

Greek Crisis: An Agreement, Finally – But Now Comes the Hard Part

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What's Your Assessment of the Weekend's Events?

After long, tough negotiations, the EU Summit resulted in an agreement for a third Greek bailout program worth close to €90 billion. The conditions that Athens will have to undertake are tougher than the ones previously proposed to the Greek government, as the economic situation in Greece has rapidly deteriorated as a consequence of capital controls.

The deadlines are also very challenging: by July 15, a list of measures (on VAT and pension system, among others) will need to be approved by the Greek Parliament in order to officially begin negotiating the European Stability Mechanism (ESM) process. New conditions include the so-called Troika *de facto* overseeing the administration on key economic matters and the creation of a €50 billion fund in which various Greek assets will be placed for privatization, debt repayment etc. as a guarantee for the bailout program and the recapitalization of the banking system.

Greek Prime Minister Tsipras will bring home a tougher plan with only tepid concessions on debt relief (on maturity extension and maybe on interest rates) to be discussed later in the process, but not the much hoped-for haircut that was deemed unacceptable by Germany. As a positive for Greece, he also brings a commitment by the EU Commission to channel some resources to pro-investment and pro-growth initiatives in the country.

While we are heartened by the agreement to a deal – frankly, any deal – given the challenges throughout the process, and would highlight the fact that this was agreed to unanimously by all the heads of state, the jury is out as to whether these terms will be agreed to in Athens, or indeed, if a regime change is potentially in the offing. Moreover, even if the agreed terms are endorsed by the Greek legislature, it may even then still result in a future renegotiation if the country is unable to carry through – meaning this may, in effect, end up being a “kicking the can” exercise. In the meantime, ECB will review the “frozen” ELA that could help Greek Banks re-open and slowly normalize liquidity conditions.

How Are Financial Markets Reacting to the News?

Since last week, financial markets were anticipating an agreement, with peripheral bonds and equity markets rallying in anticipation. Therefore, we see limited space for a further rally on this news, after an initial positive reaction. The Euro has been behaving in a counterintuitive way during the crisis, having remained relatively stable vs. the USD throughout. Although there is no conclusive evidence one way or the other, we believe this was mainly due to de-risking activities by foreign investors, that were contextually closing EUR/USD hedges (buying back Euros vs Dollars).

We believe that, of course, having a deal is good for the Eurozone as opposed to no deal. This could be considered a step towards more European integration but it needs to be followed by more substantive steps to reinforce the union. Time will tell.

On financial markets, we see high volatility ahead, not only driven by factors related to Greece, but to others as well. Stretched valuations across asset classes are, in our view, fertile soil for volatility driven by erratic news flow.

In our view, attention will soon revert to the next steps to finalize the agreement (such as the approval in some EU Parliaments) and on economic fundamentals. Uncertainty remains high as to the likelihood of legislative implementation of structural reforms in Greece, and we expect that much political noise will continue to dominate the markets.

What Are The Broader Implications for the Eurozone?

We believe that having a deal (virtually any deal) is good for the Eurozone as opposed to no deal. It is key to note that it was accepted unanimously by all the heads of state and, assuming it progresses through the next stage (although we are somewhat skeptical, as discussed above), it will have shown the limits of sole country sovereignty in the context of the EU. This could be considered a step towards more European integration but it needs to be followed by more substantive steps to reinforce the union. On this front, time will tell. Ultimately, we have seen the Eurozone struggling to cope with the seemingly endlessly recurring Greek problem, but at the end, the will to keep the Eurozone together has prevailed.

How Are these Events Impacting Your Views on the Global Economy And Financial Markets?

In our base scenario, we continue to see global growth of around 3.5% for 2015. Low oil prices and a weak euro provide favorable conditions for the Eurozone, where the impact of Greek crisis should be limited. On financial markets, we see high volatility ahead, not only driven by factors related to Greece, but to others as well.

Stretched valuations across asset classes are, in our view, fertile soil for volatility driven by erratic news flow. Financial markets are now focused on Greece and on China, but we believe that they will soon shift their attention to “Fed Watching” and at the timeline for the first rise in interest rates. Other structural elements, such as over-indebted economies, weak productivity growth and a multi-polar world with multiple geopolitical risk are other possible volatility fertilizers. Therefore, we continue to favor a cautious approach, and we call for an high diversification and limited exposure to direction sources of risk.

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