

June 30, 2015



EURO ZONE

Impasse in Greece

The impasse in negotiations between Greece and its partners and creditors is raising a lot of questions and uncertainty at the moment. The worst-case scenarios are often invoked. It is true that the risk of a damaging exit by Greece from the euro zone is becoming increasingly possible. Today's likely default on a repayment of €1.5B (C\$2.08B) to the International Monetary Fund (IMF) is another straw on an over-burdened camel's back.

Stalled talks led Alexis Tsipras' Greek government to announce radical but necessary measures to avoid the collapse of the Greek financial system. Bank closures and restrictions on cash withdrawals boggle the mind and feed the perception of a crisis. The surprise announcement of a referendum on the most recent proposal from the European Commission adds another element of uncertainty. Will the Greek population accept the conditions attached to additional aid? According to Bloomberg, the latest surveys suggest that 56% of Greeks want to stay in the euro zone, even if new austerity measures are required. However, the specifics of the measures may lower the popularity of this opinion: the demands include increasing the sales tax, increasing corporate taxes, ending subsidies on using petroleum products, measures to clamp down on tax evasion and a drastic overhaul of the pension system.

Unfortunately, these measures risk further damaging an already suffering economy. Since its pre-crisis peak in spring 2007, Greek real GDP has plummeted 26.6%. It saw increases for three consecutive quarters in 2014, but is now down again. The unemployment rate is 22.7% (compared with 11% for the euro zone) and youth unemployment is an alarming 49.7% (22.6% in the euro zone). Can Greece really undergo another round of austerity without an offer to restructure debt lower? However, the disruptions generated by an exit from the euro zone would certainly not be more beneficial to the Greek economy, at least in the short term.

At present, is it impossible to predict the future of Greece's place in the euro zone. The results of the referendum and negotiations and the will of the Greek government and of its partners and creditors leave room for too wide a field of possibilities. For the moment, the uncertainty is relatively contained. This can be seen in the euro's astonishing resilience, which continues to hover around €1.12/US\$ despite the turmoil.

Implications: The Greek crisis is creating a big stir in the news, but regardless of how it resolves itself, we must not exaggerate the impact on the real economy. Greece is one of Europe's smallest economies. Canadian exports to Greece totalled a mere C\$116M in 2014 compared to C\$38.8B to the entire European Union and C\$403B to the United States.

Of course, the uncertainty is upsetting the financial markets, but the true culprit is the risk of contagion rather than Greece's actual situation. For now, the credit spreads of the other fragile countries in the euro zone are rising, but this situation seems relatively contained. The U.S. and German bond yields are decreasing, reflecting their roles as safe havens. Stock markets are on edge, but their optimism of last week was also clearly exaggerated. It remains to be seen how the European Central Bank (ECB) will react to the latest developments. Greece's inability to repay the IMF today, or, worse, a July 20 default on a repayment of €3.5B (C\$4.87B) that Greece must make to the ECB risks complicating the situation. It is mainly if the ECB ceases to lend a hand to Greece's financial system and, by extension the Greek government, that the possibility of a new exchange rate regime becomes more plausible (including a new drachma or unilateral adoption of the euro [euroization]).

Francis Généreux
Senior Economist

François Dupuis
Vice-President and Chief Economist

Mathieu D'Anjou
Senior Economist

Benoît P. Durocher
Senior Economist

Francis Généreux
Senior Economist

Jimmy Jean
Senior Economist

Hendrix Vachon
Senior Economist

514-281-2336 or 1 866 866-7000, ext. 2336
E-mail: desjardins.economics@desjardins.com