29 June 2015

Grexit – What if?

Greek referendum changes the game

- **Greece's Prime Minister Tsipras has called for a referendum on the Institutions' proposals. The government recommends a 'No' vote, but argues this is not the same as a vote for 'Grexit'.**
- **The most recent Greek opinion polls point to a 'Yes' to the creditor proposal, but all surveys were conducted before the government recommended a 'No' vote.**
- **In our view, we are on the 'default, but no Grexit' path, but this is not sustainable given the very negative sentiment between Greece and its creditors.**
- **The ECB has decided to keep the Greek emergency liquidity assistance capped at Friday's level, implying there will be no further liquidity support to the banks.**
- **Bank holidays have been declared in Greece from Monday. ATMs are closed on Monday and are due to reopen on Tuesday subject to withdrawal limits.**
- **The IMF payment is not expected to be paid on 30 June. Missing the payment will not trigger a 'credit event' but EFSF loans can be called immediately due.**
- **Focus now turns to the backstop facilities. Both the Eurogroup and the ECB signal they are ready to intervene, but the ECB could have been more explicit.**
- **However, we expect the ECB will step up QE purchases as we enter the week. If this is not enough, other tools are likely to be explored.**
- **The market will be characterised by a broad risk-off move. We expect bunds to rally, core curves to flatten, ASW spreads to widen and the periphery to widen.**
- **In FX markets, the Greek uncertainty should trigger a rally in the usual safe-haven currencies, but it will soon be dominated by expected monetary policy responses.**

Recent research on 'Grexit'

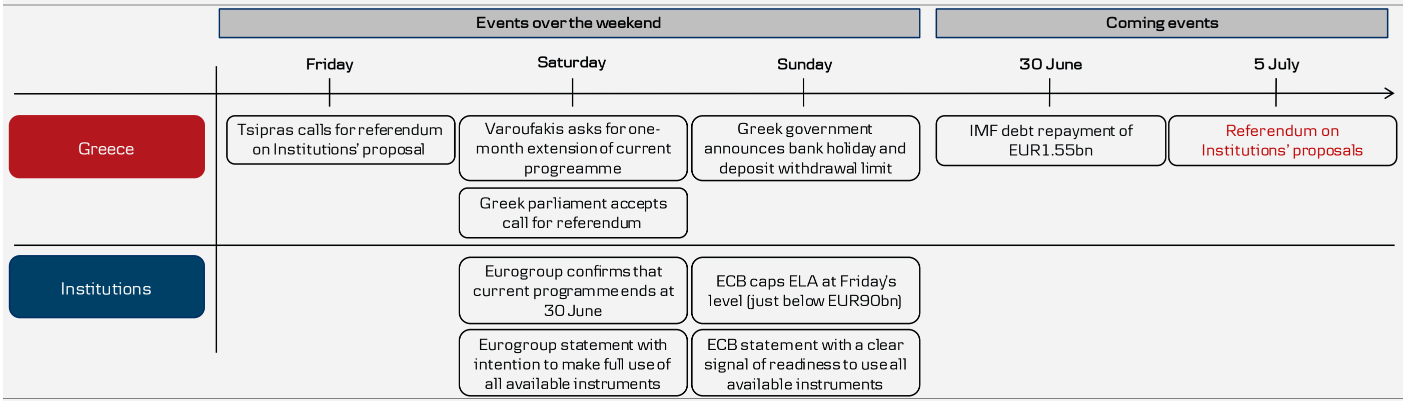
- *Presentation: Scenarios for Greece - Summer Crunch Time,* 22 June 2015
- *Grexit – What If? Implications for euro and Scandi markets* 28 April 2015
- *Grexit – what if? Don't expect any solution before the summer crunch time* 22 April 2015

