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Economics Research
http://www.credit-suisse.com/researchandanalytics

European Economics

Research Analysts

Christel Aranda-Hassel
44 20 7888 1383
christel.aranda-hassel@credit-suisse.com

Mirco Bulega
44 20 7883 9315
mirco.bulega@credit-suisse.com

Neville Hill
44 20 7888 1334
neville.hill@credit-suisse.com

Gergely Hudecz
44 20 7888 7342
gergely.hudecz@credit-suisse.com

Sonali Punhani
44 20 7883 4297
sonali.punhani@credit-suisse.com

Giovanni Zanni
+44 20 7888 6827
giovanni.zanni@credit-suisse.com

Greece – don't leave me this way

The Greek economy seems to have turned the corner in terms of activity. Fiscal developments are also broadly moving along the lines defined in the previous EU/IMF review. Overall, from the macro side, there are no elements to question the path of debt reduction expected and agreed a few months ago, leading to a debt ratio of below 120% at the beginning of the next decade.

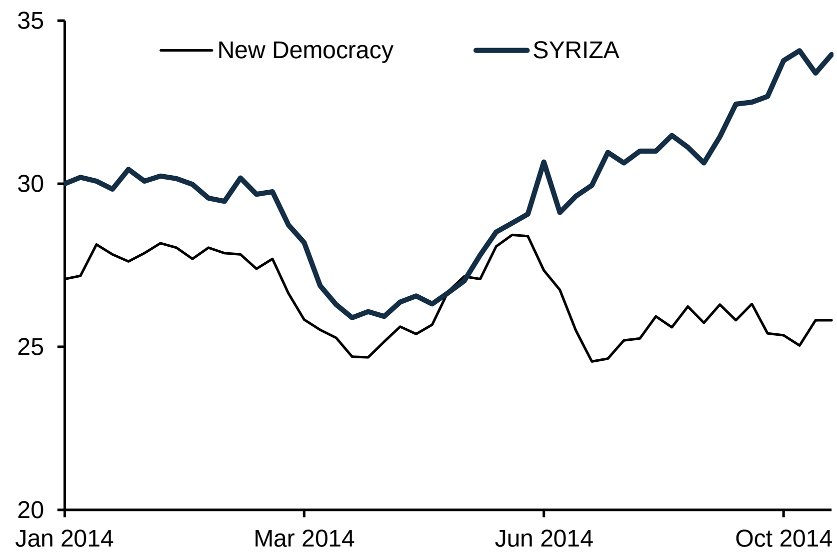
However, with an economic rebound that is still too recent and a political situation that remains fragile, markets have been rattled by the government's stated intention to leave the EU/IMF programme prematurely.

That's especially the case in the context of further rising support for the opposition party Syriza in the polls – ahead of the important election of the president of the Hellenic Republic next February – and on the back of a broader risk-off move prompted by new question marks on global (and especially European) growth.

Looking ahead, we expect the Greek situation to remain fragile until the political situation becomes clearer, which might not be the case until March 2015 – or even later. Needless to say, this could dent the nascent rebound and also complicate the government's reform action in the coming months.

Exhibit 1: Polls showing increasing Syriza lead

% of vote intentions



Source: Credit Suisse, various polls

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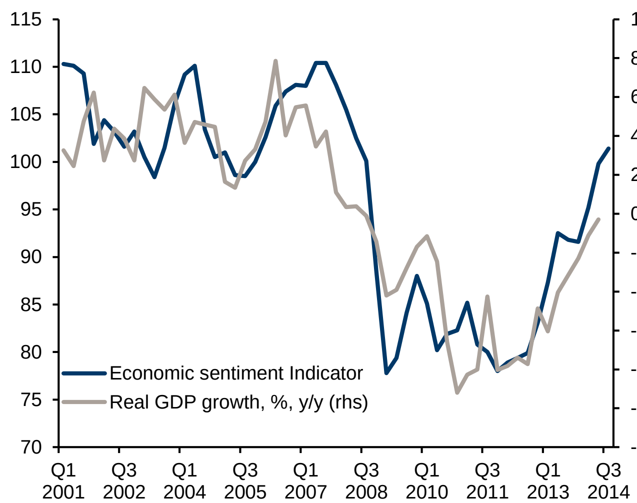
Giovanni Zanni
+44 20 7888 6827
giovanni.zanni@credit-suisse.com

