Greek Bonds Are All the Rage in Europe, If You Can Find Them

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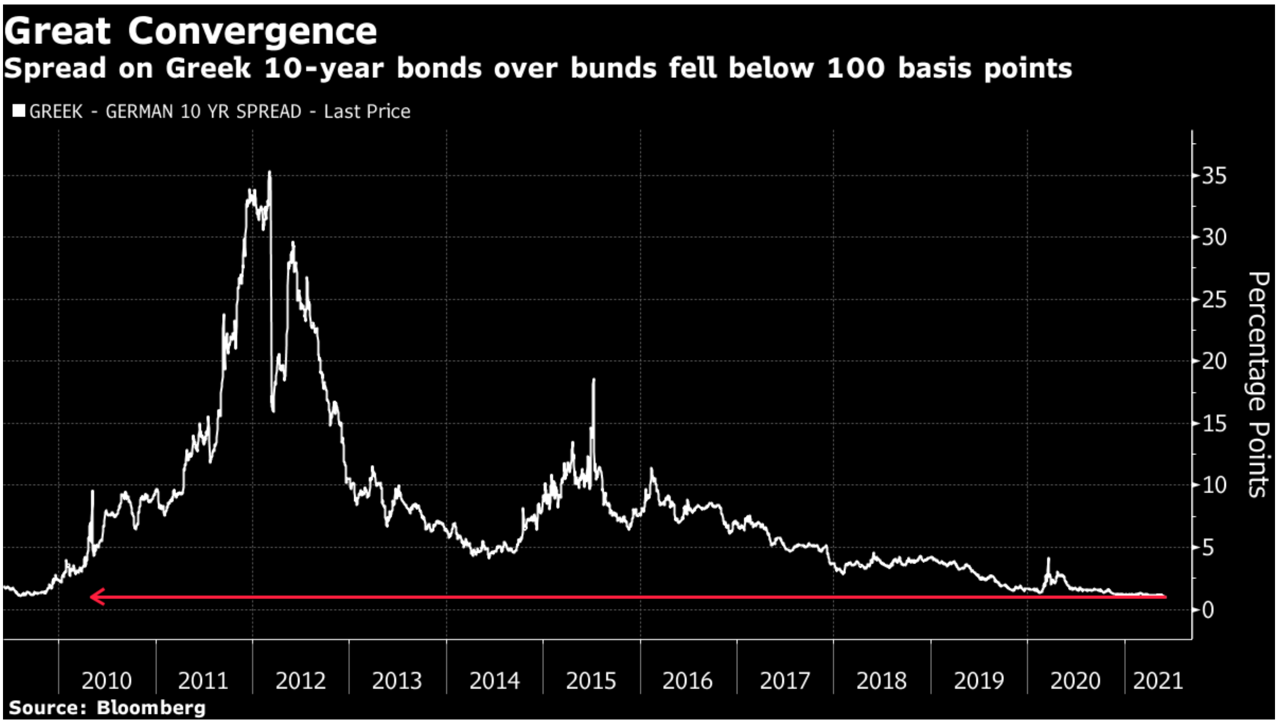
Constantine Courcoulas, Anchalee Worrachate, June 5, 2021

- Spread to bunds dips below 100 bps for first time since 2008
- Small size of the market has amplified impact of ECB backstop



Written off by most investors after a debt crisis over a decade ago, Greece's stunted bond market is making a roaring comeback.

The extra yield investors demand to hold the nation's 10-year bonds over equivalent German securities -- the region's paragon of safety -- briefly dropped below 100 basis points last week for the first time since 2008. And in an anomaly rarely seen since 2009, junk-rated benchmark notes issued by Greece pay less than Italian ones.

Backstopping the latest leg of the rally is a torrent of monetary stimulus to soften the damage of the pandemic. And it's having an outsized impact in Greece thanks to the market's small size, the fallout of international bail-outs and years of limited access to capital markets.

For investors nimble enough to navigate these illiquid yet high-yielding securities, they're proving a powerful proxy to wager that the European Central Bank will extend its phase of faster bond-buying when it meets to set policy next week.

"Despite Greece's high debt-to-GDP overall, there's not much marketable debt," said Mark Nash, the head of fixed income alternatives at Jupiter Asset Management, who has been long for four years and recently added to his position amid a bout of weakness.

He expects the Greek-German bond spread will narrow to 70 basis points, a level last seen before the collapse of Lehman Brothers over a decade ago. At 0.82%, Greek government bonds yield five basis points less than Italian equivalents.

Greece started selling bonds to private investors again in 2017 after a seven-year hiatus, yet official creditors still sit on close to 80% of the 380 billion-euro ($460 billion) government debt pile.

That has helped insulate the market from a rout spurred by fears that the ECB would begin paring back its pandemic emergency purchase program, or PEPP. Ten-year yields fell 18 basis points over the past month, bucking an increase across every other peer. Officials have since pushed back on taper talk.

Adding fuel to the rally is the fact that Greece has almost completed its planned borrowing for the year. If Athens doesn't ramp up issuance unexpectedly, there's only 3 billion euros of new bonds due to hit the market through the end of December.

This lack of supply means Greek government bonds "become harder to find especially vis-a-vis countries with frequent issuance patterns such as Italy and Spain," said Ioannis Sokos, a strategist at Deutsche Bank AG in London.

EU Windfall

That's not to say that there are no fundamental drivers. Last week, the International Monetary Fund said it sees the economy growing 3.3% in 2021, which would be the fastest pace since 2007. Meanwhile, the European Commission paved the way for Greece to benefit from further debt relief measures.

The country is also set to receive 32 billion euros from the European Union's recovery fund, a sum that could help make up for the dearth of investment that stifled growth after years of austerity.

"The EU support is significant, and has the potential to kick-start the economy," said Dimitris Dalipis, the head of fixed income at Alphatrust in Athens. That will help Greek assets, "particularly if a prudent fiscal stance is maintained and structural reforms continue."

Waiver Debate

Still, some are beginning to raise questions. Even after a string of upgrades, Greek bonds are rated junk by ratings firms. That means unless the ECB grants a waiver, they won't qualify for support after PEPP expires in 2022.

As of the end of the fourth quarter of 2020, the National Bank of Greece owned more than 20 billion euros of long-term Greek government debt, compared with about 4 billion euros before the pandemic.

While the prospect of rising yields poses a risk for indebted countries like Greece, Jupiter Asset's Nash is betting the ECB will hold down rates and expects other asset-support programs to take up the slack of the emergency backstop when it's eventually wound down.

"Given debt levels in U.S. and Europe and everywhere, I'm dubious anyone can tighten quickly," he said. "Greece won't be allowed to go to the wall."