A reflection of history: fluctuations in Greek sovereign risk between 1914 and 1929

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1. Introduction

The aim of this study was to explore the extent to which historical events, including political and institutional changes, shaped market participants’ expectations of the capacity of the Greek government to honour its debt obligations from the outbreak of the First World War until the advent of the great depression. Hence, this work contributes to the literature, which combines historical data with statistical evidence to examine the way that news interacts with capital markets to determine asset prices.

A ground-breaking article of this type by Willard et al. (1996) examined the impact of the events of the American Civil War on the market for Greenbacks, a legal tender currency issued by the Union. The literature that followed analysed the influence of war-related events on financial market assets again during the American Civil War or during the period around the Second World War.¹ Authors were particularly interested in whether contemporary market investors were able to anticipate crucial wartime developments and if, in

fact, they did. Occasionally the results of their statistical analysis were compared with claims in the conventional historiography.²

Mauro et al.’s studies differ from the aforementioned work as regards both the period and geographical region on which they focus. They examine yield spreads for sovereign bonds issued by emerging markets both before the First World War and again in the 1990s.³ Their work shows that turning points in sovereign risk during the first era of globalization are primarily associated with wars, rebellions, and political instability.⁴ No sharp changes in the time series they examined resulted from major institutional reforms. Even the promulgation of a modern constitution or the establishment of a central bank in Meiji Japan failed to elicit an immediate market response.⁵ Changes in monetary regimes, however, produced a statistically significant market reaction and affected the cost of capital even in the short term: the adoption of the gold standard in Japan in 1897 and the return to inconvertibility in Portugal in 1891 are two such examples.⁶

This article extends the analysis of the sovereign debt of emerging market economies during the classic period of the gold standard into an adjacent but quite different historical era. At the same time, it is related to the literature that focuses on wartime developments.

The historical period in question is complex. It includes both the First World War and the 1920s, a decade of widespread monetary upheaval on the Continent. Gold convertibility was restored and central bank independence was strengthened, either as a condition imposed by the League of Nations when assisting countries to *de jure* stabilize their currencies or by money doctors roaming the world.⁷

The paper makes a further contribution through the data it employs. This is the first time that daily time series for Greek sovereign risk have been compiled and presented in such a systematic way. The data is from daily observations and was collected by hand from *The London Times* and the *Stock Exchange Daily Official List*. The three time series of country risk constructed were considered statistically in isolation from their historical context. No dates were specified a priori as significant. Another contribution made by the paper is that it provides the evidence to empirically verify that central banks intervened in the markets to manipulate market prices of government debt, so as to improve the terms of any fresh borrowing. Finally, it introduces to the literature of economic history a new statistical method that can be used to detect breakpoints in the time series.

The statistical analysis here did not produce any breakpoints that would correspond to military news. The time series of sovereign risk demonstrate that it is defeat rather than war that influences market participants’ expectations about a country’s ability to honour its debt obligations. The analysis confirms that unexpected political changes have a strong impact on investors’ behaviour. In addition, it illustrates that fiscal announcements and news related to the flotation of fresh loans can change market actors’ behaviour. More importantly, it shows that the introduction of investor-friendly institutions, such as an independent central bank, did not elicit any quantitative market response. Contrary to the conclusions of studies on the first era of globalization, this work demonstrates that monetary regime change in Greece in the late 1920s, namely the introduction of the gold exchange standard, did not

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² For example, see Waldenstrom and Frey (2008) and Willard et al. (1996).
³ Mauro et al. (2006), Mauro et al. (2002), Sussman and Yafeh (2000).
⁴ Mauro et al. (2006, pp. 61–73).
⁵ Sussman and Yafeh (2000).
⁶ Mauro et al. (2006, p. 73) and Sussman and Yafeh (2000).
produce any breakpoints in sovereign time series. Institutional reforms, however, did lower the cost of capital.

The remainder of the paper is organized as follows. Section 2 describes the data employed. The method followed in the statistical analysis is developed in Section 3 where the results are presented. In Section 4 the breakpoints located in the time series are discussed and correlated to news that influenced investors’ expectations. The article closes with some general conclusions. A brief history of the period under consideration is presented in the online Supplementary material, Appendix B.8

2. Overview of the data9

Three time series have been compiled, each representing a Greek Government loan denominated in gold and traded on the London market, the most important borrowing market for the Greek government in the 1920s. All three loans were issued after the establishment of the International Financial Commission (IFC), a nineteenth-century institution which was responsible for servicing the Greek loans under its aegis. They are the Railways Loan, the Bonds Loan and finally the Refugee Loan floated in 1924. In addition, data has been collected on the British consol as a default-free government loan to construct time series for Greek sovereign risk. Sovereign risk here is defined as the ratio of the yield of a government loan to the British consol. The three Greek government loans concerned are presented in table 1.

The flotation of the Railways Loan was endorsed in 1900 and was aimed at funding the construction and running of a railway. As this was the first attempt by the Greek government to raise capital on the international financial markets since the establishment of the IFC, it was placed under the latter’s direct control. The Bonds Loan was authorized by law in 1910 and although it was secured by the surplus of tax revenues assigned to the Commission, it was not placed under their direct control. Both loans were redeemable at par in tranches drawn by lot every 6 months or by purchase on the open market, if the price was below par.

