Greece Downgraded To 'CCC+/C'; Outlook Negative

OVERVIEW

- Without deep economic reform or further relief, we expect Greece's debt
- and other financial commitments will be unsustainable.

- Greece increasingly depends on favorable business, financial, and economic
- conditions to meet its financial commitments.

- We are therefore lowering our sovereign credit ratings on Greece to
- 'CCC+/C' from 'B-/B' and removing the ratings from CreditWatch negative.

- The outlook is negative, given the risk of further worsening in liquidity
- for the sovereign, the banks, and the economy.

RATING ACTION

On April 15, 2015, Standard & Poor's Ratings Services lowered its long- and short-term sovereign credit ratings on the Hellenic Republic (Greece) to 'CCC+/C' from 'B-/B'. At the same time, Standard & Poor's removed these ratings from CreditWatch, where it had placed them with negative implications on Jan. 28, 2015. The outlook is negative.

As defined in EU CRA Regulation 1060/2009 (EU CRA Regulation), the ratings on Greece are subject to certain publication restrictions set out in Art 8a of the EU CRA Regulation, including publication in accordance with a pre-established calendar (see "Calendar Of 2015 EMEA Sovereign, Regional, And Local Government Rating Publication Dates: First-Quarter Update," published April 8, 2015, on RatingsDirect). Under the EU CRA Regulation, deviations from the announced calendar are allowed only in limited circumstances and must be accompanied by a detailed explanation of the reasons for the deviation. In Greece's case, the deviation was prompted by substantial deterioration in the liquidity of the Greek goverment and the Greek banking system--beyond our previous assumptions--and the resolution of our placement of the ratings on CreditWatch negative.

RATIONALE

The downgrade reflects our view that Greece's solvency hinges increasingly on favorable business, financial, and economic conditions. In our view, these conditions have worsened due to the uncertainty stemming from the prolonged negotiations between the almost three-month-old Greek government and its official creditors. The outlook for full-year economic growth is highly uncertain. We estimate the Greek economy has contracted by close to 1% over the past six months despite a weaker euro and lower oil prices. In our opinion, economic prospects could deteriorate further unless talks between Greece and its creditors conclude soon.

Weaker economic activity and rising arrears on taxes payable to the central government suggest that last year's relatively modest primary budgetary surplus will shift back to a deficit in 2015, absent a policy change. Greek banks are also experiencing liquidity pressures. Since end-November 2014, Greek banks have lost about 14% of their deposit base to customer withdrawals and deposit outflows have continued. The banks have funded these withdrawals primarily with Emergency Liquidity Assistance (ELA) from the Bank of Greece and with European Central Bank (ECB) financing (against European Stability Mechanism notes as collateral). The availability of this ELA financing (which we estimate at close to 7% of Greece's GDP) remains subject to frequent reviews by the ECB Governing Council.

The Greek government's credit standing faces several near-term challenges. This week, an estimated €2.4 billion in Greek treasury bills mature, with as much as one-third held by nonresidents. We assume that most nonresidents will not roll over their holdings. We expect that the government will marshal cash reserves of state-owned enterprises and municipalities to maintain a €15 billion stock of treasury bills outstanding. It might also exert moral suasion to have insurance companies and mutual funds of commercial banks increase their treasury bill holdings. If this assumption does not hold, the government could fail to achieve its borrowing requirement, leading to a default on sovereign debt, including treasury bills.

We also expect that the government will manage to continue to pay salaries and pensions in cash (rather than non-negotiable IOUs) despite weakening cash fiscal receipts.

The government's most pressing hurdle centers on its negotiations with its official lenders (the European Commission, International Monetary Fund [IMF], and ECB). In our view, if the stalemate between Greece and its official lenders is not resolved before the middle of May, then there might not be enough time for the Greek parliament to enact whatever conditions are attached to a revised lending program. Nor will the Economic and Financial Affairs Council (ECOFIN) group of eurozone finance ministers likely have time to sign off on the disbursement of the remaining €7.2 billion loan tranche to Greece under the current program or establish a successor financing facility. We consider the disbursement of this tranche to be necessary by late June so that Greece can avoid missing payment to the ECB on an estimated €3.5 billion in sovereign bonds held by the Eurosystem. Another €3.2 billion in payments to the Eurosystem are due in July. According to official data, total principal payments on medium- and long-term obligations held by commercial creditors du
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this year (including on debt issued by Hellenic Railways Organization SA) are only €300 million.

Our understanding is that talks on mutually acceptable revisions to the Economic Adjustment Programme for Greece continue, albeit at a slow pace. On April 24 and 29, 2015, European finance ministers will meet and could consider further reform proposals by the Greek government. A second payment to the IMF of €200 million is owed on May 1, followed by a €760 million payment on May 12. We think the Greek government will have exhausted its cash if there is no agreement by the date of the second IMF payment.

Although Greece's debt-to-GDP ratio was a very high 176% at year-end 2014, other features of its public debt profile are less onerous. These include its unusually long debt maturities--16.2 years for the total stock at year-end 2014 and 30 years on official bilateral financing and financing from the European Financial Stability Facility--and their low effective nominal interest rate, which we estimate is currently about 2%. Including concessional interest rates, Eurosystem retroceded interest earnings, and the interest rate grace period on official debt, we estimate Greece's general government interest at year-end 2014 at less than 3% of GDP.

A Greek exit from the eurozone is not our base-case scenario. We believe that the economic, social, and political ramifications for Greece of such an unprecedented step would be severe and likely be accompanied by widespread public- and private-sector payment defaults.

Early signs of heightened eurozone exit risk could include capital controls and bank deposit withdrawal limits as well as a cash-strapped government issuing IOUs to pay employees, pensioners, and suppliers. These IOUs could circulate as a secondary means of exchange and, over time, lead to a national currency (see "A Greek Exit From The Eurozone Would Have Limited Direct Contagion Risks For Other Sovereign Ratings," published Feb. 19, 2015).

Our sovereign ratings pertain to a central government's ability and willingness to service financial obligations to commercial creditors. In Greece's case, commercial creditors hold an estimated 20% of its total debt stock, excluding ECB and other official creditor holdings of bonded debt (see Eurozone Sovereigns To Decrease Commercial Borrowing By 2% To €916 Billion In 2015," published March 6, 2015). Debt redemptions of medium- and long-term debt owed to the private sector total less than €500 million in 2015 (less than 0.3% of GDP) and €1.09 billion (6% of GDP) in 2016, which are well below the redemptions Greece owes to its official creditors.

A missed payment to an official creditor would not constitute a trigger to lower the rating to 'SD' (selective default) under our criteria, although, all other things being equal, it would likely constitute a negative factor in our analysis. Under our criteria, only a missed payment to a commercial creditor would constitute a default (apart from a distressed exchange). The Greek government has repeatedly committed itself to excluding private-sector creditors from any further debt reprofiling, though we believe the incentives for another restructuring could shift if Greece's sovereign debt difficulties intensify.

OUTLOOK

The negative outlook means that we could lower our rating on Greece within a year if we perceived that the likelihood of a distressed exchange of Greece's commercial debt had increased further. This could be the case if, for example, we took the view that further official creditor disbursements will fail to materialize, resulting in the Greek government's inability to honor all its financial obligations in a full and timely manner.

We could revise the outlook to stable and affirm the ratings at the current levels if we believed that Greece and its creditor countries would agree on a new financial support program with policy conditions that satisfy all parties. Such a scenario could contribute to promoting political stability, tax compliance, and a gradual economic recovery in Greece.