IMF stuns Europe with call for massive Greek debt relief

'There would have to be a very dramatic extension with grace periods of 30 years on the entire stock of European debt,' the fund says

A man walks by a mural in Athens Photo: Reuters

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The **International Monetary Fund** has set off a political earthquake in Europe, warning that Greece may need a full moratorium on debt payments for 30 years and perhaps even long-term subsidies to claw its way out of depression.

"The dramatic deterioration in debt sustainability points to the need for **debt relief** on a scale that would need to go well beyond what has been under consideration to date," said the IMF in a confidential report.

Greek public debt will spiral to 200pc of GDP over the next two years, compared to 177pc in an earlier report on debt sustainability issued just two weeks ago.

The findings are explosive. The document amounts to a warning that the IMF will not take part in any EMU-led rescue package for Greece unless Germany and the EMU creditor powers finally agree to sweeping debt

relief.

This vastly complicates the rescue deal agreed by eurozone leaders in **marathon talks over the weekend** since Germany insists that the bail-out cannot go ahead unless the IMF is involved.

The creditors were aware of the IMF's report as early as Sunday, yet chose to sweep it under rug. Extracts were leaked to **Reuters** on Tuesday, forcing the matter into the open.

IMF managing director Christine Lagarde

The EMU summit statement vaguely mentions "possible longer grace and payment periods", but only at later date, and only if Greece is deemed to have complied with all the demands. Germany has ruled out a debt "haircut" altogether, claiming that it would violate Article 125 of the Lisbon Treaty.

The IMF said there is no conceivable chance that Greece will be able to tap private capital markets in the foreseeable future, leaving the country entirely dependent on rescue funding.

It claimed that capital controls and the shutdown of the Greek banking system had entirely changed the picture for debt dynamics, an implicit criticism of both the Greek government and the eurozone authorities for letting the political dispute get out of hand.

The decision by the European Central Bank to force the closure of the Greek banks two weeks ago by freezing emergency liquidity assistance (ELA), appears to have cost European taxpayers very large sums of money..

The IMF said the Europeans will either have to offer a "deep upfront haircut" or slash the debt burden by stretching maturities and presumably by lowering interest costs.

"There would have to be a very dramatic extension with grace periods of, say, 30 years on the entire stock of European debt," it said.

Debt forgiveness alone would not be enough. There would also have to be

“new assistance”, and perhaps “explicit annual transfers to the Greek budget”.

This is the worst nightmare of the northern creditor states. The term "Transfer Union" has been dirty in the German political debate ever since the debt crisis erupted in 2010.

The underlying message of the report is that Greece is in such deep trouble that it cannot withstand further austerity cuts. This is hard to square with the latest demands by **EMU creditors for pension cuts**, tax rises, and fiscal tighting equal to 2pc of GDP by next year.

Nobel economist **Paul Krugman said the cuts are macro-economic "madness"** in these circumstances.

Yanis Varoufakis, the former Greek finance minister, told the New Statesman that whenever he tried to discuss the economic rationale for the policies enforced upon Greece, he was met with blank stares. "It is as if you haven’t spoken. You might as well have sung the Swedish national anthem – you’d have got the same reply.”

Unless there is a change of course, Greece's debt ratio will still be 170pc of GDP by the time the current framework expires in 2022. Even this assumes that there is no global downturn, and that everything goes to plan. The figure is up from 142pc two weeks ago.

The IMF’s report raises as many questions as it answers. Almost no economist would accept that two weeks of capital controls could alone raise the debt ratio by 28 percentage points of GDP a full seven years later.

The backdrop to this sudden shift in position is almost certainly political. It follows an intense push for debt relief over recent days by the US Treasury, the dominant voice on the IMF Board in Washington.

The IMF’s report issued in early July was savaged by one bail-out veteran. Ashoka Mody, the former chief of Ireland’s IMF rescue, said the original findings were “fictitious” and failed to recognize the full gravity of the debt-deflation crisis in Greece.

It appears that powerful voices in global capitals and on the IMF board

have since demanded that the Fund go back to the drawing board.

Its conclusions validate what **Greece's Syriza government** has been saying all along. The debt cannot be repaid. Any formula that fails to recognize this merely stores up an even bigger crisis down the road.

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Greek bail-out

streets of Athens to heart-wrenching images of desperate pensioners queuing for cash, here are some of the starkest pictures from the past two weeks

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