VAKIFBANK GLOBAL ECONOMY WEEKLY

Possible Effects of Greece Debt Restructuring

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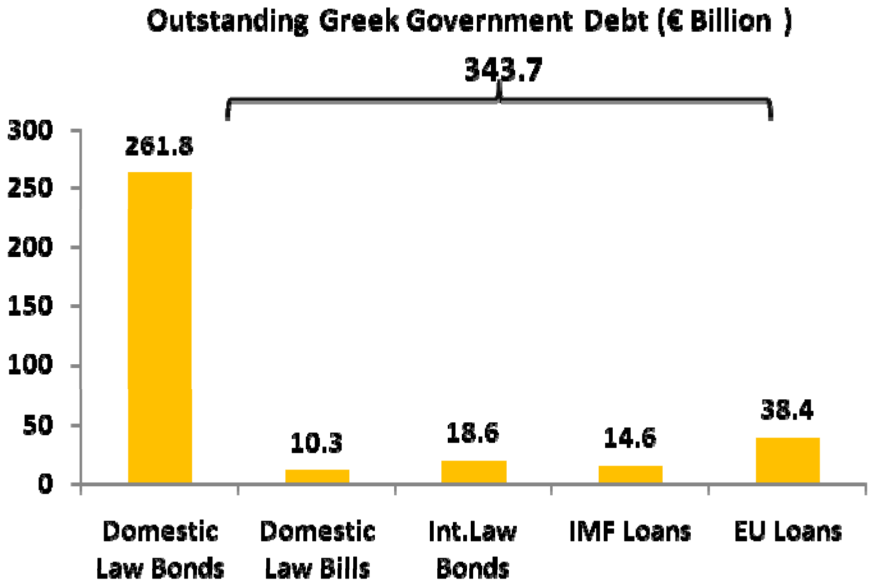
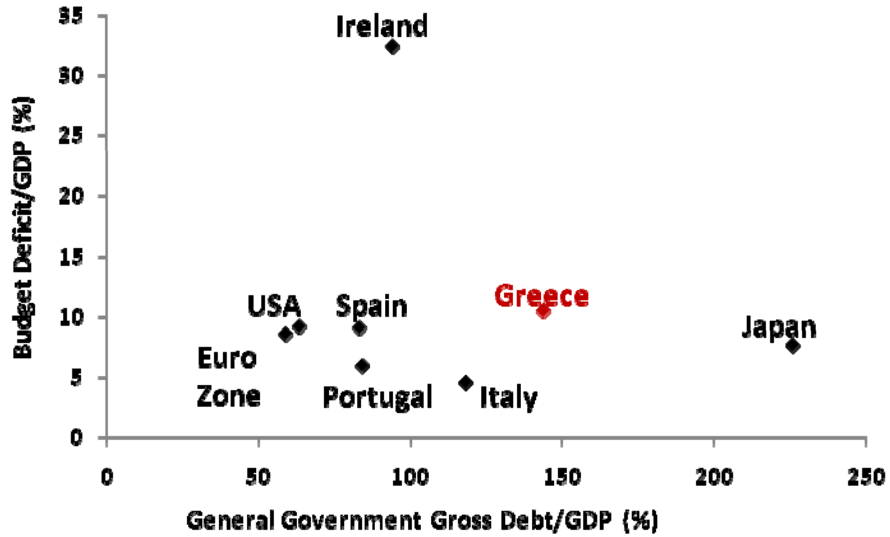
Vakıfbank Economic Research

The main risk for Greece is the default risk...



