Concession Smooths Way Toward a Greek Debt Deal

By STEPHEN FIDLER and MATTHEW DALTON in Brussels and ALKMAN GRANITSAS in Athens

The European Central Bank has made key concessions over its holdings of Greek government bonds, which will contribute to a reduction of the country's debt burden and smooth the path toward a new bailout for the country, said people briefed on Greece's debt-restructuring negotiations.

The decision by one of the Greek government's biggest creditors will narrow a gap in Greece's finances, helping pave the way for a debt-restructuring agreement with Greece's private-sector creditors and a new €130 billion ($170 billion) bailout from other euro-zone governments and the International Monetary Fund. But it is still unclear whether Greek politicians, facing public outrage, will accept the tough austerity policies pushed by European authorities and the IMF as the conditions to secure a deal.

The development came while thousands of Greeks protested Tuesday against the threat of yet more spending cuts and tax increases, and as talks continued in Athens on a new bailout deal and debt restructuring between the government and its international creditors.

The ECB has agreed to exchange the government bonds it purchased in the secondary market last year at a price below face value, provided the debt-restructuring talks have a successful outcome. The ECB won't take a loss on the transaction, but it isn't clear whether the bank will exchange the bonds at the below-par price at which it purchased them or whether it will make a profit, these people told The Wall Street Journal. News of the agreement was first reported by DJ FX Trader.

The concession appears to be a further sign of the growing pragmatism of the ECB under its new president, Mario Draghi, who took office on Nov. 1. Another signal of this was the ECB offer of three-year funds to banks in December in an effort, which seems to have been successful, to restore shattered confidence in euro-zone banks.
With worries about banks lifted, financial-market concern about the currency area’s stricken government-bond markets also eased. The ECB plans another offer of three-year funds to banks later this month.

The ECB bought the bonds at a discount to face value in a vain effort to support the price of Greek bonds. Until now, it has insisted it be repaid the full amount. Its concession means Greece reaps the benefit of the discount, rather than the ECB itself.

Greece's official creditors have been under pressure to make concessions because the expected deal with private bondholders, which will shave some €100 billion from the government's debt to private creditors, won't reduce Greece’s debt sufficiently to satisfy the IMF. The ECB concession could reduce Greece’s debt by as much as €11 billion, officials said—the difference between the price at which the ECB bought the bonds in the secondary market and their face value—although the actual reduction could be smaller if the ECB insists on turning a profit.

An ECB spokesperson declined to comment.

The idea is for the ECB, in effect, to exchange its Greek bonds for bonds of the European Financial Stability Facility, the euro zone's temporary bailout fund. The EFSF won't hold the bonds on its balance sheet, but will return the bonds to Greece, and Greece will then agree to repay the EFSF for the price at which the fund bought the bonds from the ECB.

However, the people briefed on the negotiations said another option under discussion—for national central banks of the euro zone, which are estimated to hold in their investment portfolios some €12 billion in Greek bonds, also to take part in the debt-reduction exercise—has been rejected by the ECB. This implies the central banks will insist on being paid in full.

In Athens on Tuesday, a 24-hour walkout called by public- and private-sector unions shut banks, slowed public transport, closed schools and forced hospitals to operate with skeleton staff. Demonstrators marched by the capital’s central square holding banners lashing out at austerity measures, while left-wing groups, under heavy police guard, called for revolution.

The protests came as Greek officials held a flurry of meetings to resolve lingering disputes over the new bailout, which is expected to provide the government with around €130 billion in new funds and include steep losses for private-sector investors holding Greek bonds.

Greek Prime Minister Lucas Papademos on Tuesday night met with official creditors—the "troika" of the European Commission, the ECB and the IMF—after discussions with the Institute of International Finance, the trade association representing Greece’s private-sector creditors.

As Greece’s economy has deteriorated, the hole in the country’s finances has grown. That gap could be accommodated by new loans, which would increase Greece’s debt when all parties have acknowledged that it is already way too high, deeper losses for private investors, which are already writing off as much as 70% of the value of their Greek bondholdings, or concessions by official creditors, including the ECB.

While officials said the ECB’s concessions could contribute a maximum €11 billion to fill a gap estimated at some €15 billion, it isn’t clear how the rest of the shortfall will be filled.

Euro-zone finance ministers will meet on Thursday to discuss the Greek bailout, German Finance Minister Wolfgang Schäuble said on Tuesday.

Time is short: Greece has a €14.5 billion bond repayment due March 20, and officials have sworn to include these bonds in a
With a Greek general election expected in early 2012, the political obstacles towards a debt deal could be insurmountable. Dow Jones’s Gren Manuel and Terry Roth discuss whether a path can be cleared in time.

Photo: Associated Press

The Eurozone dominoes are teetering. WSJ’s Matina Stevis checks in on Mean Street to point out that the probability of Portugal following Greece down an economically chaotic path has grown substantially.

Photo: Reuters.

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Restructuring that will see creditors receive new bonds with half the face value of the old ones.

But organizing this transaction will take weeks, and the talks have dragged on, delayed by one disagreement after another.

The latest fight is over bitterly unpopular measures sought by the euro zone and the IMF in exchange for lending more money to Athens.

These policies include a 20% reduction in Greece’s minimum wage, more than €3 billion of new government spending cuts, and further steps to slash supplemental pension benefits for retirees.

Tuesday’s protests reflect the deep discontent that has contributed to pushing the Greek aid program off track in the 21 months since the country signed its first bailout deal.

Greece has repeatedly missed targets for cutting its deficit, and euro-zone officials have been exasperated by what they see as the government’s resistance to adopting economic overhauls.

Now the European Union is insisting on a written commitment from both the government and New Democracy, the main opposition party, to support the program. On Wednesday morning, Mr. Papademos is scheduled to meet with the leaders of the parties supporting his coalition to shore up their support for a new loan deal, but it is still unclear whether opposition leader Antonis Samaras will back the policies sought by the EU and the IMF.

Skepticism about whether Greek politicians will remain committed to the program has led the euro zone to consider controversial policies for ensuring that Greece will use new bailout money to repay its debts.

Germany last week proposed the creation of a budget commissioner, named by euro-zone finance ministers, who would have veto power over Greek spending.

While that idea was rejected by other governments as too radical, Germany’s proposal for Greece’s bailout loans to be paid first into an escrow account that will pay interest to creditors before being directed to the Greek budget has gained support among other official creditors. However, it is facing opposition in Greece, these people said.

"The escrow account is an indirect oversight of Greece by Germany," said Greek opposition leader Antonis Samaras. "I have a problem with that."

The account would then be used first to repay Greece’s debts before disbursing money to fund government operations.

Analysts said this approach would ensure official and private creditors were paid before the Greek government touched the money.

They said it also makes any future threat to withhold aid payments from the Greek budget more credible, because payments could be suspended without causing a debt default that would shake government bond markets across
the euro zone.

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