The Refugee Loan was issued under the auspices of the League of Nations late in 1924. This loan was raised to provide funds for the resettlement of refugees who fled to Greece following the Asia Minor debacle. A special body, the Refugee Settlement Commission, was established to administer the proceeds of this loan. The total sum issued was £12,300,000. A substantial part of the loan (£7,500,000) was issued in London while the rest was floated in almost equal parts in Athens and New York. Principal was repayable at par by twice-yearly ballot over a period of forty years commencing in September 1925.

Moody’s Manual of Investments which at the time furnished investors with ‘a key to the relative security and stability of particular investment bonds’, assessed the Refugee Loan as a safer investment than the other two Greek loans examined. Under their system of ratings, the Refugee Loan had a “Baa” rating, while the Railways Loan and the Bonds Loan had a “Ba”.10

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8 Appendix B can be accessed in the Supplementary Material online.
9 For more on the data examined see Christodoulaki et al. (2011, pp. 9–15).
10 Moody’s rating system (from highest to lowest) was: Aaa, Aa, A, Baa, Ba, B, Caa, Ca, C. See Moody (1926, pp. vii–xi and p. 550).
All the time series compiled for this article are composed of daily observations collected by hand from sources extensively used by contemporaneous market participants to assess the creditworthiness of the Greek government. The Railways and the Bonds Loan data come from *The Times*, whereas the source of the Refugee Loan data is the *Stock Exchange Daily Official List*. They represent each day’s final transaction as a percentage of par value.

British consols have been used as default-free bonds to construct time series of Greek sovereign risk. They have been collected by hand from the same sources used for the Greek government loans. For the period between 1914 and April 1925, the data on consols come from *The Times*, whereas for the remaining period the source is the *Stock Exchange Daily Official List*.

The Refugee Loan time series employed starts on 29 April 1925, the first day that this loan was traded on the London Stock Exchange, and finishes on 31 December 1929. In contrast with all other Greek loans traded on the London market, this loan was traded every day that the London Stock Exchange was open during the entire period in question. In fact, if the number of transactions that took place each day is used as a yardstick, then the 7 percent Greek Refugee Loan was one of the most popular loans on the London market.

The Railways Loan attracted investors’ interest more than any other Greek loan issued before 1914. However, neither the Railways nor the Bonds loans were traded quite as extensively. See table A1 in Appendix A for the total number of days each year that these two loans were traded on the London market. For the period between 1914 and April 1925 when trading of the Refugee Loan commenced, two Greek loans, the Railways and the Bonds Loan, have been employed to examine how news influenced investors’ expectations of the default risk of the Greek government. For the remaining period up to the end of December 1929, the Refugee Loan has been used. The three time series are plotted on figures 1 and 2.

Archival material shows that policymakers in Greece observed the market price movements of the 1914 Loan and the Bonds Loan in order to evaluate the country’s creditworthiness on the London market. It also reveals that the National Bank of Greece, possibly in

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**Table 1. Description of the loans**

<table>
<thead>
<tr>
<th></th>
<th>Railways Loan</th>
<th>Bonds Loan</th>
<th>Refugee Loan</th>
</tr>
</thead>
<tbody>
<tr>
<td>Year of issue</td>
<td>1902 and 1904</td>
<td>1910</td>
<td>1924</td>
</tr>
<tr>
<td>Amortization (years)</td>
<td>98</td>
<td>50</td>
<td>40</td>
</tr>
<tr>
<td>Coupon rate</td>
<td>4%</td>
<td>4%</td>
<td>7%</td>
</tr>
<tr>
<td>Sum authorized</td>
<td>£2,250,000</td>
<td>£5,955,000</td>
<td>£12,300,000</td>
</tr>
<tr>
<td>Sum issued</td>
<td>£2,183,280</td>
<td>£4,367,000</td>
<td>£12,300,000</td>
</tr>
<tr>
<td>Price of issue</td>
<td>83.50%(^a)</td>
<td>86.50%(^b)</td>
<td>88%</td>
</tr>
</tbody>
</table>
| Comments             | Purchases of bonds in relation to either the Railways or Bonds loans were possible if quoted below par. All loans were repayable at par by ballot every 6 months.


\(^a\)The March 1902 issue was at 83\(\frac{1}{2}\)% percent, whereas the June 1904 flotation was at 84 percent.

\(^b\)Price of issue in London and New York. The portion floated in Athens was issued at 86 percent.

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Figure 1. Railways and Refugee Loans, 1914–1929. Note: Sovereign risk is defined as the ratio of the yield of the Greek loan indicated above to the British consol. Sources: The Railways Loan daily data comes from The Times while the source of the Refugee Loan data is the Stock Exchange Daily Official List. The data on the British consol used to construct the sovereign risk time series comes from the same source as the equivalent Greek government loan in each case.
co-operation with the government, attempted to manipulate the market prices of Greek bonds twice during the period in question.\textsuperscript{12} Certainly an organized intervention by the National Bank began in September 1924, 3 months before the flotation of the London portion of the Refugee Loan. A second intervention seems to have been planned to coincide with the issue of the Stabilization Loan in January 1928.\textsuperscript{13} The information available on these two market adjustments is summarized in table 2.


