TD Economics

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Commentary: Agreement on the Extension of Greece's Bailout Program

- Last Friday, Greece and the euro group of finance ministers issued a statement agreeing on an extension of the current bailout program for four months – through the end of June 2014. In this statement, Greece committed to fully honouring their financial commitments to all creditors in a timely manner – in other words, no debt forgiveness (at least for now).

- Greek authorities also committed to refraining from any rollback of measures or unilateral changes to policy and reforms that could impact fiscal targets, economic recovery or financial stability. In turn, Greece managed to earn a reprieve on their fiscal target for this year, a condition made necessary by the recent bout of uncertainty that has set back Greece's economic recovery.

- As per the agreement, Greece sent a list of economic reforms for review to the Troika (now renamed "the institutions") on Monday. On Tuesday, the euro group of finance ministers approved the list, as "sufficiently comprehensive to be a valid starting point for a successful conclusion of the review". While the ECB and the IMF both agreed that it was a valid starting point, both raised issues with the proposed list, regarding a lack of detail and assurances for previously-agreed reforms.

- The next step is for a ratification of the extension by euro area national parliaments, which is set to happen this week. There is likely to be some hand-wringing in the German parliament over the terms being overly lenient, and in Greece, over having given up too much. But, in the end, approval of the extension is likely.

- A more definitive list of reforms will need to be agreed on by the end of April. At that point, assuming the institutions see the review of the program as being completed, Greece is expected to receive the last portion of the bailout from the ESFS (€1.8bn), in addition to Greece's share of Euro system profits on Greek bonds in 2014 (€1.9bn) and disbursements by the IMF(€3.5bn).

Key Implications

- As we anticipated, in the end both sides were able to reach a compromise. The extension will buy some much needed time, and for the time being bring some semblance of calm to financial markets, which will now be able to return their focus to the macroeconomic backdrop. While the recovery remains uneven across countries, economic growth is accelerating in Europe, with positive surprises in both fourth quarter GDP and purchasing managers indexes (PMIs) at the start of 2015.

- In the near-term, pressure on Greek banks related to deposit outflows should ease. Moreover, the ECB may soon restart accepting Greek bonds as collateral, enabling Greek banks to lower their funding costs.

- While Athens will still need to repay €1.5bn to the IMF in March and another €450mn in early April, some type of short-term funding mechanism is expected to be granted, such as the increased issuance of treasury bills, but details remain unclear.

- Negotiations surrounding a final list of reforms in April are likely to be difficult, as evidenced by the reservations expressed by both the ECB and the IMF. Moreover, the bailout extension runs only until the end of June, just ahead of large payments to the ECB of €3.5bn and €3.2bn due in July and August, respectively. This suggests that some form of assistance program (with associated EU oversight) will likely be necessary beyond June. In this respect, the situation in Greece remains far from resolved, and will continue to be a periodic source of volatility for financial markets for some time still.

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