The Greek government coalition has recently won a vote of confidence, with a support from 155 MPs (out of 300). Such a vote was expected and confirms that the government has a sufficient cushion, currently, for normal parliamentary votes – **but it doesn't prevent political uncertainty given the upcoming (February 2015) election of a new president of the Republic, which will require a majority of at least 180.** If such a qualified majority is not found, the Constitution requires that new Parliamentary elections must be called. The current majority could possibly gather support from some of the smaller opposition parties' MPs, but as of this moment there is still no candidate and no declaration of support coming from these other oppositions.

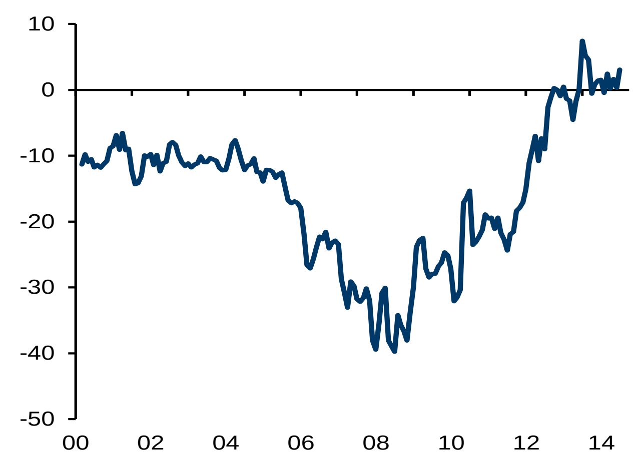
Exhibit 2: The economy seems finally on the mend



Source: European Commission, Credit Suisse

Exhibit 3: No more current account deficits

€bn, annualised



Source: Credit Suisse, Thomson Reuters DataStream

Exhibit 4: Composition of the Greek Parliament

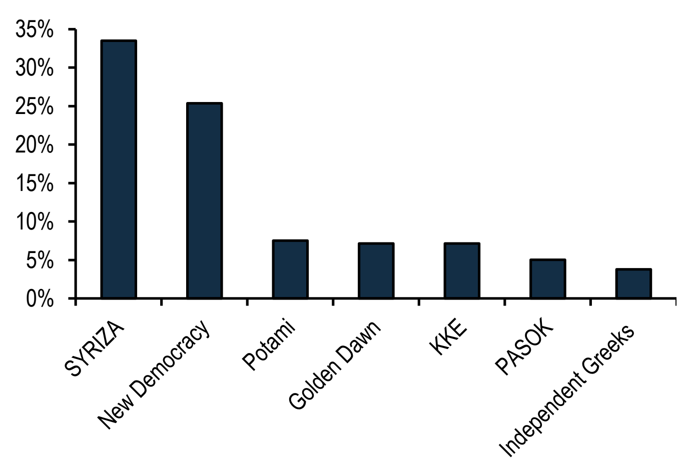
Overall seats in the Greek Parliament: 300

New Democracy	127
PASOK	28
Government coalition	**155**
SYRIZA	71
Golden Dawn	16
Independent Greeks	*13*
Communist Party	12
Democratic Left	*10*
Independents	*23*

Source: Credit Suisse, Greek Parliament

Exhibit 5: Polls showing Syriza leading

% of vote intentions, October 2014



Source: Credit Suisse, GPO

The uncertainty related to that vote – will the majority find 25 more supporting votes in Parliament? – in addition to recent polls showing a further advance of the opposition party Syriza (Exhibit 5), contributed to a sharp rise in rates (close to 8.5% as we write, from a low of 5.5% only a month ago) and to a stock market slide.