\textsuperscript{13} The Stabilization Loan was issued on 31 January 1928 under the aegis of the League of Nations.
3. Detecting breakpoints

The method applied here to detect breakpoints in the time series of Greek sovereign risk was developed in Cho and Fryzlewicz (2012). Its advantage over the popular Banerjee et al. (1992) four-step technique is that it requires no subjective input on the part of the user. It also offers good practical performance on simulated data as illustrated in Cho and Fryzlewicz (2012).

3.1 Railways Loan time series analysis

The Railways Loan data set used covers the period from January 1915 to April 1925, though trading was uneven during this period with transactions occurring on 571 days out of a possible 3,060. The concatenation of the available data points is treated as the data set in our analysis below.

Denote the time series of length $T = 571$ as $\{X_t\}_{t=1}^{T}$. Since $X_t$ is a time series with a very high degree of autocorrelation (which makes it challenging to detect breakpoints in its mean or trend), we first difference $X_t$, which reduces the autocorrelation, and look for changes in its variance by observing the behaviour of the “local” variance estimate $Y_t = (X_{t+1} - X_t)^2 / 2$. See figure 3, where $X_t$ and $Y_t$ are compared.

Then we have

$$\sigma^2 = \text{var}(X_t) = \frac{E((X_2 - X_1)^2)}{2},$$

i.e. the unknown mean of $X_t$ is cancelled out by taking the difference between $X_t$ and $\sigma^2$ which can be estimated by $(X_2 - X_1)^2 / 2$.

In reducing the problem of detecting breakpoints in the variance of $X_t$ to detecting those in the expectation of $Y_t$, the CUSUM-type breakpoint detection procedure from Cho and Fryzlewicz (2012) is applied to $Y_t$.

The procedure was developed for detecting breakpoints in a multiplicative model of the following form

$$Y_t = \sigma_{t,T}^2 \times e_t^2, \quad t = 1, \ldots, T,$$

(1)

where $\sigma_{t,T}^2$ is a piecewise constant sequence (which corresponds to the expectation of $Y_t$) and $\{e_t\}_{t=1}^T$ are (possibly correlated) standard normal variables.

The first step of the procedure is to find the most likely location for a breakpoint. We locate such a point among $b \in \{1, \ldots, T - 1\}$ as the one which maximizes the following:

$$Y_{t,T}^b = \sqrt{\frac{T - b}{T \times b}} \sum_{t=1}^{b} Y_t - \sqrt{\frac{b}{T \times (T - b)}} \sum_{t=b+1}^{T} Y_t$$

(2)

where $Y_{t,T}^b$ is interpreted as the difference between the local means of $Y_t$ over the two segments $\{1, \ldots, b\}$ and $\{b + 1, \ldots, T\}$, adjusted by a multiplicative factor of the form $\sqrt{(T - b) \times b/T}$. This factor is chosen so that, in the ideal case of $Y_t$ being i.i.d. random variables, the variance of $Y_{t,T}^b$ remains constant over $b$. Similar CUSUM statistics have been adopted in the context of breakpoint detection, e.g. in Brodsky and Darkhovsky (1993), Venkatraman (1993), and Inclán and Tiao (1994), to name but three. However, one important difference between the aforementioned and Cho and Fryzlewicz (2012) is that, in the latter $\{e_t\}_{t=1}^T$ can be autocorrelated.

Once it is found that $\hat{b} \in \{1, \ldots, T\}$ as where $Y_{t,T}^b$ is maximized, i.e.

$$\hat{b} = \text{argmax}_b Y_{t,T}^b,$$

then $Y_{t,T}^b$ can be used to test the null hypothesis of $\sigma_{t,T}^2$ being constant over $t \in \{1, \ldots, T\}$. In Cho and Fryzlewicz (2012) the test statistic and its critical value are designed in such a way that, if a breakpoint is present in a given interval, the null hypothesis is rejected with probability converging to 1. If the null hypothesis is rejected, the simultaneous locating and testing of breakpoints is repeated separately on the two segments to the left and right of $\hat{b}$, i.e. $\{Y_t\}_{t=1}^b$ and $\{Y_t\}_{t=b+1}^T$, in a recursive manner until no further breakpoints are detected. It is shown in Cho and Fryzlewicz (2012) that this procedure, further equipped with a post-processing step whose details we omit here, correctly detects both the total number and the locations of breakpoints under the multiplicative model (1) with probability approaching one.

When the procedure described above was applied to $Y_o$ it returned $t = 25$ (28 March 1916), $t = 143$ (26 March 1920), $t = 338$ (7 February 1923), and $t = 475$ (19 May 1924) as breakpoints. The right-hand panel of figure 3 shows the local variance of $X$, estimated as the local mean over each stationary segment ($\hat{\sigma}_{t,T}^2$).

### 3.2 Bonds Loan time series analysis

The Bonds Loan time series for the period in question begins in March 1917 (as there was no trading activity between April 1914 and February 1917) and finishes in April 1925. It provides only 361 observations out of approximately 2,540 data points, which again are not equally spaced. We applied the same approach to its analysis as to the Railways Loan time series. Figure 4 compares $X_t$ and $Y_o$, and the estimated local variance of $X_t = (\hat{\sigma}_{t,T}^2)$ is represented by the bold solid line. The breakpoints obtained are presented in table 5.
Refugee Loan time series analysis

The Refugee Loan time series offers a complete data set with 1,180 observations covering the period from 29 April 1925 until 31 December 1929. Owing to its particular statistical features described below, the Refugee Loan data set was analysed differently from the previous two time series.

