No rest for the wicked…

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So, after months and months of refusing to even discuss about doing the obvious, the ECB has now signalled that they will do a debt swap with Greece – this weekend. But those who for months now have been arguing that this is not only a moral, but also a financially sensible, thing to do should not start cheering as yet. For there is another twist to the story.

Let me start with the argument in favour of the debt swap. The logical argument, that is, because there is another one (see below – on what the ECB says), the logic of which evades me. The logical argument is that the ECB (which, don't forget, is there to stabilise the inflation rate and the money markets of the Eurozone) bought the Greek bonds at a lower price than their face value and thus it can easily exchange them with new bonds at a lower face value without incurring any losses. If it was to do so, it would contribute to the overnight reduction of the Greek debt by some €15bn or so (7% of Greek GDP), thus giving a valuable deep breath to the Greek government and the Greek economy, crucially, without breaking any of the rules that govern it.

One could add to the argument that, by doing this, the ECB would also help stabilise the markets. Investors would find the Greek debt more sustainable (more accurately, less unsustainable) and would thus feel that a disorderly default by Greece becomes less likely. Logically, risks should go down and so should the spreads of Greek bonds (and of other sovereign bonds in the Eurozone). Moreover, the signalling by the ECB that it has the means and resolve to contribute to the reduction of the mounting debts in the Eurozone would have a further positive effect, instilling more confidence in the markets and helping more towards stabilisation – which is one of its reasons of existence.

Until now, the main obstacle to this course of action was the opposition by the likes of the Bundesbank to a relaxation of (perceived) rules and the offering of an easy way out for Greece, one that does not place on Greece the utmost of pressures for (much needed) structural reforms and serious/permanent fiscal consolidation. But this opposition seems to have become less vocal in the last few days, so the ECB is now in a position to make this deal with Greece.

You would think this is the end of the story – but you would be wrong. The ECB, partly as a way of ensuring the aforementioned opposition voices will be kept down and partly in order to proactively avoid any criticisms that it is breaking the spirit of the rules that govern it (no bailouts), decided to justify the proposed debt swap on the basis of the following argument: the debt swap is necessary, because in the (likely) event that the Greek PSI will not have the envisaged participation Greece will (have to introduce retrospectively and) enforce the collective action clauses (CACs) that force all bond-holders to accept a haircut imposed unilaterally by Greece. In that event, the ECB will incur real losses. Adding to this argument are 'anonymous sources' from the ECB which suggest that, actually, the new bonds will be of the same face value as the existing ones – which cannot possibly be true: otherwise, why would Greece agree to the swap? (What is more likely to happen is that the ECB will either accept new bonds at a lower face value or agree to sell the new bonds at the market value: either way, there will be a saving for Greece to the amount mentioned above – either way, no CACs will be inserted or activated.)

Now, hearing this, the markets – and especially those in the markets who have placed their bets against Greece and are urgently pushing for it to default – started spreading 'rumours' that this action by the ECB will destabilise the markets because it will represent a preferential treatment for the ECB and will increase the risk of a compulsory haircut (through the CACs) to the private sector. Thus, the story goes, the Greek bonds held by private investors would lose their market value even further, marking a "disastrous precedent" and discouraging investment (i.e., inflating the spreads) in other ailing Eurozone economies. In this story, the ECB debt swap is a sin to be avoided at all costs.

This pretty much summarises the story of the Greek crisis. The obvious solutions are there. But they get stuck time after time to political compromises and concerns about Greece's credibility (as well as to Greece's own compromising of its credibility – but that's a different story). When the political backing appears weak, one part of the market (those who want a return to normality) panics, fearing that the Greek debt will become unserviceable. This then pushes the politicians to somehow find a way to take some positive action. And when they do, the other half of the market (those who wish for a Greek default, joined by those in the political sphere who wish for a collapse of the Eurozone) voices concerns on the grounds that this action destabilises the financial system. And then the politicians back off, coming up with harsher conditions and more counter-productive measures. Which in turn spreads more panic to the first half of the market and raises more questions about the sustainability of the Greek debt and Greece's ability to implement the measures. And the cycle begins all over again – putting Greece tragically in the middle of a very sad story. But let's not forget that this is a story that started from Greece. As the prophecy warns, **there is no rest for the wicked**. (Or, as the Greeks say, "he who mingles with bran is eaten by hens"…)