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Gramercy's thoughts on the Greece Bailout Package

After evaluating various official announcements regarding the most recent bailout package for Greece, we summarize our thoughts on the package as follows:

- The package offers only a token amount of debt reduction for Greece. Assuming that all goes according to plan, the debt/GDP ratio in 2016 would still be at least 120%. We believe that the Greek population will tire of austerity long before then and the package will collapse.
- The package also offers some interest rate relief to Portugal and Ireland, but does not offer any nominal debt relief. We believe that the EU will eventually relent and offer the same type of band-aid debt relief to these two nations. This also will not be enough to create a sustainable debt dynamic.
- The EU does little to address the growing stress in Spain and Italy, and therefore, contagion is likely to spread in the medium term.
- The ability of the EFSF to directly support banks is certainly a positive feature.
- The EU did not increase the size of the EFSF. With EUR 440bn size, and over EUR 200bn already used, it is woefully undersized to deal with Spain and Italy. Greece, Ireland and Portugal have a combined debt of approximately EUR 630bn. Spain has debt of approximately EUR 650bn while Italy has debt of approximately EUR 1.8tr. Italy really is too big to save, and Spain would require a herculean effort given the bad shape its banks are in.
- In the future if the EFSF were to be increased to the rumored EUR 2tr, this would imply an additional contingent liability of EUR 1tr for Germany and a bit less for France. In this case, we would expect both nations to be put on watch for a downgrade, and for France to eventually get the downgrade. It is unlikely that Germany would do anything to risk its AAA rating.

Overall, we are underwhelmed by the EU efforts so far. The devil will be in the details, and perhaps they have some other tricks up their sleeves. However, based on what has been announced so far, we believe that Greece will still end up in full default. The "Brady" type plan that Europe is proposing is not ambitious enough given the low amount of NPV savings to Greece.

The good news is that by discussing at least a small amount of debt reduction, the EU is finally admitting that the issue is not liquidity, but solvency.

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