Removing the regular spikes

A key feature of the Refugee Loan daily time series is its biannual spikes. Figure 5 which is a plot of the difference in the time series represented by \( \{X_{t+1} - X_t\}_{t=1}^{T-1} \), captures graphically these biannual spikes, which occur on the last day of each April and October that the London Stock Exchange was open. See also table 3 where the spikes identified are presented.
These biannual spikes in the Refugee Loan time series coincide with coupon payments and redemption of bonds drawn by lot. From 1 May and again from 1 November each year, coupons were paid off at Hambros Bank in London, while at the same time bonds drawn by lot for redemption could be redeemed. Consequently, these biannual, regularly spaced spikes were removed from the data set before any further analysis was carried out.

Table 3. Regularly spaced biannual spikes in the Refugee Loan time series

<table>
<thead>
<tr>
<th>Dates of spikes</th>
<th>Events</th>
</tr>
</thead>
<tbody>
<tr>
<td>30 April (Thursday) 1925</td>
<td>Coupons and bonds drawn by lot were honoured at par following 1 May and 1 November each year</td>
</tr>
<tr>
<td>30 October (Friday) 1925</td>
<td></td>
</tr>
<tr>
<td>30 April (Friday) 1926</td>
<td></td>
</tr>
<tr>
<td>29 October (Friday) 1926</td>
<td></td>
</tr>
<tr>
<td>29 April (Friday) 1927</td>
<td></td>
</tr>
<tr>
<td>31 October (Monday) 1927</td>
<td></td>
</tr>
<tr>
<td>30 April (Monday) 1928</td>
<td></td>
</tr>
<tr>
<td>31 October (Wednesday) 1928</td>
<td></td>
</tr>
<tr>
<td>30 April (Tuesday) 1929</td>
<td></td>
</tr>
</tbody>
</table>

Note: \( T = 1141 \), which coincides with 31 October 1929, is not included as a spike since, unlike in previous years, no sharp upward movement is observed. The difference is explained by the turmoil that the Great Crash on the New York Stock Exchange created on the international financial markets. Nevertheless, it is important to note that, even if \( t = 1141 \) is included in the statistical analysis as a spike, the outcome remains identical.

Figure 6. Refugee Loan time series: \( Y_t = (X_{t+1} - X_t)^2/2 \). Note: The solid bold line is the estimated local variance of \( X_t(\hat{\sigma}^2_{t,T}) \).

These biannual spikes in the Refugee Loan time series coincide with coupon payments and redemption of bonds drawn by lot. From 1 May and again from 1 November each year, coupons were paid off at Hambros Bank in London, while at the same time bonds drawn by lot for redemption could be redeemed.\(^{15}\) Consequently, these biannual, regularly spaced spikes were removed from the data set before any further analysis was carried out.

3.3.2 Detecting breakpoints in the variance

After the spikes have been removed from the data set of the Refugee Loan, the breakpoints in the variance of \( X_t \) are detected by applying the CUSUM-type testing procedure to \( Y_t = (X_{t+1} - X_t)^2/2 \). As a result, two breakpoints are

\(^{15}\) Draws of bonds of the Refugee Loan took place in Athens twice a year in March and September, commencing in September 1925. The numbers drawn were announced in the press, including British newspapers, so that repayment could be made at par after 1 May and 1 November, respectively, each year.
returned at $t = 47$ (6 July 1925) and $t = 1123$ (7 October 1929). See figure 6 and table 5 below where these two breakpoints are presented.

Subsequently, these breakpoints are used to estimate the local variance of $X_t \sigma_{s,T}^2$ as the local mean over each stationary segment $(\hat{s}_T)$. Finally, this estimate is used to compute the “variance-stabilized” version of $X_t$

$$Z_t = \sum_{s=1}^{t} \frac{X_{s+1} - X_s}{\hat{\sigma}_{s,T}}.$$  (3)

### 3.3.3 Removing the linear trend from the data
As can be seen in the left-hand panel of figure 7, there is a strong downward linear trend in $Z_t$ as obtained in equation (3). The trend is removed from $Z_t$ via a linear fit (see table 4) and the residuals after de-trending are denoted by $z_t$. See the right-hand panel of figure 7.

### 3.3.4 Fitting an AR(2) model to the residuals
To study the behaviour of $z_t$, its autocorrelation (acf) and partial autocorrelation (pacf) functions are plotted in figure 8. The acf on the left-hand panel shows that $z_t$ is strongly autocorrelated and the pacf on the right-hand panel shows that $z_t$ may be well explained by an autoregressive (AR) process of order 2.
To confirm this observation, an AR(2) process was fitted to \( z_t \); the residuals comfortably passed the Ljung-Box test for the lack of serial correlation. Therefore, we concluded that no further systematic pattern was present in the data.

4. Breakpoints and historical events

Table 5 presents the breakpoints detected by the statistical analysis of the three Greek sovereign risk time series employed here. The second column of this table refers to the historical events that correlate in time with the breakpoints identified.

