Economist Insights

Icarus

Greece and the Eurozone have managed to find agreement on a possible path towards a resolution of the Greek crisis. We look at some key questions and answers on the situation.

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Greek Prime Minister Alex Tsipras must be feeling some sympathy for the Greek legend of Daedalus and Icarus. To escape from Crete, Daedalus constructed wings from feathers and wax, and he warns his son that to escape he must fly neither too close to the sea nor too close to the sun. Last week Mr Tsipras was flying too close to his voters, and this week he is flying too close to his creditors. The issues continue to be confused and uncertain, so below are some key questions and answers to help investors understand the situation.

Has an agreement finally been found?

After a 17-hour marathon meeting the Eurozone heads of state managed to find agreement on a possible path towards a resolution of the Greek crisis. The agreement in itself is not a resolution: it does not release any cash to the Greek government. However, it does open a route through which Greece could access additional funding. This would come in the form of a new bailout program by the European Stability Mechanism (ESM). But given the breakdown in trust, the agreement sets out a list of policy measures that need to be implemented by the Greek government before other countries will even start negotiations for a new bailout. The measures contained in the agreement are actually tougher than those of the agreement proposal that was rejected by Greek voters at the 5 July referendum.

What is the timeline?

The agreement lists a set of policy measures that the Greek government must introduce and also gives a very tight deadline by which those measures have to be approved by the Greek Parliament (see chart). The first set of measures involves mainly fiscal issues (such as VAT and broadening the tax base) and pension reforms, which had been the most contentious topic in negotiations so far (and hence why the creditors want to see reforms up front). Once those measures have been passed, it is likely that some funds will be released to avoid Greece defaulting on the bonds held by the ECB. Then a second set of measures (on red tape and the banking sector) has to be approved by the Greek Parliament. This has to come with a full endorsement of the remaining measures listed in the agreement as a condition for the discussion on an ESM bailout to continue.

Can the Greek Parliament pass those reforms smoothly?

All the reforms outlined in the agreement go against the vote in the referendum that took place on 5 July, as well as against Syriza's manifesto. It is thus likely that a large part of the governing Syriza party will vote against the reforms. However, almost all the opposition parties have already announced their intention to support the agreement. But it is hard to imagine how long Mr Tsipras can maintain a government that must rely on the opposition to pass its legislation against the will of the governing party.

Hellenic calendar

Key dates towards a new bailout program

14 July	Meeting of EU finance ministers
By 15 July	Greece to pass first set of measures
16 July	ECB meeting: possible increase in ELA
By 20 July	"Bridge" financing to avoid default on ECB bonds
20 July	Bond held by the ECB expires
By 22 July	Greece to pass second set of measures
23 July	Discussion on ESM bailout can formally progress

Source: European Commission, UBS Global Asset Management

Does Greece have enough cash to survive to the end of the negotiations?
The government does not have enough cash to meet its forthcoming cash obligations (around EUR 12 billion by mid-August). This includes the redemption of the bonds held by the ECB and domestic salaries and pensions. There are also significant arrears owed to suppliers to the government. For this reason, the very tight deadline of the first set of measures was designed in order to release some "emergency" funding to meet those cash obligations. This emergency funding could come by increasing the amount of short-term government bonds that the government can issue, by releasing the profits that the ECB has made on Greek bonds it owns and possibly by loans from the European commission emergency funds and the other Eurozone countries

Will the bank holiday end soon?
Once the Greek Parliament has passed the first set of reforms we would expect the ECB to become more supportive and to increase the emergency liquidity available to the Greek banks. However, we expect the capital controls to remain in place given the fragile cash position of the banks. Similar to the Cypriot experience, capital controls and limits on cash withdrawal will probably only be lifted progressively over the next few months.

Did Greece get debt relief?
Debt relief was one of the strongest demands by the Greek government, but it does not appear in the agreement. The agreement does not rule out future debt relief, but the lack of trust towards the Greek government means that this will only be considered after the first review of the forthcoming bailout is successfully concluded. Furthermore, because of the political and legal issues it might raise, a nominal haircut is excluded. That means that any debt relief will be in the form of a reduction in the net present value of the debt through extended grace periods and lower interest rates (an extension of the relief that was already granted).

What is the EUR 50 billion fund of Greek assets?
Not only did Greece not receive any debt relief, but it was also asked to transfer EUR 50 billion of assets into a 'privatization' fund. The assets in the fund will be privatized to raise money for Greece. This shows just how far trust has broken down between Greece and its creditors. Essentially Greece is not trusted with pushing through the privatizations, so the assets must be transferred to a third party to ensure that the privatization happens. Interestingly, that EUR 50 billion matches the deterioration in the Greek funding gap since the end of last year. Back then, the so-called "Troika" of creditors was estimating a funding gap of around EUR 30-35 billion for 2016-2018. The ESM bailout under discussion will instead be in the range of EUR 82-86 billion. Half of the revenue from the privatization fund will go towards debt repayments while the other half will be used for bank recapitalisation and a growth initiative. In the event, however, it is likely that the value of the fund when privatized will be far less than the estimated value on paper.

Has the risk of a "Grexit" disappeared?
No, but the agreement has reduced it somewhat. Substantial challenges remain, especially in the short term. The set of reforms to be approved by the Greek Parliament is very ambitious from a practical perspective given the very tight deadline, never mind the political perspective. And the political repercussions for the current government are likely to be severe. Given that Mr Tsipras is likely to be ruling without the support of his party, the opposition will likely call for him to resign after a new deal with the ESM is signed. Political uncertainty is also likely to dominate the medium-term risks. The recent economic deterioration combined with the additional painful fiscal adjustment required by the agreement could lead to further political fragmentation and a hung Parliament after the next election. And if the Greek electorate feels that their referendum choice has been ignored, they may punish that betrayal by voting for the more extreme wing of Syriza in the next election.

In last week's *Economist Insight*, "Burning bridges", we suggested that Mr Tsipras had burnt his bridges behind him by calling for the referendum, leaving him with the options of outright victory for Greece (capitulation by the creditors) or utter defeat (Grexit) in the name of national pride. It seems he went for a third option: complete surrender to the creditors.