Greek bond issue, success or impasse?

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After a 3-year hiatus, Greece issued 5-year bonds last week. Unfortunately, the interest rate it paid was so high that it creates serious concerns for the upcoming impasse rather than being a cause for celebration as the Greek government wants. This bond issue does not create a clear path for Greece to enter the financial markets at the end of the EU help program in 2018. Instead, it shows the impasse that Greece will face in mid-2018.

First, the amount of the bond issue was very small, only €3 billion, instead of the planned €4 billion, because demand was low. Of this amount, half was covered with an "exchange" of 2-year bonds held by Greek banks. This means that only €1.5 billion was sold in the open market after a huge effort and significant payments to six banks and the Rothschild bank as an advisor. The amount of the loan is a drop in the ocean compared to the loans that Greece will need from 2018 onwards.

The bonds cost Greece 4.625%, while Greece borrows from the EU at an interest rate below 1%. That is, this issue is very expensive, almost five times more expensive than present borrowing. This is not crucial for a tiny loan of €1.5 billion, but, if the financial markets offer similar rates in 2018, Greece will be unable to borrow since the cost would be prohibitive.

After the disastrous Greek actions of 2015 that increased the national debt considerably, both the Greek government and the IMF have been declaring that Greece is unable to pay its debt to the EU in full. Since the debt to the EU is at 1% cost, how will Greece be able to pay the bond just issued that costs five times as much? And how will Greece be able to pay back new loans after 2018 if those also cost five times as much? Obviously, Greece being unbale to pay back the inexpensive loans of the EU, will also be unable to pay back the much more expensive loans from the financial markets.

The very expensive cost of 4.625% shows that Greece, with the present economic policy and government, does not have a hope to cover from the financial markets its large borrowing needs of 2018 and thereafter. Instead of celebrating, the Greek government should weep for the failure of the bond issue. Comparable countries have much lower 5-year borrowing costs: Ireland 0.009%, Spain 0.28%, Italy 0.77%, Portugal 1.22%. Even large Greek companies such as Mitilinaios have a bond rate of 3.1%. That is, Greece's borrowing costs are 50% higher than those of Mitilinaios. Greece needs to borrow at the current Portuguese rate of 1.2%, or lower, to be able to survive in 2018 without new loans from the EU. Otherwise, a 4th Memorandum with new loans from the EU is inevitable.

Why do financial markets give Greece the very high cost of 4.625% that deters Greece from borrowing while similar countries have a cost of 0.009% to 1.22%? Because Greece has tremendous uncertainty that is reflected in the rates it receives. The financial markets have not forgotten the disastrous "negotiation" of Varoufakis-Tsipras in 2015 that brought Greece to the brink of the total disaster of Grexit, the extreme acrobatics of the referendum, and the devastating policies that lead to capital controls which are still in effect. Markets pay attention when the government declares daily that it passes laws on economic matters with which it disagrees and plans not to implement them. The markets also take into account the official analysis of the IMF that finds Greek sovereign debt "highly unsustainable," that is, extremely unlikely to be paid back to creditors. The markets finally see that the Greek economy is stagnant, lacking the structural reforms that would rekindle it.

How could Greece win the trust of the financial markets and receive loans in 2018 with similar interest rates to the 1.2% of Portugal, that is, 75% cheaper than of the present Greek issue? First, Greece needs to win its credibility and trust through its actions. Greece should do the structural reforms rather than just plan for them for the indefinite future. Greece should show that it wants a smaller and more effective public sector. It needs to reduce business taxes as well as the bureaucracy in setting up businesses and regulating them. Greece needs to finally proceed with privatizations.

Unfortunately, it is extremely unlikely that the present Greek government will be able to achieve the required reforms within the remaining year to the end of the EU help program. The government has no plan. On the contrary, the government is divided on whether it wants to implement the reforms. For example, the Minister of Development declares that the huge business taxes are the correct economic policy! Even an efficient government, without internal divisions and without the history of the huge mistakes of 2015 would have a hard time convincing the financial markets to lend to Greece in a year at a 75% lower rate than today.

So, what will happen in 2018? The most likely scenario is that the government will call elections just before or just after the end of the EU help program and will leave to the next government the Herculean task of the real exit from the help program and financial markets borrowing. In the meantime, the present government will likely spend the money of the present expensive loan issue in the usual clientelist vote-buying tactics. Unfortunately, the difficult task of the return of Greece to normality will not start until after the elections.

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