The two time series of sovereign risk analysed here, those relating to the Railways and Bonds loans respectively, which cover the period between 1914 and April 1925 as shown by figures 1 and 2, present a consistent picture of the period in question in spite of some differences. The statistical analysis confirms this discrepancy in the behaviour of the two loans. This difference could offer a “guide to the labyrinth” of Greek public debt, while at the same time demonstrating the complexity of the markets. It could be explained by the different attributes of the two loans, some of which are not always readily apparent. For example, the seniority sequence in the service of these two loans was dissimilar: the Railways Loan was under the direct control of the IFC but the Bonds Loan, despite being secured by public revenues assigned to the Commission, was not placed under their direct control. Knowing the identity of the ultimate buyers and sellers of Greek government bonds on the London Stock Exchange could also help to shed light on why there is a discrepancy in the behaviour of the two time series. However, this is evidence that it may not be possible to find for the period in question.

Both time series demonstrate that during the First World War Greek sovereign risk remained low. Uncertainty began a month after Greek troops disembarked in Smyrna and consequently country risk increased as the creditworthiness of the Greek government

\[ \text{Figure 8. Refugee Loan time series: autocorrelation (left) and partial autocorrelation (right) functions of } z_t. \]

\[ \text{16 The Economist, 27 January 1923.} \]
deteriorated. The Asia Minor campaign, acting perhaps as a proxy of fiscal performance, prompted a continuous increase in the risk premium of Greek government debt. By the end of the Asia Minor campaign, Greek sovereign risk had rocketed, reflecting the debacle and its aftermath in a striking fashion. It is noteworthy, however, that the statistical analysis here did not locate any breakpoints that would coincide with military news.

In early 1923, as both loans’ data sets show, risk premium started falling and the statistical analysis of the Refugee Loan country risk time series reveals a strong linear downward trend in this data set. By the end of the period in question, Greek country risk had decreased considerably, but still remained higher than it had been at the beginning of 1914.

It is a real challenge, using advanced statistical analysis, to attempt to understand market investors’ behaviour during such a complex historical period. The challenge becomes even greater when irrational noise trading occurs, leading to a divergence between market prices and fundamental values.\(^{17}\) In such cases, breakpoints detected by statistical analysis do not correspond to historical events. The underlying fundamentals of bond prices, however, are more easily defined than those of stock prices, a fact that makes the analysis of time series of bond prices less subject to problems of market inefficiency.\(^{18}\)

The statistical analysis of the three daily time series examined here shows that investors acted upon news of fiscal performance and public debt developments. Political events and in particular unanticipated political changes also influenced bondholders’ behaviour. In contrast, institutional innovations, such as the adoption of the gold exchange standard and the establishment of a central bank de novo, did not produce any quantitative market response. A

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\(^{17}\) De Long et al. (1990).

\(^{18}\) Frey and Waldenstrom (2004, p. 53).
A comprehensive review of the London press of the period establishes that market participants were able to keep themselves very well informed about developments in Greece. Market actors observed and evaluated every step taken towards reconstruction. As a result, stabilization and the concomitant institutional reforms were gradually factored into the market price of Greek government debt traded on the London Stock Exchange and therefore the risk premium demanded by investors fell steadily.

The results of statistical analysis here echo findings in the literature related to this article in that the importance of fiscal announcements and political changes that are not anticipated by markets is highlighted. Our research further complements that literature by demonstrating that news related to public debt developments, and more specifically to the flotation of fresh loans, elicit a quantitative market response. Our findings, however, depart from those of studies on the first era of globalization in that the statistical analysis did not produce any breakpoint that would correspond to the adoption of the gold exchange standard in Greece in the late 1920s.

Statistical analysis indicates that the two organized interventions of the National Bank to manipulate market prices of Greek government bonds in London, as described in table 2, did not produce any statistically significant market reaction that would indicate a change in the behaviour of market participants. As table 5 shows, no breakpoints were detected during the period in which the National Bank was attempting to improve the market price of Greek sovereign debt and thus to influence the terms for further borrowing by the Greek government on the London market. One of the two loans targeted by the market interventions of the National Bank in the autumn of 1924 was the Bonds Loan analysed here. It is, however, unlikely that the breakpoint detected in mid-December 1924 by statistical analysis of the Bonds Loan sovereign risk time series was triggered by market interventions. By then not only had the terms of the Refugee Loan been determined, but the loan itself had already been issued.

In the text that follows, the breakpoints detected by statistical analysis are correlated with historical events that appear to have shaped investors’ behaviour on the London Stock Exchange.

4.1 Asia Minor: increasing uncertainty

In 1916 deals in Greek government bonds on the London market were “rare” and did not “reflect the unsettled condition of politics” in Greece. Prices of Greek government bonds were supported by purchases for the sinking fund and by wealthy Greeks, in particular by those connected with the shipping industry. The statistical analysis locates a breakpoint in the Railways Loan sovereign risk time series between late March and early April 1916. However, dealings on this loan were so sporadic throughout 1916, as table A1 in Appendix A shows, and at the same time both the political and financial conditions in Greece were so complex, that it is difficult to isolate the events that may have produced this breakpoint.