Chief Analyst
Anders Møller Lumholtz
+45 45 14 69 98
andjrg@danskebank.dk

Senior Analyst
Anders Vestergård Fischer
+45 45 14 69 96
afis@danskebank.dk

Senior Analyst
Pernille Bomholdt Henneberg
+45 45 13 20 21
perni@danskebank.dk

Greece events over the weekend



Source: Danske Bank Markets

Development in Greece – the facts

A lot has happened over the weekend – here is a brief overview of the main events:

- On Friday night, PM **Alex Tsipras called for a referendum on Sunday 5 July.** The upcoming vote was passed by the Greek parliament on Saturday Night. Greek citizens will be asked "Do you accept the institutions' proposal as it was presented to us on 25 June in the Eurogroup**?**" **The Greek government is recommending a 'No' vote. The government argues that a 'No' vote is not the same as a vote for 'Grexit'**. A plan B has not been presented by the Greek authorities. See Greek FM *Varoufakis Sunday statement* for background and motivation behind the Greek move. European Commission President Juncker on Sunday sent a *statement* in Greek, in which he explains that the negotiations had not ended when Greece called the elections and presented the latest and slightly more favourable *creditor proposal* (which is slightly more favourable than the one they will vote on).

- At the ***Eurogroup*** **meeting** on Saturday the 18 Finance Ministers **did not grant Greece the requested one month programme extension,** implying that ***"The current financial assistance arrangement with Greece will expire on 30 June 2015".*** The Finance Ministers were unanimous in putting the responsibility for the breakdown and upcoming developments in Greece on the Greek leaders. Furthermore, it was hinted that bank holidays and a deposit freeze could be imposed, as the statement said "*We stress that the expiry of the EFSF financial arrangement with Greece, without immediate prospects of a follow-up arrangement, will require measures by the Greek authorities, with the technical assistance of the institutions, to safeguard the stability of the Greek financial system".*

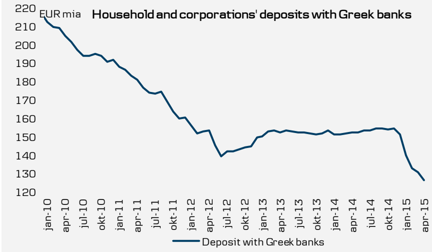
- The ECB has *decided* to keep the **Emergency liquidity assistance (ELA)** capped at Friday's level, which means that **Greek banks do not get further liquidity support** from the ECB. For the past months, the ELA has effectively kept the Greek banking system afloat and has over the past week raised the ceiling on a daily instead of a weekly basis to just below EUR90bn, according to *FT* .

- In a ***statement*****, the ECB sent a clear signal of readiness.** *"The Governing Council is closely monitoring the situation in financial markets and the potential implications for the monetary policy stance and for the balance of risks to price stability in the euro area. The Governing Council is determined to use all the instruments available within its mandate".*

- The upcoming **IMF payment of EUR1.55bn** (pooling of four June payments) is not expected to be paid on 30 June. Note that missing the payment will not trigger a 'credit event' in the framework of rating agencies or trigger CDS on the Greek sovereign. However, *EFSF loans* can be called immediately due and payable, following a missed payment to the IMF, but requires an active decision from European leaders.

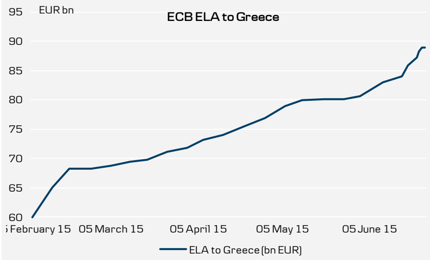
- **Bank holidays have been *declared* in Greece from Monday** and should reopen on Tuesday 8 July (after the referendum). ATMs are closed today and are due to reopen on Tuesday subject to withdrawal limits. The Greek stock market is shut too.

