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ADVANCE ECONOMIC SPOTLIGHT ON…

GREECE POST THE REFERENDUM

JUNE 2015

Recap on Greek debt crisis

Over the past few years, Greece has accepted bailouts from the Troika (International Monetary Fund, European Central Bank and European Commission) totalling $US264 billion. It was due to make a €1.6bn payment to the International Monetary Fund on Tuesday 30 June and failed to make the payment. In the lead-up to the payment deadline, Prime Minister Tsipras was offered a further bail out agreement under strict austerity measures but this was refused and a referendum was called for 5 July for the Greek populace to choose whether or not to accept a dated European Union's proposal.

After failing to make the Tuesday payment, the European Union announced there would be no further extension to the existing program and froze Emergency Liquidity Assistance (ELA) forcing Greek banks to close. This created a run on ATMs and even with withdrawal limits of €60 a day, most are out of cash.

The referendum and the European Union

In the referendum on 5 July, despite polls suggesting that they would vote in favour of the agreement, the referendum received a convincing NO vote. The European Union expected Greece to submit new proposals for an agreement on Tuesday which it failed to do with sources suggesting even the Greek government had expected the country to vote YES in favour of the original agreement given the consequences of exiting the euro. Overnight, European Council President Donald Tusk announced that Greece would be allowed an extension until Thursday to submit new plans and a full European Union Summit would be held on Sunday to discuss it.

The possibility of a plan being agreed on

Greece doesn't currently have a plan in place to present to the European Union for repaying debt and creating economic growth. Given the Greek populace's refusal to accept austerity, it is difficult to see how Greece could develop a suitable plan that would be accepted by the European Union. The results of the referendum also indicate it's unlikely that the more severe proposals currently outlined by the European Union would be accepted by Greece in any case.

If the European Union did accept a Greek agreement with less severe austerity terms, there are the following implications:

> It opens the door for countries like Ireland, Spain and Portugal to renegotiate their terms from their agreements with the European Union given these countries are showing signs of recovery and are approaching new election terms.

> It is unlikely Greece will be able to repay its debt in the future, meaning the can would still be kicked down the road to the next payment deadline next year and the uncertainty would continue.

If the European Union does not accept a Greek agreement, then there are a range of implications.

Short term

Greece will be forced to leave the Eurozone as it will not have any funds otherwise and will need to create its own currency – perhaps a return to the drachma.

> In the short term, this is likely to create volatility across Europe with a flight to "safer" assets such as the German Bund or Australian bonds. This flight started across the past few weeks as investors anticipated the outcome of the Greek debt payment deadline. Many European banks will also face some disruption due to having exposure to Greek debt.

> There will be volatility across equities markets which has already started as part of the sell off from Greek shares with US shares particularly attractive.

> The US currency may also benefit from the flight from Greece given the ongoing recovery in markets there.

Greece is also likely to face severe recession for at least the short term with no access to capital and no set plan for managing an exit from the Eurozone. With no money to fund its spending, Greece will also be forced to reform its dysfunctional tax and social services system.

Long term

- The Eurozone may benefit in the longer term from a Grexit as there are signs of recovery across the rest of the region and it is likely to assist credit ratings for investors. It also frees up resources from the European Central Bank to assist other countries in the region such as Spain, Portugal and Ireland.
- Greece may also benefit longer term as it will need to print currency and establish its own easing programs while restructuring its spending. This will assist in driving down the value of its debts in the longer term and driving growth and a stronger economy from more practical spending.

Ironically, in voting against austerity, the Greek population has essentially chosen a path that will force them to it.

In the Advance portfolios

Advance's investment mandate is the preservation and enhancement of investors' capital and the situation in Greece is one of the many risks and opportunities that Advance has monitored and factored in the diversified and sector portfolios for many years. The portfolios are allocated in favour of Australian bonds over international bonds which will see benefits in the flight to safer assets, international shares (focusing on US over Europe), and in favour of US currency strength. We also recently took short term positions in German bunds recognising the opportunities in this area as investors move out of Greece. We will continue to monitor the situation and adjust the portfolios as needed based on our investment philosophy of the interests long term of our clients.

For more information, please speak to your Advance State Manager.

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