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20 The terms of the Refugee Loan were published on 4 December 1924, which suggests that market interventions must have been terminated by that date. See The Times, “Terms of Greek Loan”, 4 December 1924. See also The Times, “Greek Government 7% Refugee Loan”, 8 December 1924.
21 Greek Extracts, Financier, 21 February 1916; see table A1 in Appendix A.
22 Greek Extracts, Morning Post, 4 October 1916.
23 Greek Extracts, Morning Post, 4 October 1916.
The two time series under scrutiny here show that sovereign risk began to increase at the end of 1919 when there had “been [a] considerable reduction in the quotations of Greek loans” on the London market.24 The statistical analysis of the Bonds Loan risk premium data set displays a breakpoint early in January 1920 when an uncomfortable “discrepancy between revenue and expenditure”25 was disclosed, demonstrating a change in investors’ perceptions of the fiscal health of the country in that month. The analysis of the country risk based on the daily data set of the Railways Loan locates a breakpoint approximately 3 months later than in the Bonds Loan, in late March 1920. Both these breakpoints indicate that investors considered it a possibility as early as spring of 1920 that the Greek government would not be able to service its debt and at the same time pursue its territorial aspirations in Asia Minor.

The Bonds Loan time series of sovereign yield spreads then displays a second breakpoint in the middle of November 1920, which supports the conventional historiography. The timing of this breakpoint coincides with the overwhelming defeat of Venizelos in the general election of that month which brought the Populist Party to power.26 Political historiography views this change of government in Athens as crucial to the course of history on the Asia Minor front and economic history literature sees it as central in explaining the slide of the drachma.

4.2 The debacle

After 1919 Greek government bonds sustained their downward trend and consequently the risk premium on Greek government debt rocketed, reflecting the decreased credibility of the Greek government as a borrower on the London market. The Economist repeatedly reassured holders of Greek government bonds that, although the situation in Athens was critical both financially and politically, there was no reason to suppose that this would affect the servicing of public debt.27 Market signals were also encouraging to investors. In 1920 the IFC paid bondholders of Greek loans issued before the 1893 default which were under its supervision their full contractual interest rate for the first time since the introduction of the Law of Control.28

The Asia Minor campaign ended disastrously for Greece in the late summer of 1922. The effect of this outcome, along with the political changes in the country that followed the military defeat, is illustrated dramatically in the sovereign yield spreads as expressed by the two time series employed here. The statistical analysis of the Bonds Loan time series detects a breakpoint in October 1922 during a period when “Greek bonds remained out of favour” on the London Stock Exchange.29 This breakpoint reflects the precarious financial situation in Athens. A military convention signed at Mudania on 11 October 1922 provided for the evacuation of the Greek population from Eastern Thrace. Approximately 200,000 people

24 Greek Extracts, Daily Telegraph, 1 January 1920.
25 Greek Extracts, Daily Telegraph, 1 January 1920.
26 The general election was held on 1 November by the Julian calendar which was used in Greece at that time. That is 14 November by the Gregorian calendar.
27 The Economist, 22 October 1921, 4 March 1922, and 5 August 1922.
28 The interest rate paid each year on the “Old Loans”, as these loans are known, fluctuated between the minimum rate defined by the Law of Control and the original nominal interest rate of the loan. For more information on these loans see Christodoulaki and Penzer (2004, pp. 15–16 and p. 60).
29 The Times, “Stock Exchange”, 15 November 1922; the Bonds Loan was traded twice in October 1922, whereas in November of that year no dealings took place on this Greek Loan.
had to leave the area for Greece “in a short space of time”.30 “Sheltering and feeding” over a million refugees while sustaining the “financial needs of the Treasury” were the most pressing problems that the Revolutionary Committee faced at the time.31

Clearly developments on the Asia Minor front had a decisive influence on the value of the country’s sovereign bonds traded in London. Political developments in the country and the uncompromising stance of the Revolutionary Committee in handling domestic issues had a strong impact on investors’ confidence in the creditworthiness of the Greek government on the London market. The value on the London market of the Bonds Loan, for example, fell to as low as 16 percent of face value on 1 December 1922, demonstrating a dramatic decrease in public confidence in the Greek government.32

4.3 Improved credibility and reform

Figures 1 and 2 clearly show that late in 1922 market actors believed that the Greek government was approaching default. In contrast, none of the Greek governments of the period, despite the difficulties they encountered in financing public expenditure, considered default an option. The humiliation of the military defeat in 1922, combined with the transaction costs, and the embarrassment of the 1893 default which still loomed large in politicians’ minds in Athens, as well as the belief that foreign aid would be forthcoming, led governments to opt for other, often controversial measures to cover expenditure rather than ceasing to honour their interest-bearing obligations.

Both time series of sovereign risk examined here present a breakpoint in early February 1923. These breakpoints and in particular that of the Railways Loan time series, since it is the first breakpoint of this data set located after March 1920, denote the end of a long period marked by the events that led to the Asia Minor debacle. It is possible that these breakpoints in early February 1923 reflect developments on the diplomatic front. On 30 January 1923, a convention was signed in Lausanne between Greece and Turkey for the compulsory exchange of populations between the two countries. In addition, the Greek government tried to improve its credibility by making positive statements in the London press about the fiscal position of the country at a time when it was searching for capital to finance the settlement of the refugees.33

Analysis of the Bonds Loan distinguishes it again from the Railways Loan and presents a breakpoint in late December 1923 which reflects the political developments in Greece that led to the return, albeit temporarily, of Venizelos to the political arena.

