are in place to launch the national procedures required for the final approval of the euro area's contribution to the financing of the second Greek bailout. At the same time, they called on the IMF to make a significant contribution to the new Greek program.

### Remaining issues:

The International Swaps and Derivatives Association (ISDA) is currently assessing whether Greece's use of CACs will constitute a credit event that will trigger credit default swap (CDS) payments. Although the net notional exposure on Greek bond contracts has been estimated at an arguably low €3.2 billion, what really matters are the gross exposures of individual underwriters of CDS. If the ISDA declares the credit event – it would be very odd if they don't – then some CDS sellers may face significant



losses if those exposure were not hedged. No announcement was yet made at the time of writing, though one is imminent.

The IMF board will meet on March 15th to assess progress towards completion of the second Greek bailout. Apart from the debt exchange, Greece had also been required to complete 38 actions before the program could be implemented. So far, there has not been any formal commitment from the IMF regarding the amount they will contribute to the program.

Greek elections will likely be held in late April and the most likely outcome is a weak coalition government. In the end, this would make implementation of fiscal austerity and structural reforms as challenging as it has been thus far. This, in combination with the dire current conditions of the Greek economy, will translate into program underperformance by Greece. In other words, a few months from now, Greece and its official creditors will be once again having detailed discussions regarding program implementation and loan disbursements. At the end of the day, this is very likely going to be just the first Greek debt restructuring. A good indicator of the odds that the market assigns to this event will come from the interest rates the new Greek bonds will trade next week after the debt swap has been done. Further-

more, given the fact that the new bonds being offered in the current swap have the same seniority as official loans, next time around, a private restructuring will have to impose the same conditions on official creditors.

Now the focus will shift towards Portugal and Ireland. Both countries are expected to be able to raise money in capital markets by the end of next year. The tough conditions imposed on Greek private bondholders will make it very difficult for them to issue debt at reasonable interest rates, despite the progress they have made thus far with their structural reforms and fiscal consolidation efforts. The high yields on Portuguese bonds are a clear indication that bondholders do not fully trust the sustainability of Portuguese sovereign debt, even under the auspice of the IMF and the EU.

The bottom line is that the preliminary results on the Greek debt swap are an important step, but by no means the end of the European sovereign debt crisis. Fiscal adjustment and structural reform will be on the European agenda for several years to come. Therefore, implementation risks across the euro zone periphery remain very much in place. Downside risks to the global economic outlook, albeit on a declining trend, are still present.

*Martin Schwerdtfeger*  
*Senior Economist*  
*416-982-2559*

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