Viewpoint:
Greek crisis: an update

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After four months of bargaining, in late June Greece and its creditors—the European Commission, European Central Bank, and International Monetary Fund—had not reached an agreement. The existing program would expire on Tuesday, June 30. If creditors didn't approve an extension, a whole new deal would have to be drawn. That would take weeks, during which Greece would have to stand financially on its own. Moreover, Greece would miss a €1.5 billion payment to the IMF. This default might, in theory, trigger a cross-default clause by European creditors, forcing a "Grexit."

June 30 drew closer, but a deal did not. Predictably, the "Grexodus" of bank deposits intensified. During June, Greek banks had been able to meet the rush of withdrawals thanks to an extraordinary liquidity line—the Emergency Liquidity Assistance (ELA) program—from the European Central Bank, with a limit of €89 billion.

Over the last weekend, a chain of events catapulted Greece into the next phase of the crisis. In this commentary, I review how Greece got here, what the referendum means, and possible scenarios post-July 5.

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A hectic weekend: the timeline

Friday, June 26:

- The latest proposal for a bailout extension emerges. Creditors offer to stretch the program through November and release funds by June 30, in time to make the payment to the IMF.
- Greece rejects the creditors' proposal, and prime minister Alexis Tsipras leaves Brussels for Athens.
- Tsipras holds an emergency meeting with his cabinet in the evening. He announces that the package of assistance and austerity measures offered by the creditors will be put to a popular vote. The referendum will take place on Sunday, July 5.

Saturday, June 27:

- The Greek parliament debates the referendum announced by Tsipras.
- Greece asks the Eurogroup of finance ministers for a bailout extension of a few weeks, so as to allow the referendum. Europe turns down the request.

Sunday, June 28:

- The Greek parliament votes on, and approves, the referendum. Opposition parties vote largely against the proposal, but Syriza and its coalition government partner have enough votes to get the referendum through.
- The European Central Bank announces that it keeps, but does not raise, the existing emergency liquidity support for Greek banks.
- Tsipras says that Greece's central bank has been forced to call a "bank holiday" and to effect capital controls. Banks will be closed; cash withdrawals will be limited to €60 a day; and Greeks will not be able to transfer money overseas. The Athens stock market will not open on Monday.
- The European Commission publishes a 10-page list of the proposals made by creditors to Greece before Athens allegedly broke off the negotiations on Friday.

Monday, June 29:

- Greece releases the exact wording and format of the referendum ballot.

Tuesday, June 30:

- The Greek government proposes a fresh two-year bailout program, under the European Stability Mechanism. The new deal would come with a restructuring of debt, and it would exclude the International Monetary Fund.
- The Eurogroup of finance ministers rejects Greece's request for a third bailout.
- Late in the evening, prime minister Tsipras sends a letter to Brussels accepting most, but not all, of the creditors' conditions, on which the referendum was to be held. He reiterates his request for an extension of the now-expired bailout program, and for a new, third rescue program worth €29.1 billion.
- Greece misses the €1.5 billion payment to the International Monetary Fund. Greece is officially in arrears with the fund and can only receive new financing after the missed payments are made.

Next key dates:

- July 5: The referendum is held.
- July 20: Two Greek bonds totaling €3.5 billion are due. The bonds are held by the European Central Bank.

That tiny canyon

Greece and European leaders continue to talk as I write these lines, and a deal could still happen before the referendum on July 5—although it's unlikely. That's too bad, because the positions of each side are remarkably close. What separates them is a canyon of mistrust.

In the June 30 offer by Tsipras, he made concessions on the value-added tax, corporate tax payments, defense spending, pensions, collective bargaining clauses, and privatization of the national power company.

The proposal, however, was subject to "amendments, additions or clarifications." These possible changes would presumably touch on the same sticking points that have precluded an agreement in past weeks: retirement age and a lower VAT on Greek islands. Germany, probably fearing that Greece would backpedal if they sit to negotiate, quickly dismissed Greece's offer.

Next step: OXI or NAI

As I type these lines, Tsipras seems committed to holding the referendum. The outcome is anyone's guess. To begin with, Greek voters will face a puzzling question. The only English translation I've seen reads:

> "Should the plan of agreement be accepted, which was submitted by the European Commission, the European Central Bank, and

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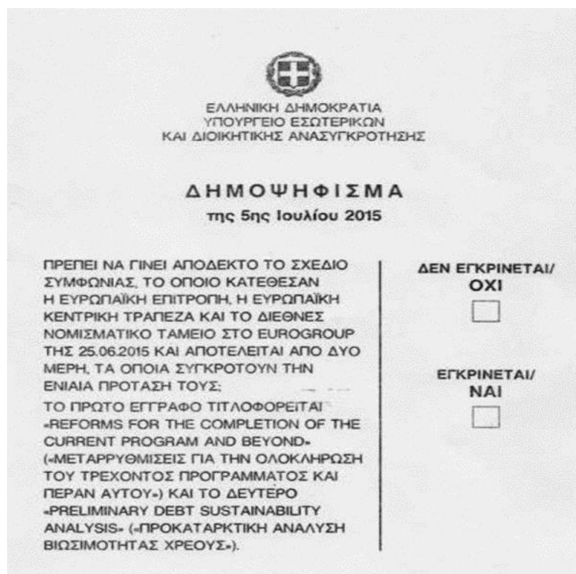
> the International Monetary Fund in the Eurogroup of 25.06.2015 and comprises of two parts, which constitute their unified proposal? The first document is entitled 'Reforms For The Completion Of The Current Program And Beyond' and the second 'Preliminary Debt Sustainability Analysis'."

