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MACROCOSM

Yes, It's Another Greece Crisis

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

But the world has moved on, and even in the worst case the euro currency is secure.

Is the euro crisis back, enflamed once again by the tiny nation that started the crisis in the first place? We think not.

Greek Prime Minister Antonis Samaras announced Tuesday that his government was bringing forward the next presidential election by two months -- to December 17 -- with the announcement coming just hours after lenders agreed to extend Greece's financial rescue by two months. If Samaras' moderate coalition government cannot get its candidate elected, there will be a "snap" general election -- and there is the risk that a radical populist government would take power, imperiling Greece's bailout and its role in the euro area.

- The voting structure is important to understand.
- The prime minister puts forward a candidate, with that candidate subject to a vote of approval in the Greek parliament.
- There can be up to three votes for the candidate, and at the moment it seems certain that there will need to be all three.
- In the first vote, the candidate needs to secure the support of 200 of the 300 sitting members of parliament. If he fails to secure 200 votes, there is another vote five days later (December 22), in which again 200 votes are needed. If the candidate fails again, a third vote is called, again 7 days later (December 29). In the third round the candidate needs to secure 180 votes.

Samaras' candidate is former EU commissioner and deputy leader of Samaras' New Democracy party Stavros Dimas. But, in fact, Samaras could have selected virtually anyone and the outcome would be we same. There is nothing in the politics of this selection process that is driven by the specific choice of candidates -- it's all about whether Samaras' coalition can survive.

- Samaras' coalition government controls 155 seats in the parliament. The main opposition party, SYRIZA (an acronym for Coalition of the Radical Left) controls 71 seats.
- The 74 remaining seats are held by a rag-bag of independents, communists, fascists and disaffected former members of the governing coalition parties.

Update to strategic view

EUROPE MACRO, EUROPE STOCKS, EUROPE FINANCIAL STOCKS, EUROPE BONDS, FX, ECB: A Greek presidential election may well fail, mandating a "snap" general election that could put the radical SYRIZA party in power. It's still possible that the current New Democracy government will squeak through the presidential election after three tense ballots. But if SYRIZA ends up in power, its crackpot economic policies would make Greece more of a failed state than it already is, and its sovereign bondholders -- mostly the ECB, the EU, the IMF and Greek banks at this point -- might suffer a haircut or an outright default. But Greece is highly unlikely to leave the euro, avoiding the potentially systemic risk of a messy break-up of the entire currency union. After Draghi's "whatever it takes" speech in 2012, with the confidence gained in the swift resolution of last year's Cypress crisis, and now with the ECB more open-minded than ever about sovereign bond purchases, we are confident that the euro area can weather this latest Greek crisis.

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- Samaras needs to find 25 votes to get over the line on the third vote on December 29. It's not at all certain he can do so.
- The best Samaras can hope for is to gain the support of 16 or 17 independent MPs and then to win over the Democratic Left MPs who all would surely lose their seats in the case of a general election, the party's support in polls having fallen to only 1%.
- As of this moment, virtually all the opposition parties have said they won't co-operate with Samaras. But that's just the opening position in a multi-stage game. Deals will get done, with swing-votes waiting until the last moment to commit in order to maximize their bargaining power.
- If Dimas fails to be elected president and it goes to a general election, SYRIZA is reasonably likely to get the largest plurality vote-share, earning it a 50-seat bonus in the parliament. Samaras' New Democracy party is now polling at about 25%, with SYRIZA polling at 29% -- which happens to be the same vote-share earned by ND in the prior election. SYRIZA would have about 130 seats, so it would have to form a coalition government with minority parties, which would be a recipe for ongoing political instability.

So there are two risk events here, with the probability of the worst-case scenario being the joint probability of the two. First, there is the risk that Dimas won't be elected president. If Dimas is not elected, then second, there is the risk that SYRIZA would win control of the government in the general election.

