



# Economic Flash!

June 27, 2011

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## Primer on Greek Austerity Vote

- Last week saw the Greek parliament approve Papandreou's cabinet shuffle, with the cabinet signing off on the proposed austerity measures. **But the real test comes this week when the Greek parliament votes on a reported €28 bn in tax hikes and spending cuts as well as €50 bn in asset sales.** We see the following outcome as the most likely:

### 1. June 29<sup>th</sup>, 30<sup>th</sup> – Budget and Austerity Implementation Votes:

Papandreou's Socialist government could pass the belt-tightening and privatization measures by a slim majority, even if their 155 official standing (out of 300 seats) is whittled down due to in-party opposition to the measures. Abstentions from opposition parties (as seen in the earlier confidence vote) could tip the balance of support in Papandreou's direction.

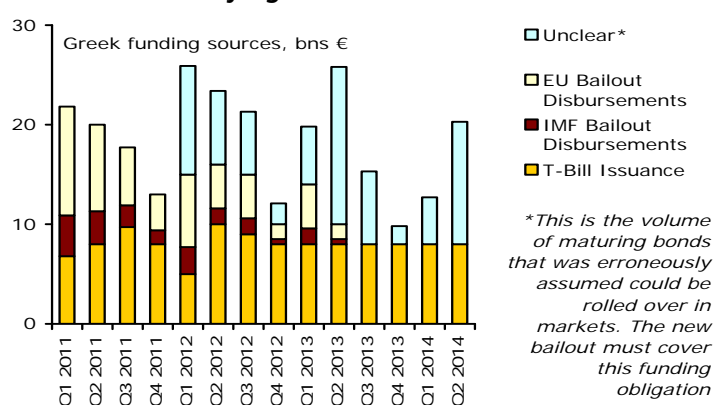
### 2. July 3<sup>rd</sup> – EU/IMF Bailout Part II Made Official:

An extraordinary meeting of EU Finance Ministers should see details of the second bailout thrashed out, including some private-sector rollovers of debt, asset sales and fresh loans. A new bailout covering Greece's financial obligations until at least mid-2014, could support the IMF payments agreed to in the original €110 bn bailout which was set to run until mid-2013 (Chart 1).

- ### 3. Sometime Before mid-July – Next Tranche of First Bailout Released:
- With a source of funding for the next 12-month period secured, the IMF would be able to release the next tranche of the original €110 bn bailout.<sup>1</sup>

- What if the austerity vote fails?** Euro area leaders stated that new austerity measures are a pre-condition for the second bailout. If the austerity vote fails, a Greek debt default in the coming months cannot be ruled out. However, euro-area leaders could still cobble together a bailout or funding guarantee for Greece, provided there are indications that Greek parliament is taking new steps to pass alternative belt-tightening measures. That could see the euro-area leaders go it alone in new loans for Greece (sans-IMF).

Chart 1  
How Greece is Staying Afloat



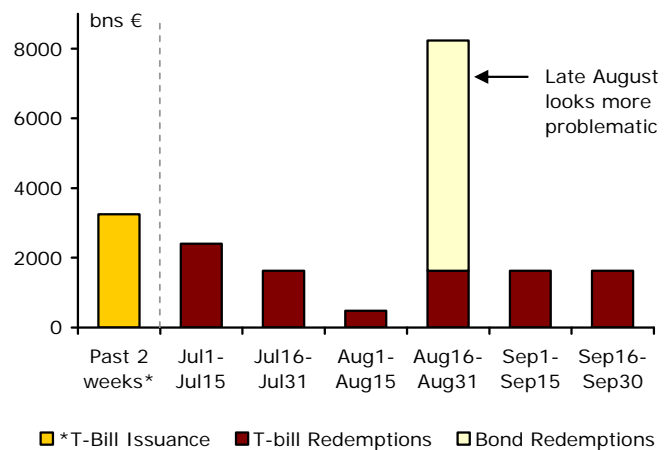
Source: Bloomberg, European Commission, CIBC

<sup>1</sup> In the original €110 bailout, it was assumed that Greece would be tapping private debt markets starting Q1 2012 to roll over its outstanding medium and long-term debt. However, having missed its austerity targets, and being effectively shut out of term funding markets, Greece's post-2012 funding source is uncertain. The IMF has thus refused to disburse its €3.3 bn share of the next tranche of Greece's €110 bailout until funding over the next 12-month period is "guaranteed".

- At a bare minimum, euro-area leaders could ensure Greece's solvency for only the next 12 months, providing fresh loans to cover bond redemptions in 2012 Q1 and 2012 Q2 (€18.3 bn). That could still see the IMF release the next tranche of Greece's bailout funds, while euro-area leaders press for additional austerity measures in the meantime. But when the September tranche of the €110 bn bailout is due to be disbursed, a funding source spanning until 2012 Q3 (the ensuing 12-month period) would need to be secured, and we could potentially see another parliamentary standoff then.

Chart 2

**Greece's Cash Crunch in Late August**



- Greece faces a €2.4 bn T-bill redemption by mid-July, which could trigger a default if Greece is shut out of T-bill markets as a result of a failed austerity vote (Chart 2). But Greece could conceivably continue issuing in T-bill markets if investors are adequately assured that euro-area leaders are trying to come up with some alternative solution to keep Greece solvent in spite of a political stalemate. A much more significant cash crunch comes on August 20<sup>th</sup>, when Greece's €6.6 bn bond matures.

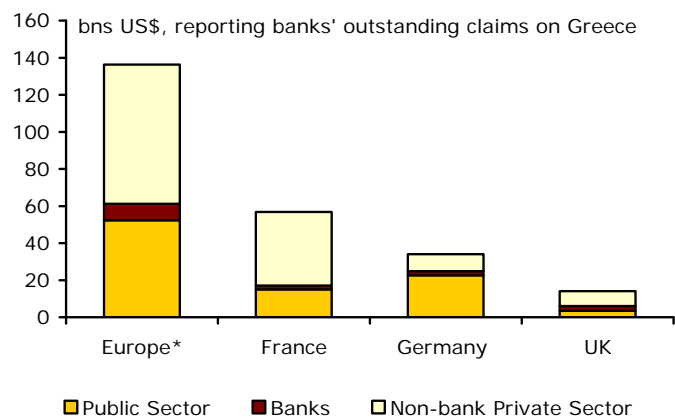
**Could Greece default on its debt in the next month?**

Greece would default if the Greek parliament rejects austerity and EU leaders refuse to grant Greece a second bailout, and/or refuse to make up any shortfall in funding if the IMF pulls out of the original bailout deal. But EU leaders may not be inclined to take such a drastic step, as most political parties in Greece agree with austerity, but disagree over the particular measures to get there. Regardless, in the case of forced default, euro-area leaders would need to move quickly to ring-fence risks and spillovers from the Greek economy into other regions' banking systems, given hefty euro-area bank exposures to Greece (Chart 3).

Source: Bloomberg, CIBC

Chart 3

**European Bank Exposures to Greece**



\*Includes: Austria, Belgium, Finland, France, Germany, Greece, Ireland, Italy, Netherlands, Norway, Portugal, Spain, Sweden, Switzerland, Turkey, UK

Source: Bank for International Settlements

**Implications & Actions**

The euro could rally back to around 1.44 EURUSD in anticipation of an eventual resolution of the present Greek fiscal hurdle. But we expect it to subsequently sell off as markets take profits with little more to look forward to. Longer-term challenges such as euro-area banking fragility, weak money growth and economic disappointments should prompt a dovish monetary and economic outlook for the euro-area, suggesting the best days for the common currency may have already come and gone.

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