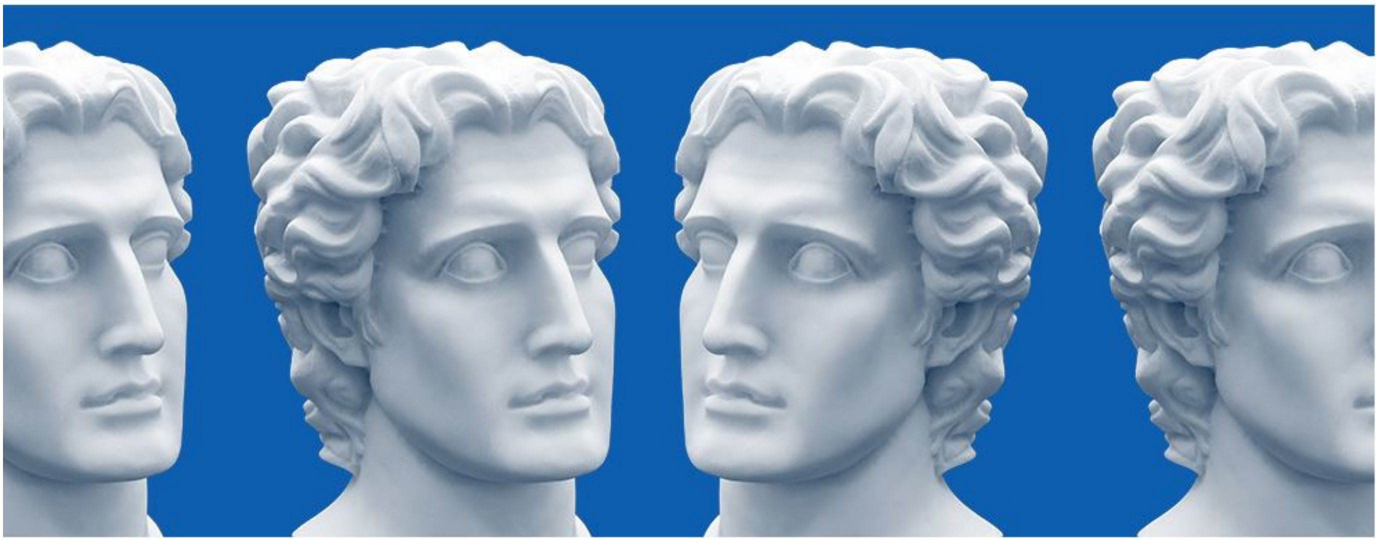

Greek bailout: déjà vu all over again

Greece and its creditors have finally reached a deal. So the immediate threat of Grexit has been averted and talks are due to begin shortly on the country's third bailout. Is this grounds for relief and celebration? The short answer is no, and this note explains why, in three parts:

1. What does Monday's deal consist of?

- A **package worth €82-86 billion** over the next three years;
- All being well, **Greece itself will fund the majority of this bailout**, via an independently held €50 billion fund of assets to be privatised, including the government's stakes in the banks, the Public Power Corporation, the Port of Piraeus and real-estate assets;
- Of this €50 billion fund, the first **€25 billion raised will go to recapitalise the banks**, while the next **€12.5 billion will be used to lower Greece's public sector debt**. Once these needs have been met, the **remaining €12.5 billion will be spent on investment** – allowing Prime Minister Tsipras to argue that he succeeded in achieving a stimulus package, even while conceding so much.