Crisis-era Europe has consistently come to the brink of degenerating into radical populist politics, but has always pulled back from the brink despite seemingly bleak polling forecasts -- we saw it most recently in the Scotland succession referendum (see "The Untied Kingdom" September 10, 2014)*. Nevertheless, let's consider how bad the worst-case scenario for Greece might be?*

- SYRIZA's agenda is a crackpot hodgepodge of wealth redistribution that it frankly calls a "great social and political movement of subversion" -- including such impossible promises as free electricity and wholesale forgiveness of personal debt to banks.
- SYRIZA wants to impose a haircut on outstanding Greek sovereign debt, beyond the haircut already imposed in Greek bailout by the so-called "Troika" of the European Central Bank, the European Union and the International Monetary Fund. After that, it wants the ECB to buy Greek bonds directly from the treasury at issue to fund the government.
- *There is about €317 billion of Greek sovereign debt outstanding (face value). About half is held by the troika, and about 10% of the residual is held by Greece's banks. So a haircut -- or even a default for that matter -- would have relatively small impact on the private sector outside Greece's own borders.*
- *And European banks are exposed to Greek banks to the tune of only about €50 billion.*

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- *In the Greek crises of the last several years, the most systemically dangerous issue was the possibility that Greece would pull out of the euro currency, perhaps triggering an overall break-up of the currency union. That is not a proximate risk here: SYRIZA is not anti-euro.*
- To be sure, if SYRIZA's policies were put in place, the Greek economy would lapse back into severe contraction after showing the first signs of recovery in years, its banks would become seriously imperiled, and there would arise serious questions about whether the rest of the euro area even wanted Greece to use the common currency. But there is no legal means for ejecting a nation from the currency union once it has joined.
- If Greece were to devolve into what amounts to a failed state within Europe, it may well issue scrip or some form of pseudo-currency that would trade internally alongside the euro, at a great and ever-increasing discount.
- Even if SYRIZA were to pull Greece out of the currency union -- and there is no treaty mechanism for that either -- at this point we are confident that the currency union would survive. *Markets seem confident too, at least on that score -- the euro has only strengthened since the emergence of this new Greek crisis.*
- The euro area, and the currency, enjoy vastly more confidence since ECB President Mario Draghi's "whatever it takes speech" in 2012 (see "On Draghi in London" July 26, 2012). Last year's Cypress crisis was a test of the post-"whatever it takes" skill, resolve and credibility of the euro area's institutions -- and that test was passed swiftly and with aplomb (see "On the Cypriot Depositor Bail-in" March 17, 2013). And given Greece's tiny size in the grand scheme of things, today even smaller than it was three years ago when it emerged as the spearhead of the euro crisis -- we don't view the risks here as imposing an existential systemic threat to the euro area.
- The ability of the ECB to respond constructively is only increased by the failure so far of its various asset purchase programs, and the increasing possibility that it will have to resort to a classical sovereign bond purchase quantitative easing program (see "Failure to Launch at the ECB" December 3, 2014).
- Draghi's cooked-up deflation emergency was enough to get hardliners on the ECB Governing Council to agree to asset-backed securities purchases (see "On Yellen at Jackson Hole" August 22, 2014). Maybe turmoil in Greece will be "whatever it takes" to move the ECB all the way to true QE.

Bottom line

A Greek presidential election may well fail, mandating a "snap" general election that could put the radical SYRIZA party in power. It's still possible that the current New Democracy government will squeak through the presidential election after three tense ballots. But if SYRIZA ends up in power, its crackpot economic policies would make Greece more of a failed state than it already is, and its sovereign bondholders -- mostly the ECB, the EU, the IMF and Greek banks at this point -- might suffer a haircut or an outright default. But Greece is highly unlikely to leave the euro, avoiding the potentially systemic risk of a messy break-up of the entire currency union. After Draghi's "whatever it takes" speech in 2012, with the confidence gained in the swift resolution of last year's Cypress crisis, and now with the ECB more open-minded than ever about sovereign bond purchases, we are confident that the euro area can weather this latest Greek crisis.