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The Baseline Scenario

What happened to the global economy and what we can do about it

Greece Saved For Now – Is Portugal Next?

Posted on April 11, 2010 by Simon Johnson | 58 Comments

By Peter Boone and Simon Johnson

The Europeans announced Sunday they would provide 30 billion euros of assistance to Greece, amid informed rumors that the IMF will offer another 10-15 billion. With a total of say 40-45 billion euros in the bag – more than the market was expecting — the Greeks have time to make changes.

The Greek government, helped by the market threat of a near term collapse, appear to have strong armed the other eurozone countries into a generous package without making efforts to change seriously their (Greek) fiscal policy. This is good for near term calm, but it does not solve any of the inherent problems now manifest in the eurozone.

Often assistance packages of this nature just help "smart money" to get out ahead of a default. This could be the case here; 40-45 billion euros total money could last roughly one year. Both Russia and Argentina got large packages in the late 1990s but never regained access to private markets, so eventually everything fell apart.

Sunday's package should make it possible for Greece to borrow short-term but it takes courage to lend for 5 or 10 years to the Greeks unless there is much more fundamental change.

There are two key things to watch for:

1) Is the global recovery so strong that Greek's economy picks up fast and their budget deficit comes down sharply?

2) Will the IMF and Greeks now come up with a real austerity program that sharply cuts the deficit so that a year from now, when the official bailout money could run out, the market is receptive to Greek debt?

The danger for private debt holders is clear: Sovereign loans invariably treated better in a restructuring than private debt. So the European aid in some sense squeezes private debt holders. They will be pleased there is no near term default, but it means their recovery value has gone down if things get bad again. Greek long term yields will probably stay high. The key market reaction to watch over the next 6-12 months is long term yields, and whether these come down to levels that imply low risk of default.

And there is still definite risk of contagion. The actions of the EU show they are willing to intervene when yields get up to 7-8% on long term debt and markets close off to a nation.

What does this really mean for Portugal or Ireland? People holding Greek debt lost a lot of money in the last few months. That will not come back soon, as markets will for a long time be wary of buying their debt – especially when Fitch just took the Greek rating to BBB minus, i.e., at the floor where the ECB now lets banks borrow against ("repo") government debt.

The Portuguese therefore are not at all out of the woods. If they do not start making serious moves towards cutting their deficit, they are next for a test.

Surely the eurozone will bail Portugal out also – but where would it stop after that? The stronger Europeans, by coming to Greece's rescue at this time with little conditionality, are effectively showing all the weaker nations that they too can get a package. This will undoubtedly reduce the resolve for needed fiscal reforms across the European periphery.

We are still lurching from crisis to crisis in Europe.

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58 RESPONSES TO "GREECE SAVED FOR NOW – IS PORTUGAL NEXT?"

Per Kurowski | April 11, 2010 at 10:12 pm |

Alt. A. If Europe helps out Greece, in fact by refinancing all the Euros already financed to Greece, in fact postponing having to account for the losses today, in fact meaning that Greece will not pay a Euro on those debts for as long as needed, then the Euro will be seen as weak and lira like and the Euro will go down.

Alt. B. If Europe does not help Greece, and in fact has to absorb as losses all the Euros already financed to Greece, in fact meaning that Greece will not pay a Euro on those debts ever, then the Euro will be seen as strong and deutsche mark like, and the Euro will go up.

Exactly the same results for Greece... and totally different short term outcomes for the Euro.

Nine, the Portuguese authorities recently informed the IMF that the debt in the end of 2010 will be probably less that 8.3, problably 7.9.

So the Portuguese situation is totally diferent of the Spanish and the Greece situation.

Ze dos Montes | April 16, 2010 at 6:22 pm |

Wrong!
1º The Portuguese has the lowest wages of the Western Europe

2º The Portuguese have the highest taxes of the Western Europe.

3º They diminish the public officers but they increase the number of Public Institutes created with public money to put people of the party of the power.

4º All the great investments in unnecessary workmanships only had been postponed, and already they were in the reality been slow in the execution.

5º Portugal is governed by corrupt of name Jose Sócrates, with innumerable shady zones in its past, and isn't behind bars because of the political control of the justice system, the same way of the third world countries.

António Cordeiro | April 16, 2010 at 7:27 pm |

Mr. Simon Johnson
Today this article had been quoted by many newspaper, radios and televisions in Portugal. Our "distinct" minister of the treasury Teixeira dos Santos said that the article that you wrote "is nonsense, revealing of ignorance and in a free world of expression nonsense's without base can be written".
If you understand Portuguese you can read this in
http://tsf.sapo.pt/PaginaInicial/Economia/Interior.aspx?content_id=1545387
Can you comment this?
