The Greek no vote: kicking the ball back to the creditors

Greek citizens overwhelmingly voted NO in yesterday's referendum. While this outcome threatens to make negotiations more difficult, it should not automatically result in a Greek exit from the monetary union. What happens at this stage is uncertain. What is sure though is that the ECB's role as the lender of last resort remains of the utmost importance. It can be expected that negotiations between Greece and its creditors start almost immediately. Even now, it's still not too late to find a solution that suits both parties. At the same time, however, it now becomes all too easy to see how Greece could be kicked out of the Eurozone by its creditors.

Even with a YES vote, uncertainty would still have loomed large. An imminent Greek exit from the monetary union would then be avoided. But more than five years after the start of the Greek crisis, it was never likely that the Greek crisis would just disappear like that. In this scenario Greek citizens would have voted YES simply because they feared the alternative would have been worse (i.e. in their belief that a NO vote would lead to GREXIT as several officials from the creditor side have suggested in the run-up to the referendum). Not only would there have been more near-term political and probably also economic uncertainty in this case, there would have been a serious risk that the Troika rejected all Greek requests for less austerity. Sustainable economic growth, in this scenario, would still have been very difficult to achieve.

It's true that yesterday's NO vote is absolutely no guarantee that Greece's creditors now become more tolerant in this respect (even though it's in their best interest). There is indeed a clear risk that the creditors will continue to give most weight to the moral hazard argument. This means that they may continue to believe that Greece should commit to strict fiscal discipline in order for the Eurozone to survive in the long run (even though this is detrimental for the Greek economy). Debt forgiveness on the other hand, though desirable and necessary, is not very urgent at this point in time. That's because Greece's debt burden (at around 180% of GDP), given the low effective interest rate and long maturity, is less problematic than what the headline figure seems to suggest. Moreover, economic growth would quickly send the debt ratio on a lower trajectory. This would be true even in case of a gradual decrease of the primary balance (see graph 1). It's a shame creditors have ignored (were ignorant about?) the debt dynamics over the last five years.

From a cost-benefit perspective, we have argued several times that Greece would best stay in the Eurozone. However, in case Greece's creditors would now continue to prescribe/request more of the same (i.e. large primary surpluses ad infinitum) this would no longer be self-evident. The best we can hope for right now is that Greece is permitted a looser budgetary stance. Preferably, European capital for infrastructure programs soon finds its way to Greece. Once confidence is restored, Greece will almost certainly return to growth. The fact that its export sector will continue to struggle is not very relevant in this respect, at least not in the near future. The huge negative large output gap (the difference between actual GDP and potential GDP) suggests there is plenty of scope to catch up. This off course does not mean Greece should not take on further reform steps.

Given the dreadful state of the Greek economy and prospects of more austerity, yesterday's NO vote should not be too much of a surprise. Average living standards in Greece are now 25% lower compared to their pre-crisis peak in 2008. What's more, the official unemployment rate stands at more than 25% with the same figure for the Greek youth more than twice as large. In contrast to what several European officials have declared, it's important to bear in mind

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that the Greek NO vote does not express a Greek willingness to leave the monetary union. Indeed, opinion polls over the last few weeks have shown an overwhelming support for euro membership. At the same time, however, the huge setback in living standards among Greek citizens also implies that the alternative of exiting the eurozone is no longer absolutely terrifying for a large part of the Greek population. Graph 2 illustrates that and compares Greece and Argentina. While Greece would not just follow Argentina's path*(i.e. after the peso devaluation of late 2001) if it were to leave the monetary union, it's clear that the current situation is just not sustainable. In this view, yesterday's referendum outcome is understandable.

Both parties are likely to start negotiations again. These are likely to turn out very difficult once again. The ECB's role, meanwhile, remains by far the most important one. If the institution would decide to stop its emergency liquidity assistance (ELA), a Greek exit from the monetary union would be reality even before negotiations started. Moreover, it's not entirely clear whether merely keeping the ELA at current levels (at around bn 90 eur) would suffice. Even though there are capital controls in place, Greek banks could rapidly run out of money. Anyway, if the ECB's decides to pull the plug (almost certainly with political backing), this would mean the end of the eurozone as we know it.

We still (like to) think that the ECB will continue to play its funding role while negotiations take off again. Even now, it's still not too late to find a solution that suits both parties. The next big redemption (bn 3.5 eur to the ECB) for Greece is due in two weeks (20 July) so that leaves enough time in theory. While it's obvious that the creditors can and will not just give in to all of Syriza's demands, it's close to impossible to ignore the signal sent from Athens yesterday. A last minute deal still seems ~~likely~~ possible. At the same time, however, it now becomes all too easy to see Greece being kicked out of the eurozone.