Deposit flight from Greek banks



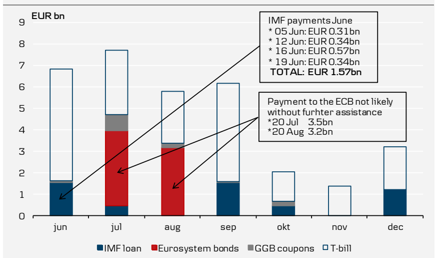
Source: Danske Bank Markets

ECB has capped the ELA facility



Source: Danske Bank Markets

30 June IMF payment is not expected



Source: Bloomberg, Danske Bank Markets

Known unknowns – what to look for

- Focus now turns to the **backstop facilities** and whether and when they will be **activated.** Both the Eurogroup and the ECB gave a clear signal that they are ready to intervene**. ECB** statement**: *"The Governing Council is determined to use all the instruments available within its mandate".*** Admittedly, the ECB statement could have been more explicit, but it leaves the door open for any action in the coming days. The **Eurogroup statement** was also very clear ***"Euro area Member States intend to make full use of all the instruments available to preserve the integrity and stability of the euro area. This will complement any actions the European Central Bank may take in full independence and in line with its mandate.*** *EFSF and ESM remain the strong instruments with our full backing that they have always been."*
- Although the ECB signal could have been stronger, **we expect that ECB will step up QE purchases as we enter the week**. If this is not enough to counter the market moves over the coming week, other tools are likely to be explored, possibly including the *ESM Secondary Market Support Facility* or potentially adjusting the OMT programme so it can be activated for countries that are not currently in a programme.
- **Greek public opinion** is, like the political picture, very divided on whether the creditors' proposal should be accepted. The most **recent polls actually point to a 'Yes'** to the creditor proposal, although all surveys were conducted before the current government recommended a 'No' vote. The degree of chaos over the next week with banks closed is also likely to affect the referendum outcome.