Source: Bloomberg, Europe Commission



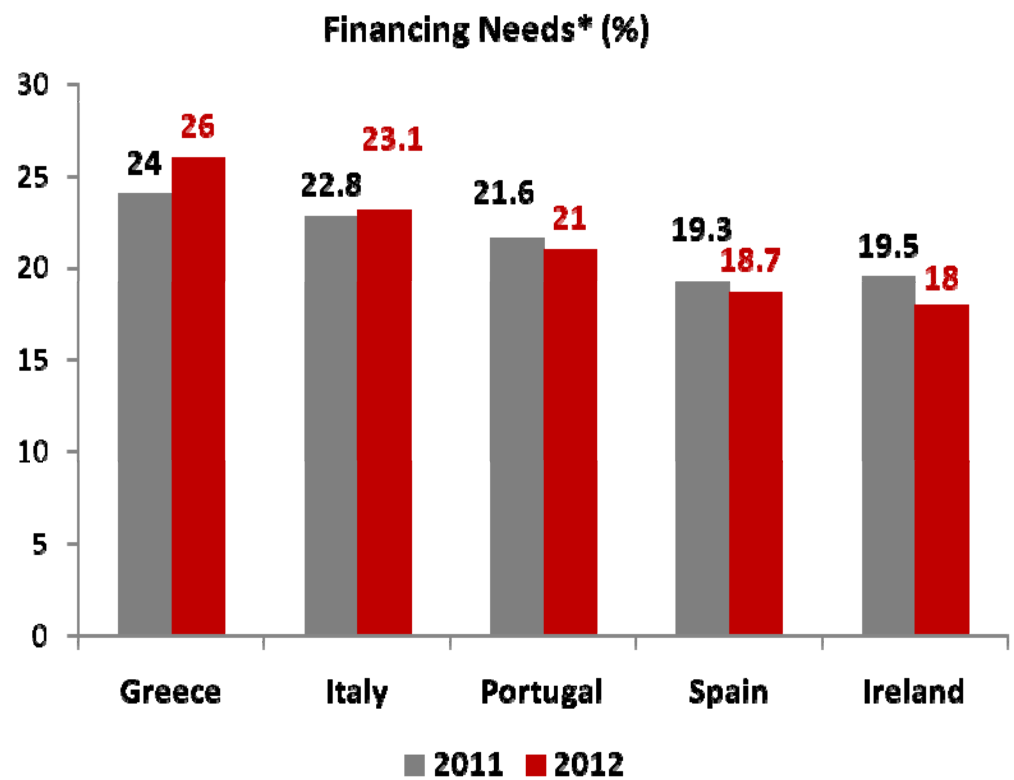
Source: Bloomberg

- The total amount of domestic Greek government debt outstanding of EUR 343.7 bn is expected to reach EUR 375 bn in the forthcoming periods. 2010 budget deficit releases indicate that Greece is still running a large primary deficit. The main reason behind the high deficit is the budget income collection below the planning level. Once speculation about a Greek debt restructuring intensifies due to high deficit, risk perception towards PIIGS (Portugal, Italy , Ireland, Greece, Spain) countries start to increase.

- The main risk for Greece is the default risk as Greek default would immediately increase the risk of contagion to the peripheral countries and would exacerbate the problems.

- Despite Japan and US have higher government gross debt to GDP ratios than Greece, these countries do not have a default risk as they could easily carry out borrowing facilities in the markets.

Financing Needs of PIIGS countries are expected to stay at high leves in 2011 and 2012...



