

## OPINION

## Only Debt Relief Will Do

By Marcello Minenna

It's been a month since the eurozone approved an €86 billion (\$97.19 billion) bailout loan to Greece, yet the country's creditors have yet to come to a decision regarding debt relief for Athens. Now with a parliamentary election on Sunday that may not return a conclusive result, it looks like that decision will be further delayed.

Markets have been eager for a sign of what the creditors might do. Christine Lagarde, managing director of the International Monetary Fund, signaled recently that her institution would support lengthening bond maturities to 30 years or lowering interest rates, but not forgiving any debt outright. This is significant because the IMF has led the

**Greece needs to reduce its debt quickly. Adjusting interest rates or maturities won't be enough.**

charge for debt restructuring, and markets rejoiced at the prospect that investors would not be required to take haircuts. Greek bond yields collapsed, with the 10-year bond reaching 8.4% implicit yield after a peak of 13% in mid-June.

But the truth is that this form of debt relief will do nothing to reduce the burden or the riskiness of Greece's debt. Such a restructuring merely substitutes one risk for another: The debt would no longer carry the risks associated with an overwhelming burden due relatively soon, but instead would carry the risks of long-term economic and political variables associated with any longer-term debt.

The problem with the debate about Greek debt relief is that neither the creditors nor Athens are willing to contemplate what would be the obvious solution if Greece were a private-sector borrower. If we imagine Greece's debt as a private loan from a bank, it would have long ago been reclassified as a nonperforming loan and reposted on the bank's balance sheet at its current market

value. The difference would have been recorded as a loss.

Similarly, Greece could have offered a haircut on its existing debt, reducing its debt burden to about €150 billion from €310 billion, bringing its debt-to-GDP ratio to a level closer to Germany's. This would have reflected a marking-to-market at the face value of Greek debt over the summer, before the bailout plan triggered a sharp increase.

A comparable scenario unfolded in March 2012, when Greek bonds held by the private sector underwent a nominal haircut of 50% (about €100 billion) but whose effective size was closer to 70%. That haircut wasn't far from the market's valuation of Greece's public debt at the time.

The difference this time is that around 80% of Greek bonds are now held by the European Central Bank, the European Financial Stability Facility, eurozone governments or the IMF. A market solution would have required a political endorsement.

But precisely because so much of Greece's debt is held by public creditors, these creditors are more likely to prescribe to the usual "extend and pretend" recipe of deferring risk. A write-off now would entail significant political risks today, as German and other voters object to relief for a profligate Greece. A longer time horizon for Greek risk suits today's politicians much better.

Recent history indicates that extending bond maturities to avoid losses to public creditors is no solution. Today this could prove more harmful than ever because Greece is facing years of deflation. This trend, which is afflicting all of the eurozone despite the ECB's purchases of sovereign bonds under its quantitative easing program, will depress nominal GDP and exacerbate the debt-to-GDP ratio.

The more time is added to bond maturities, the more perverse effects will be free to operate in the Greek economy. This puts Greece on a path of unsustainability even steeper than its current one.