After unsuccessful attempts to raise capital on the international markets for the rehabilitation of refugees, the Greek government turned to the League of Nations for assistance. The news that an external loan on behalf of the refugees was to be granted to Greece under the auspices of the League was first announced to the public early in May 1923.34 It took a whole

30 The Times, “A Million Refugees”, 19 October 1922.
31 The Economist, 21 October 1922.
34 The Economist, “Greece”, 16 June 1923.
year, however, before in May 1924 it was finally confirmed that the Greek Refugee Loan would be floated in the following October or November. At the same time the Bank of England consented to despatch a second advance for the continuation of the settlement of the refugees until the flotation of the loan. The breakpoint that the analysis of the Railways Loan time series detects in May 1924, the last breakpoint that this series presents, coincides with these developments as they related to the flotation of the Refugee Loan. It also signifies the return of the country to the financial markets, for all that this return was under the supervision of the League of Nations.

In the end, the terms and conditions of this loan were finalized and announced early in December 1924. On 8 December subscription lists were opened in London at 9:45 a.m. but had to be “closed at about one minute past ten” that same morning and “hundreds of belated applications were excluded”. 35 “The actual result far outstripped the most optimistic expectations”, 36 as the Greek Refugee Loan was 21 times oversubscribed. 37 The breakpoint located in the Bonds Loan sovereign risk time series in the middle of December 1924 correlates with the success of the flotation of the Refugee Loan on the London market as this encouraged “buying of some of the older Greek loans”. 38

The euphoria created by the success of the Refugee Loan soon faded away. By March 1925, it was apparent that the proceeds of this loan would not be sufficient to complete the resettlement of the refugees. 39 In March 1925, the Bonds Loan time series presents the last breakpoint detected by statistical analysis. There is no obvious reason that would explain this change in the Bonds Loan time series other than that it was by then evident that the settlement of the refugees would be a more costly operation than had been anticipated.

The Refugee Loan sovereign risk time series employed to provide insight into the way that investors reacted to news from May 1925 until the end of 1929 shows that two statistically significant market responses resulted. A breakpoint is detected at the beginning of this period, early in July 1925, and a second one occurs close to the end of the period under scrutiny here, early in October 1929. See also table 5. The breakpoint located early in July 1925 must surely have been produced by the coup d’état of General Pangalos and the political events that followed, 40 since the news of the political turmoil in Athens triggered “a sharp decline” in the value of the Greek Refugee Loan on the London market. 41 By the time of the breakpoint a new government had been formed and the Minister of Finance had already announced both the economic policy and the aims of the new government. 42 The policy adopted by officials was to convince the financial markets that what had happened in Athens was “a mere change of government”. 43

The final breakpoint located in the time series occurs early in October 1929 when uncertainty had already begun to loom over the world’s stock exchanges. This breakpoint might

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36 *The Times*, “Heavy Rush for Greek Loan”, 9 December 1924.
37 Pepelasis Minoglou (1993, p. 89). The press at the time reported fifteen times and compared the Greek Refugee Loan with the German Dawes Loan which was covered thirteen times over.
38 *The Times*, “Stock Exchange”, 10 December 1924.
41 *The Times*, “Fall in Greek Bonds”, 26 June 1925.
reflect developments related to new borrowing by the Greek government, as described briefly in the last paragraph of this section.

The statistical analysis of the Refugee Loan time series does not reveal any breakpoints between July 1925 and the implementation of a League of Nations stabilization plan in 1928. However, it is apparent from figure 1 that eventual stabilization and the concomitant institutional reforms had already been factored into the market value of the bonds and consequently the creditworthiness of the Greek government improved on the London market. There are no breakpoints corresponding to events that the literature regards as playing a significant role in achieving monetary stability: that is to say the elections of November 1926, settlement of war debts with Great Britain, resorting to the League of Nations in 1927, and finally the flotation of the Stabilization Loan in 1928. Crucially, there is no statistically significant change that coincides with the establishment of the central bank and de jure stabilization of the drachma.

The central banking reforms and the adoption of the gold exchange standard in Greece in 1928 would hardly have taken investors by surprise. Both events had been publicized in the press. In addition, there was generally a lengthy time span between the initial, possibly informal, announcement and the promulgation of the reforms. Statements about the Greek government’s intention to stabilize the drachma appeared in the British press as early as July 192544 and the matter was frequently in the news up to the de jure stabilization.45 The formal announcement and the timing of de jure stabilization of the drachma close to its market value were therefore anticipated by market participants. The drachma had been de facto stabilized for a whole year before May 1928 and the monetary authorities as well as government officials involved advocated at every opportunity legal stabilization without “revalorization”.46

News about possible central banking reforms in Greece appeared in the British press on the same day that the Greek representatives in Geneva officially asked the Council to authorize a stabilization loan for Greece. The Financial News of 15 June reported that, under the League’s scheme, the National Bank of Greece “would be transformed into an issue bank and would engage a foreign advisor”.47 Some of these central banking reforms would in any event have been anticipated by the markets, as they were an integral part of all the League-sponsored reconstruction schemes that had preceded the Greek stabilization plan. Three weeks later, The Economist published a long article on the negotiations between Greek officials and the Financial Committee of the League. It was reported that a prerequisite for the flotation of a League-sponsored loan was that the Greek parliament authorize “the gradual conversion of the National Bank of Greece into a central bank of issue of modern type”.48 By that time, however, not only had the manner of central banking reform in Greece been agreed upon, but the statutes of the new bank of issue had been drafted.49