**a resource rich country that was able to benefit from China's and Brazil's rapid expansion*

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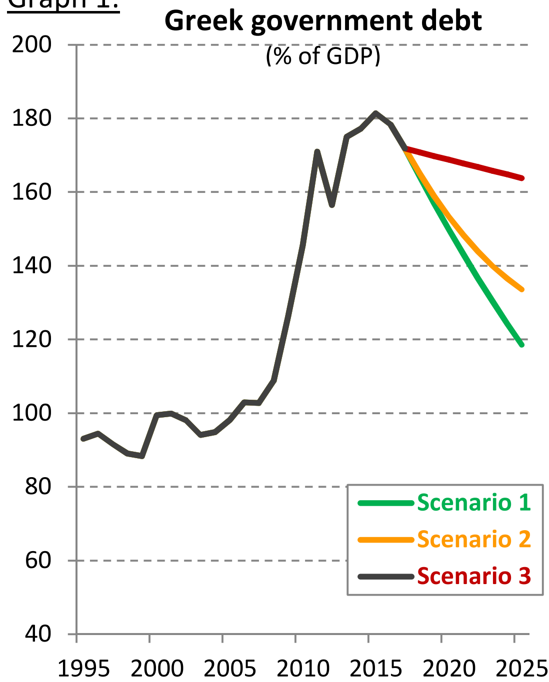
Graph 1:



➔ Assumption in all 3 scenario's until 2017:

	Nominal growth	*Implicit interest rate*	*Primary surplus*
2015	*-1.5*	*2.5*	*1*
2016	*2*	*2.5*	*2*
2017	*3.5*	*2.5*	*3*

➔ **Scenario 1:** Recovery scenario

2018-2025: nominal growth at 4%

~ nominal GDP back to pre-crisis level by 2025

primary balance surplus at 3.5%

implicit interest rate at 2.5%

➔ Scenario 2: Recovery with gradual decrease of PB

2018-2025: nominal growth at 4%

primary surplus gradually deteriorates to 0%

implicit interest rate at 2.5%

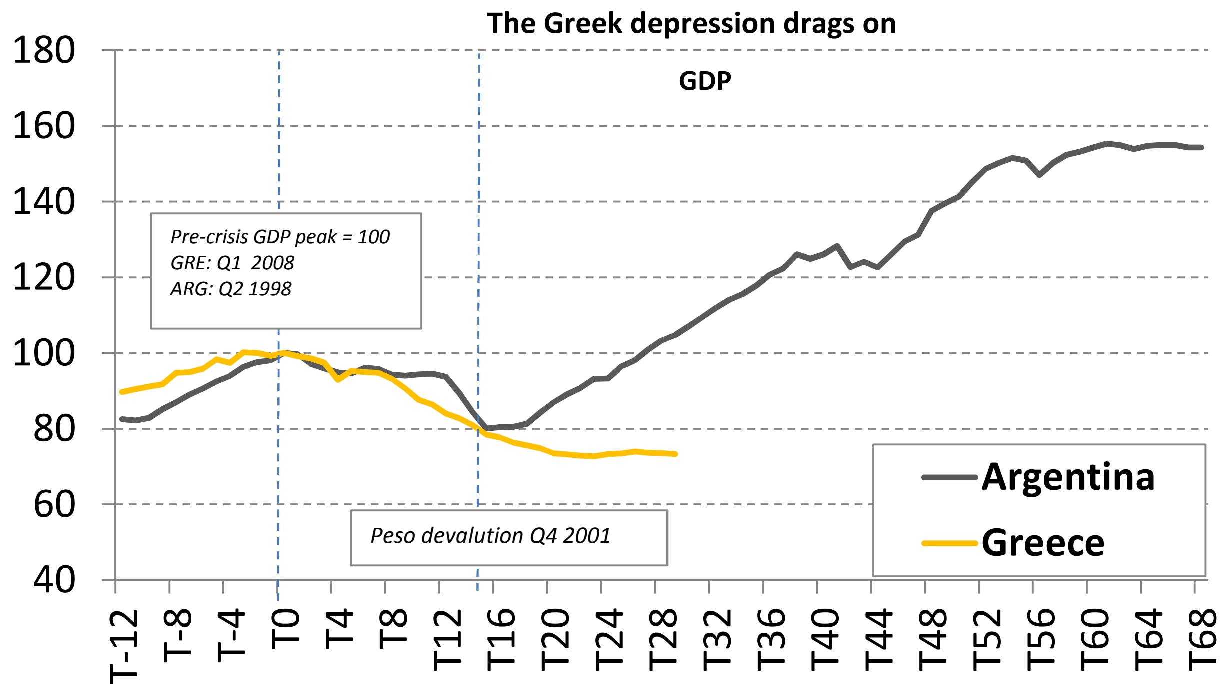
➔ Scenario 3: no growth scenario with high primary surplus

2018-2025: nominal growth at 0%

primary balance surplus at 3.5%

implicit interest rate at 2.5%

Graph 2:



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