We had been highlighting the political risk linked to the February 2015 presidential elections since early last year, reiterating it many times in previous publications – but markets have been complacent so far, probably hinging on the fact that the economy was showing the first signs of a clear turning point, with unemployment falling as well, and with fiscal developments moving in the right direction. This was expected to provide some additional political support to the government.

However, **the combination of a deterioration in European growth prospects, the continuing improvement in polls for the opposition party Syriza as well as the fact that February elections are drawing nearer is clearly a volatile mix for investors in Greek debt.**

An additional element of uncertainty is that the EU part of the EU/IMF programme is drawing to an end and that the exit strategy is unclear. The government, probably to support the narrative that Greece was leaving the crisis fully behind, suggested in recent weeks that it could get a clean exit – like Portugal and Ireland – even drawing to an early end the IMF part of the programme (normally due to continue until Q1 2016).

Below are a few considerations we would like to highlight, given the facts above:

- **While Syriza is leading in the polls, it does not seem able to govern on its own** (i.e., it is very unlikely it will have an outright majority). As such, the problem is as much one of potentially protracted uncertainty in the formation of a government and on the bias of any new government (depending on who are the coalition partners). A coalition of Syriza with the Democratic Left and with the new center-left, pro-European movement, To Potami, would imply a more traditional center-left approach than if Syriza were to side with the Independent Greeks, for example, which have a more nationalist approach and are strongly opposed to the EU and the IMF.
- **Syriza is not calling for an exit from the euro area.** It is more likely that, in the end, a new Syriza-led government would reach a new agreement with the EU/IMF – after some further volatility, to be sure – than something more disruptive (i.e., Greece leaving the euro area), in our view. Especially because…
- …**It is just a fallacy to believe that Greece can leave the euro and default on its debt because it now has a primary surplus**, and that it would be better off by doing so. There are indeed several additional forms of support currently provided to Greece by the European Union, notably through the repayments of ANFA[1]& SMP profits and through EU structural funds, as well as through the ECB liquidity support – that would be lost in case of an exit from the euro area. The primary surplus would vanish and significantly larger problems would materialise for the Greek economy and for its financial sector.
- **On the exit strategy from the EU/IMF programme: our understanding is that the Greek authorities will settle for a reduced level of monitoring and conditionality, with some kind of programme remaining in place** – likely in the form of a credit line facility (already available under the ESM toolbox), or something else made ad hoc for the country. **It is worth nothing that under a credit line facility of this type Greek assets would remain eligible for the repo facility of the ECB.** The IMF will also probably remain, again with possibly a tweak to the programme conditions and characteristics. A decision on the follow-up from the current programme is not expected before early December.

1 ANFA: Agreement on Net Financial Assets. It is an agreement to remit the profits made on Greek assets by the European Central banks back to Greece.

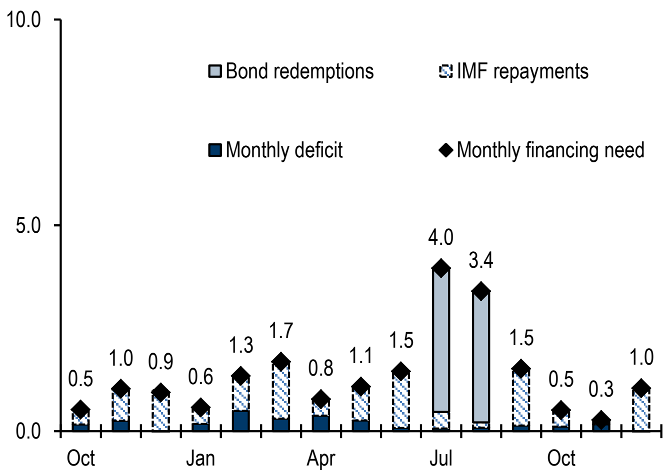
- **Given the recent market reaction, it is unlikely that private investors will provide support to Greece without a EU/IMF programme in place for some time.** And that is clearly crucial, given that Greece would still have some funding requirements beyond those provided by the Troika. Commission Vice-President Katainen said on Thursday there should be "no doubt that Europe will continue to assist Greece in whatever way is necessary" so the government can keep financing itself.