I think that piece of wretched English means:

> "Should Greece accept the offer described here?"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ΔΗΜΟΨΗΦΙΣΜΑ
της 5ης Ιουλίου 2015

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Greek or English, this question is all Greek to me

Even assuming the original Greek ballot is readable to voters, they still will need to understand the proposal documents. After reading their combined 17 pages, this economist got: (a) a headache, and (b) no clue whether he should vote "yes." The language is too technical in many paragraphs, and it's difficult to get the whole picture of how the agreement will change people's lives. With a bit more time, Greek leaders might have been able to explain the deal—as governments do during regular election campaigns. But on the current timetable, voting "yes" is a leap of faith.

A "no" seems easier to interpret. The president of the Eurogroup strongly suggested on Monday, June 29, that Greeks are choosing between staying or not in the eurozone. In principle, if Greeks voted "no," creditors wouldn't come back with a new bailout offer.

Besides, Greece can't make a July 20 payment to the ECB without financial assistance. The ECB, in turn, can't justify liquidity assistance (the ELA) to an insolvent country. If the ECB cuts off the Greek banking system, Greece is *de facto* out of the eurozone.

A rejection, therefore, evokes terrible, immediate pain. But I don't think most "no" voters fully grasp the consequences of a Grexit. I know I don't.

In theory, savers would lose most of their money, now re-denominated in new drachmas. Foreign investment would collapse. Unemployment and poverty would rise even higher than they are today. Hyperinflation is possible.

But some studies have shown that dropping the euro would be good for Greece in the long term. A devaluation would help the country become more competitive. In due time, foreign investment would come back, and Greece would regain access to capital markets. Besides, crippling austerity wouldn't be necessary any more.

So the result of the referendum hangs on the interpretations of a difficult question by a poorly informed electorate.

Tsipras and his party have urged Greeks to vote "no," because the terms offered by creditors are too harsh. (That in itself is confusing, as Tsipras' latest offer is within spitting distance of the creditors' proposal.) If Greeks accept the proposal, Tsipras has said he would step down as prime minister and call fresh general elections.

Two polls conducted by Greek newspapers, before Tsipras called the referendum, found that 60% of voters could accept the bailout conditions. But a more recent survey by Economist Intelligence Unit gave a 60% "no" vote. In addition, a poll conducted on June 28-30, and published in a Greek newspaper, showed 54% of those planning to vote would say "no" to the bailout, whereas 33% would vote "yes." The pool of undecided voters is thus quite deep.

Scenarios

What happens after the July 5 referendum? From most to least likely, in my opinion, here are the scenarios:

A. Despite the latest polls, I think the most likely result is that Greece votes to accept the bailout. The ECB would immediately raise the emergency liquidity assistance to Greek banks. The Tsipras administration would be replaced, whether after a fresh general election or by a technocrat government.

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B. Greece votes "yes" but keeps the current government in charge. Syriza, the majority party, would be in the uncomfortable position of accepting bailout terms that they had previously refused. Conversations with Europe would be more tense than under scenario A. Prime minister Tsipras, finance minister Yanis Varoufakis, and other visible leaders would probably be replaced by other Syriza members.

C. Greece votes "no" to the proposed terms, but both sides agree to sit down again and try to find new terms for a bailout program. In this case the new deadline becomes July 20, when a €3.5 billion payment to the ECB is due. (Greece can't make this payment without financial assistance, and the ECB wouldn't keep Greece in the Eurosystem if it's declared insolvent.)

D. The least likely scenario is that Greece votes to reject the bailout and the ECB pulls the plug immediately. Grexit becomes a *fait accompli*.

Contagion, volatility, and central banks

A general concern is contagion to other peripheral markets. Memories of 2012 might push investors to ditch sovereign bonds of Spain, Portugal, and Italy, lifting borrowing costs and even barring market access to those governments. But things have changed quite a bit in Europe since 2012.

European institutions can avert a crisis in three ways. The ECB is already purchasing €60 billion worth of assets a month. The central bank could step up or frontload those purchases, calming the markets.

Second, a ruling by the European Court of Justice makes it possible for the ECB to buy sovereign debt when a country can't access the markets—as long as the country submits to a financial assistance program.

Finally, in the name of financial stability, the European Stability Mechanism could throw a lifeline to banks or governments.

Volatility and European sovereign yields have risen from a week ago, but not to extreme levels, so the ECB hasn't felt the need to announce extraordinary measures.

The main channel of transmission of Greek troubles to the United States is financial markets. Financial conditions are likely to tighten, probably through a stronger dollar, higher credit spreads, and lower stock prices. The Federal Reserve's Open Markets Committee doesn't meet until July 29, and an unscheduled meeting before then is not in the cards.

Still, on its July 29 policy statement the Fed is likely to acknowledge the increased international uncertainty. The odds of a rate hike on July 29 were already slim, and Greece is lowering them even more. My baseline scenario of a liftoff between September and December still stands.

I don't foresee any actions by the Fed motivated directly from Greece.

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