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# On the Greek Referendum Surprise

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**Lorcan Roche Kelly**

**Deja vu for world markets -- Greece ups the ante of panic once again.**

Greek prime minister George Papandreou's surprise announcement late yesterday of a referendum to approve the second EU bailout deal has resurrected worst-case fears of financial chaos in Europe, and sent markets into a tailspin. Reports this morning make it clear that Greece's EU partners have been caught by surprise by the announcement, and it seems that even the Greek finance minister -- hospitalized this morning with stomach pains -- was not aware that the announcement would be made.

In a report issued early yesterday we warned that "the details of just about everything announced after last week's marathon [European] summit -- remain to be worked out." We warned that Europe could still face a "difficult test of enduring a speculative attack, to establish that Europe has really built a robust safety net," and that stocks would have to suffer a correction (see "Not Crazy, Still Cheap" October 31, 2011). We had no idea it would happen this way, or so quickly. Now, in the wake of Papandreou's bombshell, stocks worldwide have given up more than all their gains from last week following the summit (see "On the Europe Summit" October 27, 2011), with European banks giving up the most.

We're now back in the world of intense existential uncertainty we faced early in the summer when it seemed that Greece would be politically incapable of being bailed out, or experiencing an orderly default. In June we began a client report (see "Greece: Suicide, Not Murder" June 7, 2011) with:

> …the Greek government of George Papandreou finds itself caught between a rock and a hard place. The rock is the so-called "troika" of the European Union, the European Central Bank and the International Monetary Fund. The hard place is the Greek people. Papandreou now has no room to maneuver.

We are now five months further into the crisis, and -- despite all the progress made at the inter-governmental level -- Greek political risk has not gone away. Let's review what we know so far, which is precious little:

**Update to strategic view**

**EUROPE MACRO EUROPE FINACIAL STOCKS:** Just when it seemed Greece had fallen off the crisis map, Papandreou places it back firmly front and center, and raises the specter of disorderly default and existential risk for the euro currency. We think the referendum, if it even happens, is unlikely to be substantive. But the heightened level of political chaos in Greece perpetuates the crippling uncertainty that has gripped Europe and the world. We will be watching carefully for responses by Europe's dominant political authorities, as well as for speculative attacks and the defenses called up by Europe's institutions.

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- The referendum is not likely before January -- if it happens at all -- because it is proposed to be a vote on an EU bailout deal that has not been finalized yet.
- It is unclear what exactly the referendum would or could ask. Some reports suggest that a vote on a fiscal matter is unconstitutional in Greece. But it is likely that any wording would be viewed as an "in or out of the Euro" vote. With Greek support for euro membership at 70% according to a recent poll, it is likely that such a referendum would be passed.
- But it is Friday's confidence vote in the Greek parliament that is most important at the moment. Papandreou is running out of allies ahead of the vote, with his PASOK party now only controlling 151 of the 300 seats in parliament. Calls for his resignation from his own party ahead of today's ministerial meeting further weaken his position.
- If Papandreou is defeated in the confidence vote, then there will be snap elections in Greece, which would forestall the need for a referendum. The election itself would amount to a referendum, with the winning party enjoying a mandate to finalize negotiations, or walk away from the table. The latter is highly unlikely, as walking away from the table would call euro membership into question -- and neither major party opposes euro membership, both recognizing it is generally supported by the electorate.
- Opposition leader Antonis Samaras described Papandreou's move as "his attempt to save himself" by setting "a divisive, blackmailing dilemma that endangers our future and our position in Europe."
- The reaction from the rest of Europe has been one of barely disguised horror, with French president Sarkozy and German chancellor Merkel due to discuss the development later today. Eurogroup president Jean Claude Juncker said that a no vote in the referendum could leave Greece bankrupt, adding that Papandreou had taken the decision without discussing it with his European colleagues.
- There has been no statement yet from the IMF -- which has yet to finalize the payout of the €8 billion sixth tranche of the 2010 bailout package, which was approved by the Eurogroup last Friday. It is unclear how the referendum threat, or the collapse of the Greek government would affect the disbursement. This is a major short-term risk. Failure to make the disbursement would throw Greece into a cash crisis in a matter of days, unable to roll over maturing debt.

## Bottom line

Just when it seemed Greece had fallen off the crisis map, Papandreou places it back firmly front and center, and raises the specter of disorderly default and existential risk for the euro currency. We think the referendum, if it even happens, is unlikely to be substantive. But the heightened level of political chaos in Greece perpetuates the crippling uncertainty that has gripped Europe and the world. We will be watching carefully for responses by Europe's dominant political authorities, as well as for speculative attacks and the defenses called up by Europe's institutions.

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**Correction**

In yesterday's report "Not Crazy, Still Cheap," author Donald Luskin erred by stating that US stocks were higher on the Monday following the Sunday night failure to support Lehman Brothers. They were in fact lower. This does not affect the observation that the systemic effects of Lehman's collapse were not immediately apparent. The author regrets the error, and thanks the client who pointed it out. A corrected version of the report can be downloaded from the archives.