The Greek Debt Crisis: Epic Uncertainty

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We continue to monitor the tense standoff between Greece and its international creditors. Unless both sides dramatically return to the negotiating table, Greece looks set to default on its €1.5 billion International Monetary Fund (IMF) loan payment tonight. While European Union (EU) leaders are still trying to coax Prime Minister Alexis Tsipras back to the table (though they have made no new concessions), the Greek hard-line stance appears increasingly entrenched, regardless of the potential consequences.

A Fluid Situation

The play book from here appears broadly as follows, although we stress the situation is extremely fluid, and a wide range of possibilities are plausible:

- Following a default to the IMF, the second bailout package will cease to exist. Hence, even under a "Yes" vote at Sunday's referendum (which would jeopardize Tsipras' political future), Greece will likely need to negotiate a third bailout deal, and do so before the €3.5 billion repayment to the ECB falls due on July 20. This is no easy task.
- In our view, the biggest question following an IMF default is what action, if any, the ECB might take. Having already opted not to increase the emergency liquidity assistance (ELA), the expiry of the second bailout package means the ECB could demand additional collateral from the already imperiled Greek banks, or take even harsher means to revoke its funding support. Any such action would be very detrimental, although the ECB may show some reluctance to being the institution that pushes Greece further toward a euro exit.

- Another key institution to watch over the coming week is the European Financial Stability Facility (EFSF), which will need to make the (political) decision on whether to accelerate Greece's loans, thus triggering cross-default provisions for private creditors. International Swaps and Derivatives Association (ISDA), if requested, could also rule on whether the IMF default constitutes a "credit event" that would trigger credit default swap (CDS) contracts. Again, it is likely that these will wait until after Sunday's referendum.

A last-minute deal today is still possible, but we see it as unlikely given the extremely divisive politics of the last few days and Tsipras' active campaign for a "No" vote at Sunday's referendum:

- Greek voters are being asked whether to accept or reject the deal proposed on June 25 as part of the second bailout negotiations. The leaked text of the referendum question (in English translation) reads: "Should the agreement plan submitted by the European Commission, European Central Bank and the International Monetary Fund to the June 25 Eurogroup and consisting of two parts, which form their single proposal, be accepted? The first document is titled 'Reforms for the completion of the Current Program and Beyond' and the second 'Preliminary Debt sustainability Analysis.'" This makes for a highly technical vote.
- Crucially, Tsipras and the Greek government are trying to frame the question as one of "Yes or no to pension reform and more austerity." In contrast, European leaders are trying to frame the question as one of "Yes or no to EU membership," with neither side focusing on the details (which were already out of date by the time the referendum was announced). Tsipras arguably had the head start in his pitch to the Greek public, but which of these options the Greek people believe they are voting on—more austerity or EU membership—could make a big difference to the final result. Prior polls have signaled disillusionment with austerity but also support for the euro.
- Presently, there are no reliable polls on the referendum question itself, and getting a read on the state of popular opinion is difficult. We await more polling and clearer displays of public sentiment over the next few days. While a "Yes" vote may seem logical to many outside observers, it's important not to dismiss Greek anger at the European Commission and IMF, and the possibility of a resultant "No" vote.

In either event, we don't see a "Yes" or a "No" vote as a clear mandate, thus setting the stage for extended uncertainty.

Markets React

Greek government bond trading has virtually ground to a halt, with electronic trading platforms temporarily suspending trading. The players are few and far between. The markets have been raising odds of an exit, but it is still not the base case. The level of uncertainty is dizzying; there are too many questions and too many potential outcomes for the markets to think clearly. Liquidity in Italy and Spain has deteriorated, as evident by the price action. However, yields and spreads have been relatively contained. There has been very little real contagion. Even the euro has been desensitized. Yet the markets remain cautious. We could be on the verge of receiving a third bailout program, which could give Greece and the markets some time. It won't be smooth. But even stable uncertainty would be a welcome change to all the noise.

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Disclosure

Views expressed are as of June 30, 2015, at 4:30 pm EST. As we prepare this article, negotiations may still be in process.

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