

# Greek Default Possibilities. 2015.

<b>What is the situation in Greece?</b>	<ul style="list-style-type: none"><li>· Government finances have been improving during the austerity measures, the current account is now in surplus, the budget in primary surplus and economic growth has recovered, however, unemployment has risen sharply to 26%.</li><li>· Syriza has chosen a far right nationalist party, the Independent Greeks as their coalition partner. The Greek government is therefore strongly anti European Union and anti austerity.</li><li>· Syriza will likely have to stick by its election campaign promises to end austerity and seek a write-down of the national debt.</li></ul>
<b>What is the troika's stand?</b>	<ul style="list-style-type: none"><li>· The largest creditor of Greece is Germany and she will not countenance a debt write-down.</li><li>· Initial discussions between the Greek finance minister and the European Union have been adversarial.</li></ul>
<b>Will Greece default?</b>	<ul style="list-style-type: none"><li>· Nobody can foresee what will happen. The troika is clear that any debt reorganisation will be contingent on Greece continuing its austerity and reforms. Greece is clear that austerity has ended. We have a standoff.</li><li>· In the coming months Greece is expected to receive loans as part of the initial bailout plan, loans that may now not be disbursed given recent developments. Greece may face a cash shortage and difficulty in refinancing it's national debt in the next two months.</li></ul>
<b>What would happen if Greece were to default?</b>	<ul style="list-style-type: none"><li>· Greek creditors would face a write-down of their assets, in this case Greek bonds. A legal process would begin to reorganize the debt.</li><li>· Greece would lose access to bond markets until it was clear if it would be allowed to remain in the currency union.</li><li>· Greece would likely be ejected from the currency union and have to introduce a new Drachma at an initial exchange rate of 1 Drachma per Euro. The Drachma would likely devalue rapidly. There would be shortages and import inflation would surge. A deep recession would follow. Drachma borrowing costs would also soar. However, the flexibility of having independent monetary and fiscal policy and a flexible exchange rate would place the responsibility and fate of the Greek economy with the Greeks.</li><li>· Risk assets across the world and particularly in Europe will sell off. Portuguese bonds would suffer especially as they are not part of the ECB QE program. Greek stocks would crash.</li><li>· In terms of real economic impact, Greece is 2% of the Eurozone economy so the impact would be contained.</li></ul>

**Would Greece defaulting be a Lehman Event? What are the contagion risks?**

- The real economy impact would be small. Greece represents 2% of the Eurozone economy.
- Impact on investor sentiment will likely be serious and risk assets would sell off. The ongoing ECB QE would likely limit the downside in Eurozone sovereign bonds although Portugal might suffer as it is rated BB and thus not part of the ECB QE program.
- The Eurozone now has banking union and a bailout fund. In the past year, the ECB has required Eurozone banks to shore up their capital.
- The financial damage will not likely be as wide ranging as Lehman's insolvency because Greece is not as systemically integrated into global financial systems. Importantly, in the post Lehman world, riskier swaps are collateralized with high quality investment grade collateral so transitive counterparty default risk is mitigated.

**What are the longer term implications for Europe?**

- Syriza's victory in the polls will embolden other Euro sceptic parties such as Podemos (Spain), National Front (France), the UK Independent Party and Alternative for Germany for example.
- If Syriza is successful in defying the ECB and Germany it might set a precedent for other members such as Italy, Spain and Portugal to abandon austerity.
- If Greece is forced out of the union, depending on how painful it is and to whom, it could be a template for other members to exit.
- For Greece the choice is one between the long term ache of staying in the Euro and the short term excruciating pain of leaving it. A Greece with an independent currency, central bank, monetary policy and fiscal policy would be responsible for its own fate. A Greece in the Euro might benefit from short term analgesics such as the ECB's QE and bail out loans but be hostage to the policies and principles of Brussels and Frankfurt.