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Greek fire

By Adrian Murdoch

“Greece is back”, said the country’s PM in the aftermath of a successful sale of five-year bonds. Perhaps. But it is only back on a long road to rehabilitation.

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With a successful return to the European debt markets under its belt, Greece must realise that it cannot afford to let the reform process stall.

Greek fire is one of the most fabled of Greek scientific discoveries. Developed in the seventh century by a certain Callinicus, it was an incendiary weapon that would continue to burn even when on water. Used to great effect against the Muslim fleets, what was called the “flame of heaven” changed the nature of war. But it had one drawback. It occasionally blew up in the soldiers’ faces.

Only two short years ago Greece was, as one DCM head calls it, “the fallen angel and centre point of the European sovereign crisis”. It even gave its name to the portmanteau phenomenon – the Grexit – the putative departure of Greece from the European Union.

Now it had made a move out of a crippling recession. And, at the beginning of April, the Greek government returned to the markets with a 4.75% €3bn five-year bond yielding 4.95%. Many hope that it is as much of a financial game-changer as Greek fire was a military one. As heavily oversubscribed as it was pre-publicised, little wonder that Prime Minister Antonis Samaras told Reuters at the end of March that “Greece is back”.

Around 600 accounts wanted to get their hands on the paper. Not even a car bomb from leftist agitators, which, symbolically, went off outside a Bank of Greece building in central Athens as the bond was being launched, or a widespread strike, were able to derail the sale.

A successful bond deal does not mean, however, that Greece is out of the woods. Despite a successful debt restructuring that saw more than €100bn of government debt wiped out in 2012, Greek debt is still enormous. The total amount of money Greece will have borrowed since May 2010 from the Troika – the European Union, European Central Bank and International Monetary Fund – will reach €246bn by 2016. To put that into perspective, that is equivalent to 135% of the country’s entire GDP in 2013.

And the economy remains in tatters. Goldman Sachs’ positive comments on the country’s restructuring are bitter-sweet. “Greece is gradually exiting a deep recession, having shed almost 25% of its nominal GDP between late 2009 and late 2013,” it noted. Public debt remains 178% of GDP, the economy shrank by 3.9% last year and growth is expected to be only an anorexic 0.6% this year, according to the IMF. Unemployment is a stubbornly high 26.7% and the standard of living has set the country back decades.

Much like the support act for a headline star, it was a €500m 5% five-year senior bond sale by Piraeus Bank to yield 5.125% towards the end of March that heralded the Hellenic rehabilitation. The first Greek bank to appear in the capital markets for four long years was welcomed, albeit mostly by short-term leveraged investors and hedge funds. Despite the low rating of Caa1/CCC/B– the order book was six times subscribed and proved not only the need for yield, but that Greece could return.

Speaking on the day after the deal, Armin Peter, head of debt capital markets EMEA syndicate at UBS, captured the new mood of optimism. “It was a great success all around. It fuelled confidence that more will come and that it should be only a matter of time until the long-expected government issue finds its way back into the market," he said.

The Piraeus Bank bond performed well in secondary trading. In early April it had tightened in to roughly 350bp over mid-swaps or a yield of 4.125%. And other Greek companies signalled their intentions to follow suit. State-owned Greek utility PPC is currently planning a sale of €300m debt and other banks such as National and Alpha are likely to be tempted into the water.

With both the Piraeus Bank trade and now a sovereign issue, there is a meaningful curve for those potential issuers to price off.

Line in the sand

Most importantly of all, though, the sovereign deal drew a line in the sand about the country's recovery.

It wasn't even a case of whether it was a smart move or not – it was necessary. Let's not forget, the Troika loans for Greece have an interest rate only a little over 2%, and Athens has 20 years from 2022 to repay them in full. Not punitive by any stretch of the imagination. But as one DCM banker said, new funding will be more expensive than bailout loans, but that is not the point. "You have to go back," he said.

David Schnautz, director, interest rate strategy at Commerzbank, agreed, saying: "Greece has to start tapping the market. It will have to pay up in the beginning, but this is a case of 'invest in your investor base'."

Expected

After the deal was priced it became clear that a third of the paper had gone to hedge funds and only 4% to pension funds. As Greece comes back to the market a change in the investor base will be seen. The shape of the current book is not something that concerns Lee Cumbes, head of European SSA DCM at Barclays; indeed, it is almost expected.

"If you look at Portugal as a proxy it helps," he said. "The difference between the five-year syndicated tap in 2013 versus 2014 is that there was a distinct improvement in distribution. The 2013 deal had 24% hedge fund involvement, which was down to around 7% this year, while Benelux and Scandinavian involvement rose this year too. At the moment, Greece is seen as in the earlier part of the cycle."

Ratings is the sword of Damocles that has hanged over Greece. The sovereign is, undeniably, junk. At B– it is rated six levels below investment grade by both S&P and Fitch – and at Caa3 by Moody's. Although that constrained the number of accounts that could take part in the first deal, the massive demand for the paper was enough to show that it was not that much of a hindrance.

Two points stood in Greece's favour. First, that in the current environment of falling yields, the premium that Greece had to pay was considerably lower than it might once have done. Second, the ratings agencies appear almost kittenish in their views of Europe this year and while Greece is still a long way away from investment-grade status, many expect a more positive tone from the raters soon.

Back to dollars?

The obvious question is what is next for Greece. Several bankers suggest that a US dollar deal could be on the cards. "It is a well-developed credit market that is not so focused on the bank-based loan dynamics that you see in Europe," said one DCM banker. He cited Spain's US$2bn five-year sold at the end of February last year as a possible model. The paper was priced at mid-swaps plus 300bp and, importantly for Spain, the deal was no more expensive than issuing the equivalent bond in euros. Significantly, half of the paper went to US accounts. This could well play in Greece's favour as only 15% of its euro bond went outside Europe.

But although Greece has undoubtedly managed a coup with this bond sale, it still has a long way to go. "Greece is still in the recovery situation and real-money accounts are still licking their wounds," said one London banker, referring to the haircuts investors took on the debt. "The country still needs to continue the reform process."

After the bond was priced, a jubilant Deputy Prime Minister Evangelos Venizelos said: "The markets have voted for Greece." He was absolutely right, but the fear of a backfire, like with Greek fire, remains. Greece must remember that this is just the beginning of the reform process rather than the end.

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