Recent polls on Greek support to an agreement with creditors

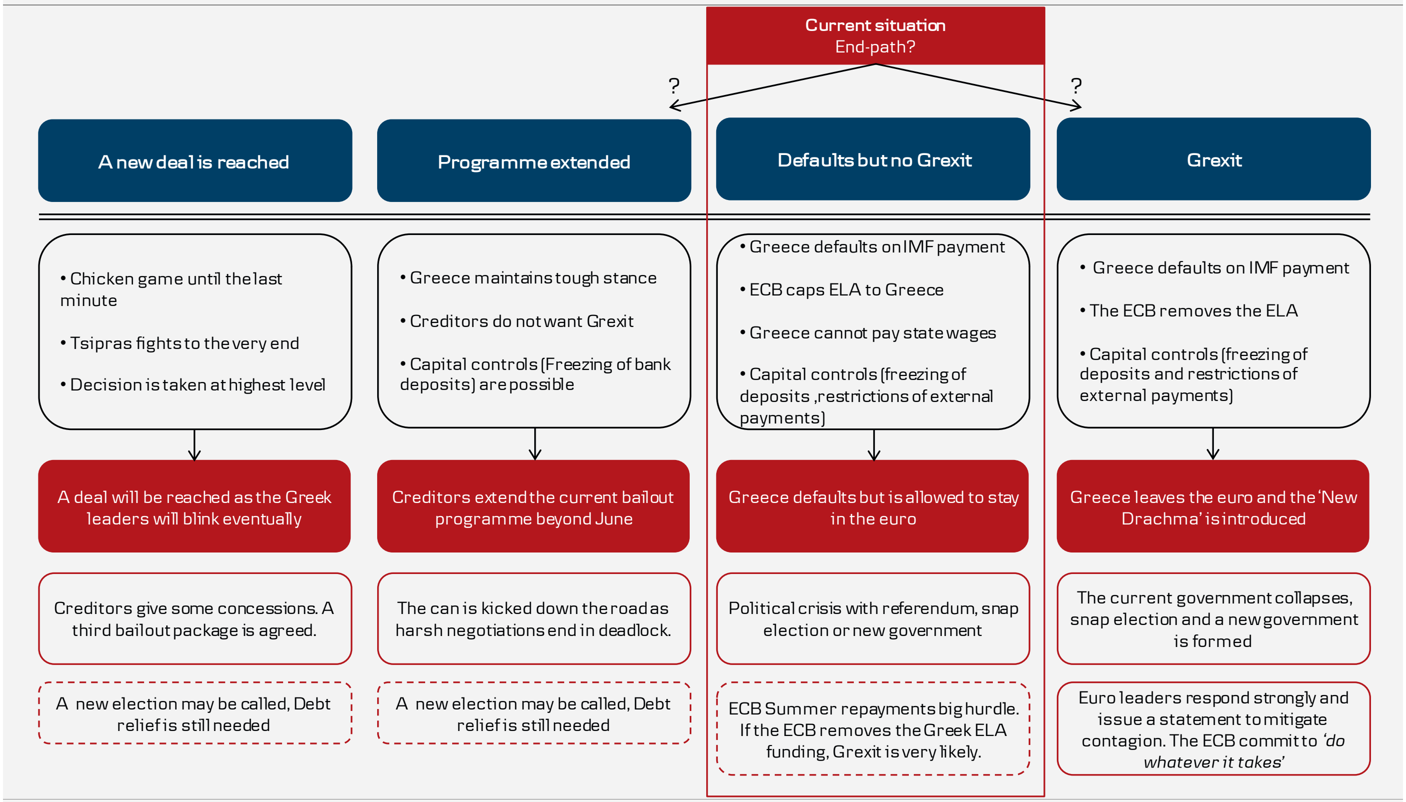
Greek polls - All surveys have been counducted prior to the breakdown in negotiations and the Governments 'No' recomendations (%)				
	Yes	No	Not decided/Blank	
Wants agreement	57	29	14	
Source: Alco Poll (24-26 June)				
	Yes	No	Not decided	Blank/No answer
Vote to agreement	47,2	33,0	18,4	1,4
Source: Kappa Research for To Vima				
	Now		Before (29 May)	
	Yes	No	Yes	No
Do you agree with the way gov. And pm are handling negotiations?	28,6	61,4	33,4	59,4
Do you personally want tougher stance even if it means grexit?	22,8	72,3	23,2	71,2
	Gov.		Creditors	
Who is responsible for delay in negotiations?	52,1		32,4	
	Yes		No	
In your opinion will there be an agreement in the end?	58,2		18,6	
Would you personally like an agreement?	76,8		18,7	
	Proposal		Grexit	
If you were to choose between the creditor proposal and grexit, what would you choose?	49,7		27,2	
Source: http://.protothema.gr/ (10-12 June)				

Main scenario: going to plan B

The Finnish FM said on Saturday after the Eurogroup meeting that "Plan A is now B". The problem is that we did not have a clear plan B and the **development from here is very uncertain**. Below we have sketched different scenarios. We are currently on the **"default but no 'Grexit' path"**, but it is hard to see how this can be a sustainable equilibrium given the very negative environment between the Greek government and the creditors. The risk of ‘Grexit’ has never been bigger, but there is still time and several steps before this event materialises.

The situation for the Greek public is likely to deteriorate rather fast over the coming week amid the bank holiday and elevated uncertainty over the future for Greece. There is no doubt **we are in unchartered territory.**

Greek scenarios – currently heading for ‘Default but no Grexit’



Source: Danske Bank Markets

Exposure to Greece

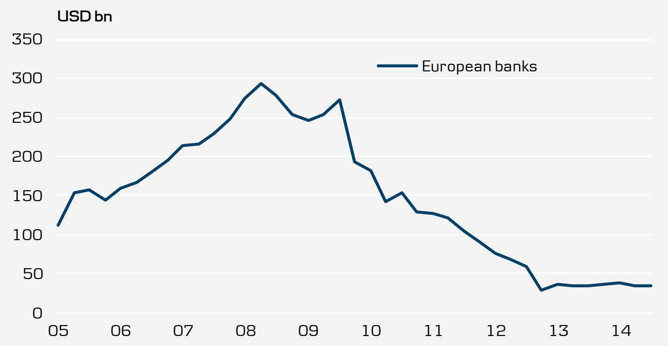
The exposure to Greece has been reduced considerably, but there will be some spill-over to other banks in the euro area (see chart below on the left hand side). However, even if the current situation results in a ‘Grexit’, it would not lead to a euro break-up, in our view, as the euro area is in a much better shape to deal with a Grexit compared to both 2010 and 2012. Greek public debt has been ‘transferred’ from the private to the public sector, and the other peripheral countries’ current account and fiscal deficits have been reduced significantly while the growth outlook is improving. Nevertheless, Greece’s destiny will impact the elections in Spain and Portugal later this year.

