Greece: more of a contagion to sentiment than markets (so far)

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We found it surprising that the Greeks voted so strongly for a 'no' [to austerity] given most commentators and prior polling showed more mixed opinions.

However, regardless of the outcome of the referendum, solving the problems facing Greece was never going to happen quickly, even if they had voted 'yes'. The 'no' vote makes any subsequent discussion more difficult and makes it much harder to put anything in place to protect the Greek economy from the near-term fallout.

What next?

Our expectation from here is that with the Greek banks continuing to see cash outflows even within the capital controls framework, they will run out of money very soon. Their only source of additional cash would be if the European Central Bank (ECB) raised the ceiling on its Emergency Liquidity Assistance (ELA) programme, which is already providing the only source of liquidity for the Greek banking system.

We do not expect the ECB to end the programme — which is tantamount to actively causing the banks to fail — while politicians are still in conflict. However, we also do not think it will raise the ceiling, thus passively allowing the Greek banks to run out of money.

As a result, economic activity in Greece will deteriorate further as the payment systems required in a modern economy begin to fail. There have been some efforts to alleviate the situation such as free rail journeys to help people get to work, but as the delivery of goods fail, we could potentially see the beginnings of a humanitarian crisis.

Looking further out, we expect efforts will focus on reopening the banking system, which may entail a new Greek currency of some nature, such as IOUs, while from the markets perspective, the next point of focus will likely be the 20 July debt repayment to the ECB.

Portfolio implications

In our portfolios we are avoiding any direct exposure to Greek debt and are mindful that contagion has so far been to sentiment and relatively limited within financial markets. While the issues of the Greek government and Greece's banking system should be contained, we continue to expect volatility, but view Europe to be better able to deal with the fallout than it was in 2012.

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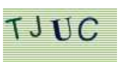

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