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World First Briefing Note:

What next for Greece?

Despite the ‘No’ vote yesterday, we may have to wait as long as two weeks for decisive action in Greece. However, we have never been further down the path to a Greek exit from the Eurozone, with most analysts having Greece leaving the single currency as a ‘base case’.

Was this the last chance for a bailout?

No, but the chances of a bailout agreement have lessened as a result of the referendum result. The IMF cannot contribute as Greece is ‘in arrears’ having missed its EUR1.5bn loan repayment last month. For a new bailout to be put in place a request for a loan from the European Stability Mechanism must be made.

This will then be combined with a Memorandum of Understanding (MoU) to detail the conditions of the bailout and finally this will be put to a vote of the Eurogroup (which would need to be unanimous) as well as parliamentary votes in Greece, Germany, Holland and Finland. This isn’t going to happen overnight, and even following a ‘Yes’ vote, this would have taken weeks to finalise and for funds to be disbursed.

A bailout is still possible but creditors can take their time, Greece cannot.

July 20th is the next deadline

On July 20th, two weeks from now, Greece is set to pay back a EUR3.5bn bond to the European Central Bank. Were Greece to avoid or not be able to pay back that amount then the ECB would be forced to withdraw the liquidity assistance it is providing the Greek banking system by calling in its loans.

At the moment, the ECB is providing liquidity to Greek banks in exchange for collateral; usually Greek sovereign debt. In a situation where Greece defaults on its ECB payment, however, that collateral is next to worthless and the loans would in turn be withdrawn. In the absence of that euro liquidity another currency would have to be taken on to open banks and restart commerce.

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This may be a form of Greek government IOU in the short term which in turn may transition into a New Drachma (ND). Any euros left within Greece would be hoarded as a store of value against a dramatically devaluing local currency.

In the meantime, we expect the ECB to wait for the negotiations; it cannot make an overt political move in withdrawing liquidity support while talks are still ongoing.

What about the debt?

Tsipras and the Greek negotiating team will take up the fight in the next series of talks and position themselves around gaining debt relief. I believe that any debt relief coming Greece's way would only be limited to tinkering with maturity (paying back debts over a longer time frame), rate cuts (paying less interest) and coupon deferrals (paying back the interest later as well). A haircut – actively cutting the amount that Greece owes – would represent a very hot political potato and would form a dangerous precedent. The IMF, one of Greece's creditors, has found itself isolated in the view that relief is needed – it will meet considerable political opposition in Europe however.

And the market reaction?

Greece is seen by some as a domino; merely the first to fall in an inevitable collapse of the Eurozone. It is the job of the European Central Bank, European Commission and Eurogroup to make sure that this doesn't happen. Naturally it is countries that are seen to share similar debt characteristics with Greece that traders will be watching closely. Italy, Spain and Portugal are all seen as overly indebted with the latter already having taken a bailout back in 2010. We are likely to see a sell-off in their sovereign debts as investors shift cash to safer assets. Likewise, the euro could be sold heavily as investors bet on further monetary policy action from the central bank to stave off another credit crunch or continent-wide recession.

The reaction will not be limited to Europe, of course. Already, banks are starting to push their expectations of when the Federal Reserve and Bank of England will hike interest rates, given the market uncertainty. Oil prices are falling on global growth concerns. Copper is down for the same reason. Any market reaction will be met with an unequal and opposite central bank reaction to make sure the music doesn't stop.