- **Funding requirements:** On the funding side, borrowing requirements for Greece have decreased significantly after the PSI and the restructuring of the European loans. They are small in the coming months (Exhibit 6), and will remain so for the rest of the decade. Specifically, **over 2015-16, the funding needs are around 30bn** (consider zero net issuance of T-Bills), of which 12bn are required to repay the IMF, around 10bn more to deal with loans and bond redemptions, and the rest for the remaining expected for the budget deficit and for other smaller items (including repayment of arrears).

  On the resources side, Greece should benefit from the remaining tranches from the IMF (until Q1 2016), for 12bn (i.e., so in effect the IMF is not providing new lending over the period); 9 billion are expected from privatisation receipts and ANFA & SMP profits, while the remaining amounts – just under 10bn – should have come from various sources (including potentially what will be left from the bank fund after the stress tests results and the sale of banks' preference shares) and from market access. The latter seemed totally feasible until very recently, given the lower rates reached along the bond curve up to September and also the issuance already executed earlier this year..

Exhibit 6: Monthly financing needs' estimate

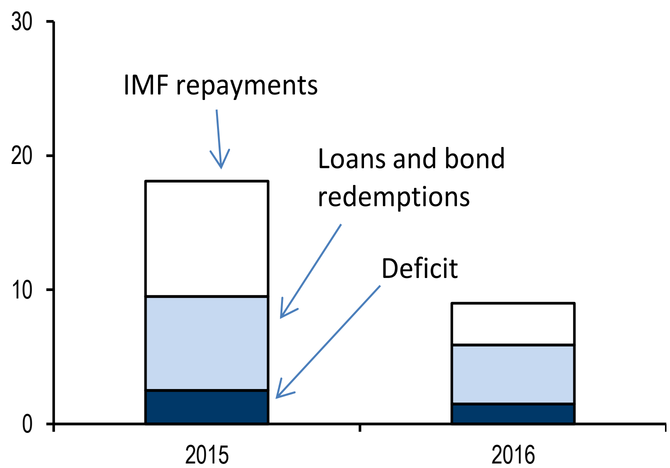
€bn, Oct 2014 – Dec 2015



Source: Credit Suisse estimates

Exhibit 7: Financing needs 2015-2016

€bn



Source: Credit Suisse estimates

Clearly, the latter does not seem that viable anymore, at least until the current political situation is clarified – which could take us until March 2015 or longer.

In the short term, Greece (as well as other countries in the euro area) will also have to deal to the possible additional recapitalization needs post AQR/stress tests and also with the finalization of the 5th review with the EU/IMF. Our understanding is that an agreement is not out of reach, although some additional reforms might be needed before the review gets the sign-off.

CREDIT SUISSE

GLOBAL FIXED INCOME AND ECONOMICS RESEARCH

Ric Deverell
Global Head of Fixed Income and Economics Research
+1 212 538 8964
ric.deverell@credit-suisse.com

GLOBAL ECONOMICS AND STRATEGY

James Sweeney, Chief Economist
Co-Head of Global Economics and Strategy
+1 212 538 4648
james.sweeney@credit-suisse.com

Neville Hill
Co-Head of Global Economics and Strategy
+44 20 7888 1334
neville.hill@credit-suisse.com

GLOBAL STRATEGY AND ECONOMICS

Matthias Klein
+44 207 883 8189
matthias.klein@credit-suisse.com

Wenzhe Zhao
+1 212 325 1798
wenzhe.zhao@credit-suisse.com

Axel Lang
+1 212 538 4530
axel.lang@credit-suisse.com

Jeremy Schwartz
+1 212 538 6419
jeremy.schwartz@credit-suisse.com

US ECONOMICS

James Sweeney
Head of US Economics
+1 212 538 4648
james.sweeney@credit-suisse.com

