Greece under Syriza. A Compromise. A Debt Exchange Offer.

A compromise for Greece and the troika.

- A debt exchange offer.
- New debt at much extended maturities. Face value smaller than existing face value.
- New debt to feature step up coupons to equalize the NPV of cash flows versus the existing debt.
- Effectively a refinancing.

Very quickly after winning the Greek elections, Syriza has approached Independent Greeks as a coalition partner. A coalition of the radical left and nationalistic right make strange bedfellows. Syriza’s 149 seats to Independent Greeks’ 13 mean Syriza will mostly have discretion in policy. With the elections out of the way, the question is, what next? Alexis Tsipras had made conciliatory sounds during the election but victory can change things significantly. Syriza had campaigned on a decidedly anti austerity ticket which was softened slightly during at the eleventh hour. With a stronger mandate than they had expected, Syriza may return to a more intransigent position. Indeed they may be expected to by their supporters.

Tsipras is in an unenviable position. On the one hand he has promised an end to austerity and to renegotiating the national debt with the ECB, EU and IMF, specifically seeking a one third write down of face value. The Germans have signalled that debt forgiveness is out of the question and that a Greek exit from the union is a practical possibility.

The Greeks will want to end austerity, to renegotiate the national debt and to reduce the face value of the national debt, as well as to benefit from the ECB’s bond purchase program. The Germans will want the Greeks to maintain austerity, continue to service their debt, and not write down any debt. A compromise needs to be found. There is no guarantee it will be.

A practical compromise would involve the following. Austerity measures could be partially rolled back so that the government could run a budget deficit. The terms of debt would be restructured to provide the Greeks more time to achieve cash flow solvency and balance sheet stability. Specifically, the coupons on the debt would be reduced but the maturities of the debt would be extended. The debt would include a 10 year moratorium on coupon payments but step up in later years. The average duration of Greece’s liabilities are just over 16 years. The debt could be restructured to push the average out to 30 years. The coupons would start in year 10 and step up. This would satisfy the Germans that there was no bailout but rather a constructive reorganization. New debt could also be issued on a novel basis requiring an explicit senior and secured claim on a proportion of tax and other government revenues. This innovation could be adopted even for non distressed issuers.

Even then, the ECB will not be able to buy primary issue, and of the secondary issue, special arrangements are required since the ECB already owns more than 33% of the Greek national debt, beyond the limit specified in its current QE program. For Greece to benefit from QE. It would have to make some concessions on austerity and it certainly could not seek a debt writedown. What Greece could seek is an exchange offer in which the longer maturity step up coupon debt is exchanged for the existing debt. Theoretically, the face value of the new bonds could be less provided the NPV of the cash flows is equal to the NPV of the old cash flows. This would require a higher average coupon or a much extended maturity. The former is not feasible given Greece’s current cash flow but the second is certainly a possibility. These are details of course but as is so often when politics interferes with economics, a compromise solution is more cosmetic than real.