2. What are the preliminary hurdles over the week ahead?

- 15th July: ***Mr Tsipras must get Greece's Parliament to agree on a sales-tax overhaul***, pensions reform and an increase in the retirement age – all rejected in the recent referendum. On current reckoning, he will succeed but, given likely defections within his coalition government, this will only be with the support of the main opposition parties;
- 16th July: ***The European Central Bank (ECB) Governing Council will meet***. Assuming Mr Tsipras has succeeded, it could (1) lift its freeze on emergency lending, giving Greek banks a little more room to breathe; and/or (2) increase the limit on the amount of short-term debt Athens can issue. Or it could decide to do nothing at all – on the grounds that maintaining the freeze maintains the pressure;
- 17th July: ***Germany's Bundestag is being recalled for Friday***, as it is one of a number of other parliaments that needs to approve the deal. Angela Merkel should be able to shepherd it through, though with some defections likely. Parliaments in Finland and Slovakia could prove more problematic;
- 20th July: ***Greece has €3.5 billion (plus €600 million in interest) due to the ECB***. But because the International Monetary Fund (IMF) has primacy among creditors, the €2.6 billion Greece owes it must be repaid first, bringing the total needed by next Monday to nearly €7 billion. Around half of the funds could come from the profits on Greek bonds held by the ECB, which were promised to Athens as part of its 2012 bailout. But that still leaves €3.5 billion to be found from some as-yet-unspecified source of bridging finance. France has proposed drawing on the European Financial Stabilisation Mechanism, involving all 28 EU member states. However, UK Chancellor George Osborne has said that this is "a complete non-starter". This fund can be accessed on the basis of qualified majority voting, so theoretically the UK could be bounced into participating – but the European authorities probably don't want to add an increased risk of Brexit to their Grexit woes;
- 22nd July: ***Mr Tsipras must pass more measures through parliament***, including European banking union rules and a code to speed up Greek court procedures. This could put further strain on the governing coalition, assuming a reshuffle has not already taken place.

3. More fundamentally, why can't this deal work?

Assuming the preliminary hurdles can be overcome and the talks on Bailout III begin, what could possibly go wrong? The short answer is plenty, and from four main sources:

1. ***The €50 billion privatisation fund will never be realised***
   Greece was set exactly the same target – equivalent to 27% of its annual national income - under the

Papandreou government of 2011. *Actual* sales since that date have amounted to only €3.5 billion. A further €3.5 billion of potential sales are currently tied up by parliamentary and local authority challenges, disputed property rights and planning problems. Though the legislative changes that the government is being forced to enact will arguably ease the situation, economic conditions, the current government's opposition to asset sales and the need to access funds quickly are hardly the backdrop to achieving top-dollar prices.

2. ***Yet more austerity won't work***
   Mr Tsipras drew comfort from two sources, following the deal on Monday: first, the €12.5 billion investment stimulus to be provided by the privatisation fund, and second the possibility of debt restructuring. On the former, however, if the privatisation fund cannot raise €50 billion – and we do not believe it can – then the stimulus is fiction. And on the latter, there were no firm commitments even to discuss the issue. When a country is in double-dip recession, with its banking sector severely impaired and capital controls set to remain in place for some time, increased austerity is likely to make debt and deficit targets *harder* to meet, by shrinking national income. This is exactly what has happened over the past five years.

3. ***Creditor tensions could resurface***
   The IMF can only participate in Bailout III if it believes Greece's debt is sustainable, and we already know that it regards debt restructuring as a vital part of achieving sustainability. If it can't get the other creditors to agree (and Germany's Finance Minister Schauble has his face set against it), then the Fund's notional €16.4 billion contribution to the Bailout III package could be under threat. This is a serious possibility: the IMF's insistence on sustainability delayed the 2011 bailout agreement and froze payments again in 2012 for a number of months.

4. ***Political backlash in Greece is highly likely, and the creditors should be careful what they wish for***
   Back in June, we speculated (*Could it be the politics, stupid?*) that a desire to effect a change of government in Greece underlay the creditors' increasingly hard line. After Monday's capitulation by Mr Tsipras, and under the pressure of the timetable he now has to enact, this seems more likely than ever. A government reshuffle looks to be the bare minimum. Mr Tsipras has said that he would not be prepared to head up a national unity administration, but fresh elections later this year are a possibility.

   The creditors are presumably hoping for a more reform-friendly administration, but democracy can be an unpredictable process. Furthermore, previous bailouts have *not* been helped by political paralysis – five prime ministers and eight finance ministers have been in place since the start of the financial crisis in 2008, whereas the UK has taken 36 years to chalk up the same number - and a repeat under Bailout III could further weaken prospects for the privatisation fund.

<u>Bottom Line</u>:

Last weekend's meetings reportedly nearly ended in fisticuffs (the mood in the finance ministers' all-nighter was described as "violent") and Grexit. So the fact that both were avoided provides some immediate relief. The short-term hurdles over the next week may be overcome, though sourcing the full €7 billion needed for next Monday's ECB and IMF debt repayments still looks troubling at this stage.

More fundamentally, however, there are serious concerns about the longer-term prospects for the deal. If, as we believe, the privatisation fund is unrealisable, this Bailout III financial 'black hole' will have to be plugged by some other means – additional loans, further austerity and/or debt restructuring could all be the subject of yet more negotiations. For all the twists and turns of recent months, this deal is simply déjà vu all over again.

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