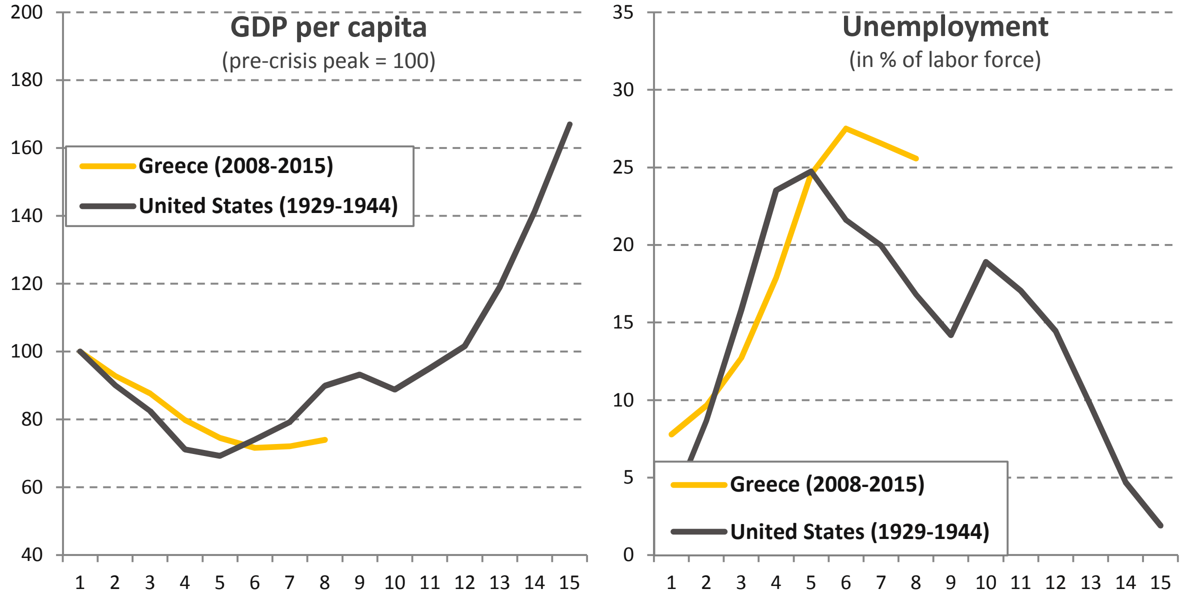
The Great Greek καταστροφή (catastrophe)

Discussions between Greece and its creditors about a third rescue plan have finally entered a critical phase. Whereas a last-minute agreement satisfying all parties was still possible going into last weekend, there is little to no hope for such an outcome. An agreement now seems in place, but it's far from clear what's in it for Greece. Indeed, without further significant changes to the creditors' plans an exit from the monetary union may now be Greece's least bad option. As a result, a Greek exit from the eurozone has become the base case scenario but certainly not because it was inevitable.

- At the time of writing some sort of agreement between Greece and its creditors seems in place. The deal (of around bn 85 EUR) would cover Greek financing needs over the next three years and include a significant amount (around bn 20EUR) for the recapitalization of Greek banks next to a large privatization program. Not all is clear at this point, but it definitely looks like Greece is facing more economic pain. With harsh conditions imposed and little to no perspective for Greek citizens in place to confront the future, the agreement looks extremely fragile.

The Great Greek Catastrophe



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- From a cost-benefit perspective, we have argued several times before that Greece would stay best in the eurozone on the condition that an appropriate deal could be reached. However, the current agreement is not what we had in mind when stating this. Even though our former base case scenario of a last-minute deal now seems to play out, it's very easy to become much less optimistic about the future for Greece in the Eurozone. Without further significant changes to this agreement, Greece exiting the monetary union may now be even in the country's best interest. We have referred to Argentina in this respect several times before. It's unlikely Greece would just follow Argentina's post-2002 path to recovery. At the same time, it's doesn't take require too much imagination to see the Greek economy recovering again outside the eurozone as the beneficial effects of currency depreciation and default gradually start to pay off.

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- The “Great Depression” in the United States is generally known as a decade of big economic turmoil. It wasn’t until WWII that the US economy started to revive (see graph). But the situation for Greece looks set to become much more difficult. Following five years of severe budgetary savings, a huge loss in livings standards for the Greek population and mass unemployment, its’s nearly impossible to see light at the end of the tunnel. To call the current Greek situation an “economic depression” looks far too mild.

- Though far from inevitable (there were lots of chances to close an appropriate deal), a Greek exit from the monetary union has now become our base case scenario. Without a looser budgetary stance and the prospect of a debt restructuring further down the road (as more structural reforms are implemented), it’s difficult to see the economy not going through a new deep recession again. In all likelihood, the difficult negotiations over the last couple of months have already produced exactly that. Admittedly, a Greek exit may not be imminent now that some sort of agreement is on the table. On the other hand, that is absolutely no guarantee that it will not happen. Timing this of course, is close to impossible.

- There’s a lot more to say about the future of the eurozone. From a political point of view, it’s clear that the eurocrisis is back (from never been away). Where there’s no will, there’s no way. As things currently stand, even with the significant progress made over the last couple of years, the eurozone is still lost in the woods.

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