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MACROCOSM

Here Come Greek Elections -- and QE from the ECB

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Donald Luskin with research input from **Lorcan Roche Kelly**

This Greek crisis is not a euro crisis. And sovereign bond purchases will make sure of it.

Yesterday's failure of the Greek parliament to elect a president means that Greece will hold a general election on January 25, 2015 (see "Yes, It's Another Greece Crisis" December 10, 2014).

Polling at the moment shows that SYRIZA -- The Coalition of the Radical Left -- is maintaining a 3 to 6 point lead over Prime Minister Antonis Samaras' New Democracy party. But its lead is diminishing. It's certainly possible that ND can come back to win. After all, radical populist movements in Europe have consistently been defeated in Europe in come-from-behind victories for moderates, as in Scotland's recent succession referendum (see "The Untied Kingdom" September 10, 2014).

Even at current polling, SYRIZA could not secure an overall majority in parliament. It is itself already a coalition, so it would be difficult for it to attract other parties to form a government. So with a SYRIZA win, at minimum there would be a great deal of ongoing political instability in Greece. If SYRIZA wins big enough to earn an outright majority, so much the worse. SYRIZA's insane economic policies will set a collision course with the "troika" of the European Union, the International Monetary Fund and the European Central Bank which funds Greece's bailout package.

We will come back to the Greek election over the coming weeks, but for the moment, only one thing matters. The Greek election is a risk event for Greece -- it does not matter for the euro area as a whole. In other words, it is not a re-emergence of the euro crisis.

- In the crisis, the critical issue was the market's lack of confidence in the ECB's ability and willingness to keep the euro from chaotically breaking up. ECB President Mario Draghi's famous July 2012 "whatever it takes" speech ended that concern (see "On Draghi in London" July 26, 2012).
- Now, if the worst comes for Greece and it becomes a failed state that gets gradually and informally deprecated out of the euro, there doesn't have to be contagion to the other countries sharing the common currency. There doesn't have to be a system-wide run on the currency that would result in a messy 18-way break-up.
- This morning Italy auctioned a 10-year bond to yield less than 2%, for the first time ever. This is not what contagion looks like.

Update to strategic view

EUROPE MACRO, ECB, EUROPE BONDS: Failing to elect a new president, there will be general elections in Greece on January 25. The radical SYRIZA party currently leads in the polls, but its lead is diminishing. The moderate New Democracy party can still win, as moderates have consistently won in Europe's crisis era elections, following close calls with radical populists. But it doesn't matter anyway -- the era of contagion is over, so even if Greece becomes a failed state that gradually and informally exits the euro, it won't threaten the common currency. We think now that the ECB will announce QE with sovereign bonds at its January meeting three days before the Greek election, and begin purchases after the March meeting.

[Strategy Dashboard home]

The thing that will drive euro area markets in 2015 won't be Greece -- it will be the ECB. The teasing over true quantitative easing with sovereign bonds will end, and a policy will be announced. We've come full circle over the year. We've gone from ruling it out (see "No Way ECB QE" October 1, 2014) *to ruling it in* (see "Failure to Launch at the ECB" December 3, 2014) *and now to expecting it.*

- Last week Reuters published a widely circulated story purportedly outlining plans for QE being discussed within the ECB. As reported, the dominant plan -- in which each national central bank would assume the risk of its own nation's sovereign bonds -- is a non-starter. It would mean there would no longer be common monetary policy across the euro area.
- But the story is important because it shows that the Bundesbank has realized it has lost the argument on sovereign QE, and is now just struggling to throw ideas out that may influence the terms of surrender.
- The timing of ECB purchases of sovereign bond purchases is going to be tricky. We think the most likely scenario is something similar to the roll-out of Outright Monetary Transactions (OMT) in 2012 (see "On the September ECB Policy Decision" September 6, 2012). There will be a general announcement of sovereign bond purchases as a policy at the ECB at the next Governing Council meeting, to be held on January 22, 2015, just three days ahead of the Greek election. But there won't be any detailed modalities of how those purchases are to be undertaken. Actual purchases are unlikely to start until after the March 5 meeting, which, interestingly, will be held in Cyprus.
- A January announcement will spread "foam on the runway," allowing the markets to ignore any adverse outcome from the Greek election. It's a form of reiterating Draghi's 2012 "whatever it takes" promise.
- But by waiting to actually commence buying until after the March meeting, the ECB can avoid the appearance of panicking in response to an adverse Greek outcome.

What will ECB QE with sovereign bonds achieve for the euro area economy? We'll be writing about that shortly.

Bottom line

Failing to elect a new president, there will be general elections in Greece on January 25. The radical SYRIZA party currently leads in the polls, but its lead is diminishing. The moderate New Democracy party can still win, as moderates have consistently won in Europe's crisis era elections, following close calls with radical populists. But it doesn't matter anyway -- the era of contagion is over, so even if Greece becomes a failed state that gradually and informally exits the euro, it won't threaten the common currency. We think now that the ECB will announce QE with sovereign bonds at its January meeting three days before the Greek election, and begin purchases after the March meeting.

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