Direct Greek exposure via official aid facilities

EUR bn	Bilateral loans	EFSF	SMP	Intra euro-system liabilities	Total
Germany	14	38	7	29	88
France	11	29	5	23	68
Italy	9	25	5	20	59
Spain	7	17	3	14	41
Total	53	131	27	115	326

Source: ECB, EFSF, Danske Bank Markets

European banks exposure to Greece is very limited



Source: BIS Foreign claims by nationality of reporting banks, immediate borrower basis, Danske Bank Markets

Official sector exposure is higher than private sector

Greek Debt Composition, Ult. Mar 2015, EUR bn	
Bonds and Notes	82
Bonds issued domestically	64
Bonds issued abroad	3
Securitization issued abroad	0
Short-term notes	15
Loan	231
Bank of Greece	4
Other domestic loans	0
Special purpose and bilateral loans	7
Financial Support Mechanism loans (EFSF, IMF and bilateral)	205
Other external loans	5
Repos	10
Total	313

Source: PDMA Consolidated foreign claims of reporting banks - ultimate risk basis, Danske Bank Markets

Market impact

The market will be characterised by a **broad risk-off move** as we open Monday. In the **Fixed Income space,** we expect Bunds to rally, core curves to flatten, ASW spreads to widen and we believe the periphery could widen as much as 30-50bp vs core initially on the open. The extent of the move will be **heavily dependent on the magnitude of the policy response.**

As we expect the first step will be the ECB increasing QE purchases to counter the market move, it could take some time before the magnitude of the response is clear to the market. As we expect the policy response to be significant, if needed, we foresee that contagion will not extend for more than a few weeks. In particular, since we do not see this as a systemic euro risk, and as the Euro leaders including the ECB have the tools to eliminate contagion. In fact, a **strong signal from the ECB would, in our view, be sufficient to turn the initial sell-off into a rally**.

Also, we expect the FX markets to open with a rally in the usual safe-haven currencies, USD, JPY and CHF. The market expectation of ECB readiness to add more QE, if the Greek situation escalates, is key. This will be crucial for EUR-crosses, which we expect to fall broadly, even as expectations for a Fed rate hike are pushed back. Notably, the latter will likely limit the fall in the cross, as the FOMC has clearly stated its reluctance to start hiking at a time of elevated European uncertainty. The same reasoning applies to the Bank of England and GBP. Crucially, the SNB is largely left without tools and we expect EUR/CHF will be in for a marked sell-off in coming days.

In Scandi, EUR/DKK should also come under downward pressure in the coming days. For more on Scandi markets, see Scandi markets ahead: Spillover to Scandi market from Greek crisis.

Relevant links

- *Eurogroup statement #1*
- *Eurogroup statement #2*
- *ECB statement*
- *Latest proposal of the institutions (published by the EU Commission)*
- *IMF: Strategy on Overdue Financial Obligations*
- *Greece FM Varoufakis Response*
- *ESM FAQ*
- *ESM: Guideline on the Secondary Market Support Facility*

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This research report has been prepared by Danske Bank Markets, a division of Danske Bank A/S (‘Danske Bank’). The authors of the research report are Anders Møller Lumholtz, Senior Analyst, Anders Vestergård Fischer, Senior Analyst, and Pernille Bomholdt Henneberg, Senior Analyst.

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