Jay Feldman
+1 212 325 7634
jay.feldman@credit-suisse.com

Dana Saporta
+1 212 538 3163
dana.saporta@credit-suisse.com

Xiao Cui
+1 212 538 2511
xiao.cui@credit-suisse.com

LATIN AMERICA (LATAM) ECONOMICS

Alonso Cervera
Head of Latam Economics
+52 55 5283 3845
alonso.cervera@credit-suisse.com
Mexico, Chile

Casey Reckman
+1 212 325 5570
casey.reckman@credit-suisse.com
Argentina, Venezuela

Daniel Chodos
+1 212 325 7708
daniel.chodos@credit-suisse.com
Latam Strategy

Juan Lorenzo Maldonado
+1 212 325 4245
juanlorenzo.maldonado@credit-suisse.com
Colombia, Ecuador, Peru

Alberto J. Rojas
+1 212 538 4125
alberto.rojas@credit-suisse.com

BRAZIL ECONOMICS

Nilson Teixeira
Head of Brazil Economics
+55 11 3701 6288
nilson.teixeira@credit-suisse.com

Daniel Lavarda
+55 11 3701 6352
daniel.lavarda@credit-suisse.co

Iana Ferrao
+55 11 3701 6345
iana.ferrao@credit-suisse.com

Leonardo Fonseca
+55 11 3701 6348
leonardo.fonseca@credit-suisse.com

Paulo Coutinho
+55 11 3701-6353
paulo.coutinho@credit-suisse.com

EUROPEAN ECONOMICS

Neville Hill
Head of European Economics
+44 20 7888 1334
neville.hill@credit-suisse.com

Christel Aranda-Hassel
+44 20 7888 1383
christel.aranda-hassel@credit-suisse.com

Giovanni Zanni
+44 20 7888 6827
giovanni.zanni@credit-suisse.com

Gergely Hudecz
+44 20 7888 3742
gergely.hudecz@credit-suisse.com

Sonali Punhani
+44 20 7883 4297
sonali.punhani@credit-suisse.com

Mirco Bulega
+44 20 7883 9315
mirco.bulega@credit-suisse.com

EASTERN EUROPE, MIDDLE EAST AND AFRICA (EEMEA) ECONOMICS

Berna Bayazitoglu
Head of EEMEA Economics
+44 20 7883 3431
berna.bayazitoglu@credit-suisse.com
Turkey

Carlos Teixeira
+27 11 012 8054
carlos.teixeira@credit-suisse.com
South Africa

Gergely Hudecz
+44 20 7888 3742
gergely.hudecz@credit-suisse.com
Czech Republic, Hungary, Poland

Alexey Pogorelov
+7 495 967 8772
alexey.pogorelov@credit-suisse.com
Russia, Ukraine, Kazakhstan

Nimrod Mevorach
+44 20 7888 1257
nimrod.mevorach@credit-suisse.com
EEMEA Strategy, Israel

JAPAN ECONOMICS

Hiromichi Shirakawa
Head of Japan Economics
+81 3 4550 7117
hiromichi.shirakawa@credit-suisse.com

Takashi Shiono
+81 3 4550 7189
takashi.shiono@credit-suisse.com

NON-JAPAN ASIA (NJA) ECONOMICS

Dong Tao
Head of NJA Economics
+852 2101 7469
dong.tao@credit-suisse.com
China

Dr. Santitarn Sathirathai
+65 6212 5675
santitarn.sathirathai@credit-suisse.com
Regional, India, Indonesia, Thailand

Christiaan Tuntono
+852 2101 7409
christiaan.tuntono@credit-suisse.com
Hong Kong, Korea, Taiwan

Michael Wan
+65 6212 3418
michael.wan@credit-suisse.com
Singapore, Malaysia, Philippines

Weishen Deng
+852 2101 7162
weishen.deng@credit-suisse.com
China

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