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Greferendum and the markets

Anatole Kaletsky | GaveKal | 29 June 2015 |

Contrary to most of this morning's headlines, the astonishing weekend events in Greece will almost certainly prove bullish for risk assets around the world and especially in Europe.

The European market mayhem triggered by Alexis Tsipras' bizarre referendum announcement (which Greek officials only found out about through Twitter in the midst of a negotiating session with the Troika in Brussels) seems reminiscent of the panics about US politics created by the 2013 US government shutdown and the debt-ceiling battle in 2011. The reason for optimism is that the shutdown of the Greek banking system this week not only guarantees a temporary collapse of the Greek economy, the "shock-horror" story on which the media have focused. Much more importantly, the week-long economic and financial collapse between now and the Greferendum, virtually guarantees a vote against Tsipras. And given that Tsipras's suicidal incompetence in the EU negotiations has made a change of government the most plausible way out of the Greek crisis, bringing forward this "regime change" must surely be good news (see Greek default would trigger regime change, not Grexit).

In suddenly calling the Greferendum, Tsipras has again misplayed his hand. He is now throwing down his last remaining card - domestic democratic support - and it will probably turn out to be a deuce. His chances of persuading a majority of Greeks to vote for default and Grexit seemed pretty slim even on Sunday morning, when one poll showed 57% of voters supporting an unspecified "deal" to stay in the euro, while another showed 47% willing to accept a "painful" agreement versus 33% prepared to vote "no". Probably more significant than these opinion polls was the outcome of last January's election, which the Syriza party won by only a hair's breadth, a fact which seems to have been forgotten by many market commentators - and by Tsipras himself.

Syriza won only 36% of the popular vote in the January election, leaving Tsipras far short of the absolute majority he now needs. Even if he kept every single Syriza supporter and won over all of the Communists plus his natural enemies who voted for the ultra-nationalist New Greece Party and the neo-nazi Golden Dawn, Tsipras would just scrape home with 52%. But that would have been on the basis of last January's voting, before anyone explained to the Greeks the implications of rejecting a bailout and defaulting on the IMF, EU and ECB.

Back in January, Tsipras offered Greek voters a free lunch - an end to austerity, higher pensions, wages and public spending, plus a pledge that their euros would be untouched. On Sunday 5 July, Greek voters will be offered a different prospect - bank closures with a daily limit of €60 on ATM withdrawals, a total collapse of commerce, and probable expulsion not only from the euro but also from the EU if Greece votes to override EU law by refusing to honor debts to EU institutions or tries to repay these obligations in new drachmas. In essence, the referendum question will be rephrased by the EU authorities, with strong backing from most of the Greek media, along these lines:

1. Do you want the banks to reopen and release your savings? Vote Yes.
2. Do you want to live on €60 a day indefinitely? If so, vote No.

Once the full implications of default were spelled out - loss of bank deposits, conversion of pensions and public sector wages from euros into devalued IOUs and, ultimately, the loss of EU subsidies and other membership benefits - it always seemed likely that public opinion would swing against Tsipras. That's why we have long argued that the best outcome of the Greek mess would be a regime change in Athens, followed by a sweetheart deal offered by the EU to a Mario Monti-style technocratic government. We believed, however, that such a "regime change" would probably require an actual default, followed by a month or two of economic chaos and the replacement of euro pensions, savings and wages with worthless domestic IOUs (see Greeks inch toward surrender). Now this regime change looks like happening quite smoothly after an economic and financial paralysis lasting just one week.

The main risk to this scenario was that the EU politicians would be too diplomatic to spell out these consequences before the referendum and Tsipras might squeak a win against the odds. The signal for that would have been an ECB decision to keep funding the banks and allowing them to feed out cash to the Greek savers. Now, this risk has been removed by the announcement of a full week of bank closures. This almost guarantees a vote against Tsipras in the referendum. By next week, therefore, Greece is likely to have a new technocratic caretaker government willing to sign up to whatever the Troika requires. In exchange, the EU will surely soften its reform demands and offer generous debt relief (no haircuts but plenty of rescheduling, grace periods and interest cuts).

In short, the Greek "crisis" will probably be over by next week. I think that will be an important event, given the psychological role of Greece in keeping a lid on what would otherwise be a boiling bull market in risk assets around the world.

Anatole Kaletsky is co-founder of GaveKal Research, GaveKal is one of the world's leading independent providers of global investment research. It also advises several funds with combined assets of more than US$2bn. In Australia, GaveKal Capital's GaveKal Asian Opportunities Fund is available through Certitude Global Investments.