*:Gross Gen.Govern.Debt Maturing+ Budget Deficit/GDP

Source: IMF

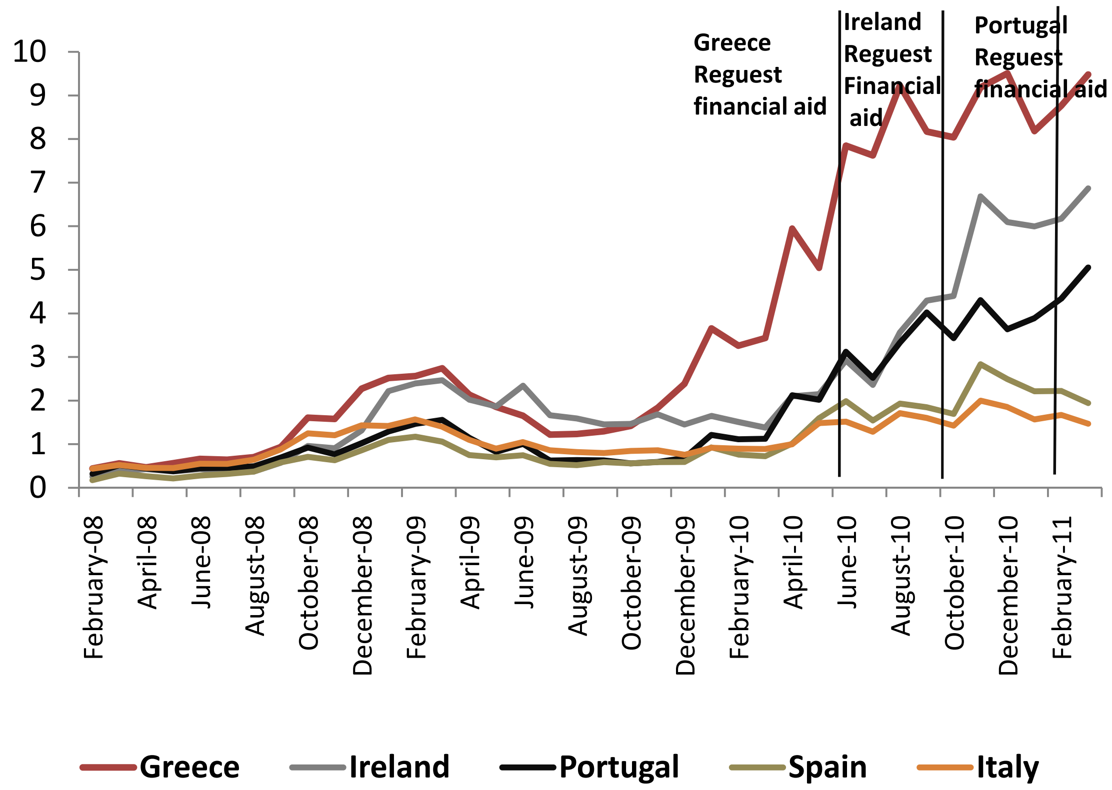
- Financing needs which is defined as gross government debt plus budget deficit per GDP, is expected to reach 26% for Greece and 23% for Italy in 2012. Whereas financing needs of other peripheral countries are expected to decrease.

- Greece's financing needs are expected to reach EUR 201.8 billion in 2011 and to EUR 193 billion in 2012. 70 percent of the financing needs is planned to fullfilled through short term borrowing in 2011.

- Greece has to pay out EUR 67 billion redemption in 2012, EUR 24 billion of this will be paid out by EU/IMF. As many central banks have started to tighten monetary policies and increased rates, Greek redemption conditions seem to be exacerbated.

The interest rate on Greece's 10-year bonds reached to record high levels as fears mount that Greece will have to restructure debt...