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44 Greek Extracts, Financial News, 6 July 1925. See also The Economist, 10 January 1925.
47 Greek Extracts, Financial News, 15 June 1927.
48 The Economist, 9 July, 1927.
The London press reported developments in Athens as they unfolded.\textsuperscript{50} A statistically significant market reaction might be expected, reflecting the announcement of the imminent establishment of the Bank of Greece. In fact, statistical analysis of the daily observations of the Refugee Loan shows that financial market actors’ behaviour was not dramatically influenced by the news. Market prices of Greek government bonds, however, did respond to the information available. Bond prices drifted gradually upwards as news of institutional changes in Athens reached the market and consequently, as figure 1 illustrates, the spread between the yield of the Refugee Loan and the British consol steadily declined.

The political authorities expected that institutional developments resulting in the establishment of a central bank and the adoption of the gold exchange standard would facilitate an influx of foreign capital essential for economic growth. However, by May 1928 the Greek government had over-borrowed and the international economy was about to enter the most severe depression ever experienced. A few months after Greece adopted the gold exchange standard, in December 1928, a loan for public works with a nominal value of four million pounds was issued on the London market, on similar terms to those of the Stabilization Loan. Only one-third of this loan was covered. A month later, in January 1929, the Greek government signed an agreement with Seligman & Co for a loan with a nominal value of up to 54 million dollars.\textsuperscript{51} The agreement provided for the flotation of a loan on terms similar to the Stabilization Loan on the condition that the IFC would assume responsibility for its service. Seligman would take responsibility for any part of the loan that remained uncovered. On 30 October 1929 the \textit{Evening Standard} announced the cancellation of this loan.\textsuperscript{52} The official reason for the termination of this agreement was that the IFC had refused to assume responsibility for the service of this loan.\textsuperscript{53} The timing of the termination of the agreement, however, is more revealing than the official announcement.

5. Conclusion

In this article three daily time series of sovereign risk have been compiled using Greek government loans denominated in gold and the British consol as a default-free government loan. The objective has been to analyse them statistically so as to shed light on the way that historical events, including institutional changes, interact with capital markets to determine asset prices.

The daily time series of Greek sovereign risk analysed here demonstrate that during the Great War, country risk remained low. However, the value of Greek bonds traded on the London Stock Exchange decreased dramatically in response to developments in Asia


\textsuperscript{51} The nominal value of this loan in sterling was approximately eleven million, close to that of the Refugee Loan of 1924. This means that the Seligman Loan was potentially a bigger lending operation than the Stabilization Loan.

\textsuperscript{52} Greek Extracts, 30 October 1929.

Minor and consequently the risk premium soared. News relating to the military campaign in Asia Minor became a proxy for fiscal performance.

The statistical analysis clearly shows that investors acted upon news of fiscal performance and public debt developments. Political events and, in particular, political changes that had not been anticipated also influenced the behaviour of investors in Greek government debt.

Institutional innovations such as de jure adoption of the gold exchange standard and the establishment of a central bank de novo did not produce any quantitative market reaction. Formal announcements on institutional changes such as the adoption of the gold exchange standard and the establishment of a central bank were unlikely to contain new information. Such reforms are promulgated over a period of time and need to be ratified by parliament. Market actors were able to observe and carefully evaluate every step taken towards stabilization. As a result, stabilization and the concomitant institutional reforms were gradually factored into the market price of Greek sovereign debt traded in London. The credibility of the Greek government on the London market improved and consequently the cost of capital was lowered.

**Supplementary material**

Supplementary material is available at *EREH* online.

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*Conflict of interest statement.* None declared.

**Archival Sources**

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Emmanuel Tsouderos Archive, Bank of Greece, File 22, Athens.


References


Appendix A

Table A1. Total number of trading days per loan on the London Stock Exchange, 1914–1925

<table>
<thead>
<tr>
<th>Year</th>
<th>Railways Loan</th>
<th>Bonds Loan</th>
</tr>
</thead>
<tbody>
<tr>
<td>1914</td>
<td>25</td>
<td>3</td>
</tr>
<tr>
<td>1915</td>
<td>23</td>
<td>0</td>
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<tr>
<td>1916</td>
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<td>1919</td>
<td>34</td>
<td>7</td>
</tr>
<tr>
<td>1920</td>
<td>79</td>
<td>77</td>
</tr>
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<td>65</td>
<td>11</td>
</tr>
<tr>
<td>1922</td>
<td>62</td>
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<td>56</td>
</tr>
<tr>
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<td>108</td>
<td>122</td>
</tr>
<tr>
<td>1925</td>
<td>39</td>
<td>54</td>
</tr>
<tr>
<td>Total</td>
<td>596</td>
<td>364</td>
</tr>
</tbody>
</table>

Source: Our own calculations using the daily data of the Railways and the Bonds loans collected from The Times.

aNumber of observations from 1 January 1914 until 30 July 1914. Between 30 July and 31 December 1914 the London Stock Exchange remained closed.

bNumber of observations from 1 January 1925 until 28 April 1925.