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## Greece - the never ending story

Gerhard Winzer



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The breakdown of the negotiations between [Greece](#) and its creditors as well as the planned referendum on 5 July troubles capital markets. Greece itself is formally not insolvent. As long that this is not the case the European Central Bank (ECB) will do whatever it takes to contain spillover risks. After the referendum, the next key date will be 20 July, where bonds issued by the ECB will be payable. Until then a number of decisions has to be taken and a new financial package negotiated.

### **Breakdown of negotiations**

The negotiations between the creditors and Greece broke down over the weekend. The reason for is that the prime minister of Greece announced plans to hold a referendum on 5 July.

### **Banks will be temporarily shut down**

In response, the Eurogroup announced that the EFSF financial arrangement will expire by the end of June. Following this decisions, the Governing Council of the European Central bank decided to maintain, i.e., not increase, the ceiling to the provision of emergency liquidity assistance (ELA) to Greek banks at the level decided last Friday. In order to avoid a bank run, the Greek's financial stability council decided to impose capital controls. Banks will be shut down until at least 6 July and cash withdrawals will be limited to EUR 60 a day. The cashing of cheques will be halted and fixed term deposits will be locked down, according to Bloomberg.

### **There's a lot at stake**

It is still rational for both sides to reach an agreement. At stake are massive wealth losses and chaos in Greece and spillover effects and increasing disintegration in the Eurozone. Last week, it seemed that an agreement could finally be reached. Unfortunately, on Saturday the negotiations broke down. Nevertheless, a compromise between austerity and haircut on the one side and reforms on the other side is possible. Maybe it will be reached with another government in Greece.

The current government in Greece did not accept the conditions of the adjustment program from the beginning. It argued in favour of higher pension payments and wages, an end of austerity and a debt haircut.

### **The content of the referendum on 5 July is not clear**

The question and implications of the referendum are not clear. Besides the current adjustment program will expire on Tuesday. Most probably, the question will be whether Greece should accept painful austerity or not. De facto, the Greek people will vote whether they want to stay in the Eurozone. Closed banks, limited cash withdrawals and a collapse of the Greek economy argue for a positive outcome of the referendum.

A "Yes" vote would probably cause the Greek government to retreat. In that case, snap elections would be called. In the best case, a technocratic government would be installed. This would most likely lead to an agreement between Greece and the European institutions. As long as the hope for such a positive outcome exists, the creditors will stand ready to help Greece. A "No" vote or a new radical government in Greece would probably lead to a [Grexit](#) in the end.

### **Uncertainty burdens capital markets**

In the meantime, increased uncertainty could cause temporary price losses of risky assets (equities, corporate and government bonds with credit risk). In addition, the Euro remains under pressure.

However, the European Central Bank will do whatever it takes to avoid spillover risks. Especially, it will try to contain a negative spiral of a loss of confidence and asset price losses. The ECB has a range of instruments available: Quantitative easing, rate cuts, conditional provision of unlimited liquidity, targeted liquidity refinancing operations, and so on.

### **Weakness of the Eurozone becomes visible**

The Greek tragedy makes the weakness of the Eurozone visible. It still lacks the necessary institutions for the sustainable functioning of a currency union. There are no common economic, fiscal and financial policy institutions. Obviously, the currency union is not irrevocable. The legal implications of an exit of a country are completely unclear.

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## **Gerhard Winzer**

Gerhard Winzer has worked at Erste Asset Management since March 2008. Up until March 2009, he was Senior Fund Manager in Fixed Income Asset Allocation; he has been Head Economist since April 2009.

He holds a degree from a polytechnical college and studied economics and business at Vienna University with a special focus on financial markets. He holds a CFA charter and participated from 2001 to 2003 in the doctoral programme for finance at the Center for Central European Financial Markets in Vienna.

From July 1997 to June 2007, he worked in research at CAIB, Bank Austria Creditanstalt, and UniCredit Markets & Investment Banking. His last position was as Executive Director for Fixed Income / FX Research and Strategy. He was responsible for research on asset allocation at Raiffeisen Zentralbank (RZB) in Vienna from July 2007 to February 2008.