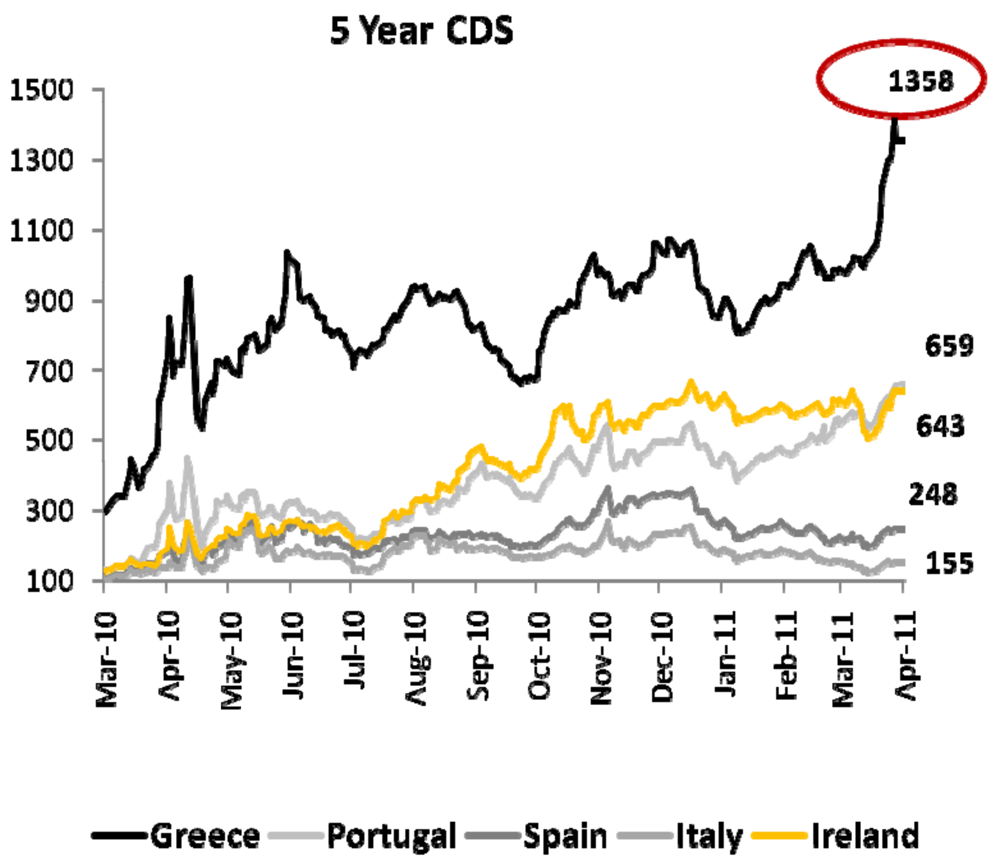
Spread Between German's 10 year Bond and Greece's 10 year Bond (%)



Souce: Bloomberg

- The ongoing debt crisis in PIIGS countries increased debt restructuring or default risks towards these countries.
- The risk of debt restructuring contagion resulted in widening spread between Greek government bonds and German bunds. Interest rates on 10-year Greek bond increase to 15.38%, 10-year Irish bonds to 10.65% and Portugal bonds to 8.41%.
- This means that investors have demanded higher interest rates to account for the added risk of buying these countries' securities.
- As interest rates for the governments of peripheral countries increase, it has become more expensive for them to finance their operations.

5 year Greece CDS is higher than critical 1000 level…



Source: Bloomberg

- 5 year Greece CDS is much more higher than other PIIGS countries.
- Greece CDS increased sharply after the restructuring speculations and reached to 1000.
- CDS of Brazil and Argentina were higher than 1000 when they announced default. Hence it shows that 1000 is a critical level.
- However, as Greece is a member of European Union (EU), the possibility of default is lower than the possibility of restructuring.

Debt restructuring…

High Budget Deficit

and

Gross Government Debt

increase the possibility

of debt restructuring.

Maturity extension

and

Haircut

are the possible restructuring methods for Greece.

RESTRUCTURING

Restructuring will cause risks for the banks which have the Greek equities.

There is a possible risk of Greek restructuring contagion to countries such as Ireland and Portugal.

Possible Costs of Debt Restructuring…

1-Credibility Loss of European Union Policies and Moral Hazard:

- Restructuring of Greece debt would result in questioning of EU credibility. If the contagion to other countries realized , this would lead to moral hazard speculation for EU.
- It would be very costly for EU to let Greece restructure its debt, if other countries, such as Spain Portugal, Ireland would be the next.

2-Banking Sector Risks:

- Under the consideration of the fragile structure of European banking sector, the Greek debt restructuring would have significant systemic risks.
- According to Bank for International Settlements (BIS), European Banks are still carrying USD154 billions of Greece risks.
- This concern would increase risk primia of many European economy.

Possible Costs of Debt Restructuring…

3-Direct Costs:

- The contagion of debt restructuring Greece to other highly indebted countries would increase cost for Germany and France.
- It is estimated that, 50 percent of hair cut of Greek debt would cost losses of EUR19.2 billion for European countries.

4-Greek Distinctive Risks:

- Greek economy is highly dependent to tourism sector that is affected from other countries income. So it is hard to obtain fiscal soundness.
- The other peripheral countries like Spain have taken more steps for fiscal structural reform than Greece, this leads timing of debt restructuring to be qestioned by other countries.

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