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MACROCOSM

Greece Re-Re-Revisited

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If Greece could export uncertainty, it would be the richest country in the world.

As expected (see "Can Stocks Keep Melting Up?" February 10, 2012), the Greek parliament voted in favor of the new austerity package last night. This vote is not the end of the Greek story, but it is another banana peel avoided.

It is worth doing a recap of the other potential banana peels that still remain in the path toward a resolution of the Greek situation.

- The latest round of private sector involvement (PSI) -- Eurospeak for bond-holder loss-taking -- seems to be agreed, but the bailout package has to be in place to allow this to go ahead.
- The ECB still remains a hold-out in the PSI negotiations, adamantly refusing to take any losses. But seems to be softening its stance on a complicated finesse under which its losses would be masked by a bond swap with the EFSF, to help the package get through.
- Payments on the bailout package will be dependent on Greek politicians *implementing* -- as opposed to *agreeing to implement* -- another round of austerity, with the goal of bringing Greek debt towards 120% of GDP by 2020.
- In the press conference after the most recent Eurogroup meeting, held last Thursday to consult on progress on the Greek agreement, the committee of euro area finance ministers laid out their terms:
  - The Greek government has to find another €325 million of savings to replace the savings that would have been achieved through pension reform, an element of the austerity program that was unable to get through the Greek parliament. Greek finance minister Evangelos Venizelos will have to show how he intends to fill this hole in time for the next Eurogroup meeting, scheduled for Wednesday.
  - Yesterday's vote met only part of the Eurogroup's demands. Greece must -- also formalize in law what the Eurogroup calls "prior actions" -- meaning the parliament has to make official various austerity measures that have previously been negotiated. Voting on those measures is expected later this week.

Update to strategic view

EUROPE MACRO, FX: Greece's parliament has approved new austerity measures despite intense internal political gamesmanship. There are still €325 million in budget cuts remaining to be found, and more parliamentary votes this week affirming prior budget commitments. We expect a deal will be struck, but with Greek elections looming in April, there is a heightened risk that Greece may exit the euro currency. While not the catastrophe it would have been last year – and still unlikely – managing it would be a serious challenge and a serious risk.

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    - The Greek government will have to cede more power to the so-called troika, specifically the European Commission. Commissioner Olli Rehn said that the EC would increase its monitoring on the ground by increasing its resources in Greece and by expanding the interventions of its task-force. It would be more typical to hear an army general, not a European Commission official, talking about "resources on the ground" and a "task force." But the militaristic language points to how much sovereignty the Eurogroup is looking for the Greeks to give up.
- It seems that trust between the Greeks and the troika has almost completely broken down, with Jean Claude Juncker, president of the Eurogroup, saying that it can no longer live with a system where promises are made but implementation is weak.

There are two deadlines for the Greeks, one market-driven and one political.

- There is a €14.5 billion bond due for redemption on March 20. If the PSI deal is not in place before that -- or if the Eurogroup has not agreed to the second bailout -- then a disorderly default would be likely.
- On the political side, elections in Greece are scheduled for an as yet unconfirmed date in April. Yesterday's divisive vote has left Greek domestic politics in turmoil, with some members of every party voting against their party's position on the austerity package. Much of this week will be spent reshuffling parties, which is far from ideal election preparation.
- Two months from an election, it is likely that Greek politicians will continue to visibly assert their independence. This may lead to opposition New Democracy leader Antonis Samaras -- the favorite to win the next election -- refusing to sign up for any further troika terms.

For now, presuming Venizelos can find the €325 million in required savings, the ball has moved back to the Eurogroup's court. Momentum seems to be in favor of a resolution being found, but with the political situation in Greece already tense, the risk of a political accident remains high.

German patience is wearing thin, and Greece's debtor's leverage seems to be used up.

- Phillip Rosler, German economy minister and leader of the FDP, the Christian Democrats' junior coalition partner, said that the prospect of Greece leaving the euro currency is "less scary."
- This may not reflect the mainstream German government view, but it is a significant departure to have it said out loud that euro exit is anything but unthinkable. This suggests that the Greek default risk that dominated 2011 will be replaced in 2012 by the risk that Greece will leave the euro.

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- The PSI agreement assures that we are going to get an orderly Greek default. Allowing Greece to leave the euro – while a growing prospect, still quite unlikely in our view -- would be a much more challenging matter. But as we said last week, the world has changed since the panicky days of former Greek Prime Minister Papandreou's proposed referendum on euro membership. European political and economic integration has proceeded to a point at which a Greek exit would not be the existential threat and global catastrophe that it once would have been (again, see "Can Stocks Keep Melting Up?").

Bottom line

Greece's parliament has approved new austerity measures despite intense internal political gamesmanship. There are still €325 million in budget cuts remaining to be found, and more parliamentary votes this week affirming prior budget commitments. We expect a deal will be struck, but with Greek elections looming in April, there is a heightened risk that Greece may exit the euro currency. While not the catastrophe it would have been last year – and still unlikely – managing it would be a serious challenge and a serious risk.