Portfolio Manager van Skagen Tellus

Torgeir Høien

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The Euro Is Not Going to Check Out of Greece

"Don't forget to pay the debt we owe" was Socrates's final plea before he died from hemlock poisoning. He owed a rooster. Will Athens too ensure its debts are paid? If not, will a default lead to a Grexit? In my opinion, the answer to both questions is "no".

The sovereign bond fund I'm managing has been in and out of Greek sovereign bonds since the fund's inception. The fund's last voyage into the Aegean Sea was a year ago. But we unbound the fund's Ulysses in early November, as I didn't enjoy the prospects of left-wing populists dipping their hands in Athens' meager coffers. The election turned out worse than I expected, as the radicals in Syriza teamed up with the nutty right-wing populist Independent Greeks.

Thales thought everything was water; his student Anaximenes believed it was air. It's a mistake to think all of Greece's problems is debt. Massive sovereign debt is a hurdle, but the key problem is how to get the economy moving again. Right now, it is as stuck as Achilles behind the tortoise in Zeno's paradox.

If this continues, the Greek macro outlook risks becoming a micro story. Syriza's economic programme is a disastrous repeat of the heavy-handed interventionist policies pursued by Andreas Papandreou's Pasok party from 1981 onwards. Greek commerce, already under immense pressure, is likely to collapse under the weight of higher taxation, wasteful public expenditure and tighter regulations. Misguided left-wing policy-making, not sovereign debt, is the main cause of Greece's woes.

In 2014, it cost Greece 4.3 percent of GDP to its sovereign debt. This was roughly the same as public interest expenses in Ireland and less than in Italy and Portugal. With a decent economic recovery, that number would have declined further this year and would soon have been close to that of France. The recovery has stalled, however, and the Greek economy is likely to shrink

this year. And it just takes two years of about two percent negative growth to have as much effect on Greek income as the cost of its current sovereign debt burden.

It now looks likely that Athens will be able to pay its bills, including maturing IMF debt, until the end of June. Ordering local authorities to deposit their cash with the government at the Bank of Greece has bought Athens some time. The deadline can probably be extended further, perhaps to the end of July, by a similar diktat issued to publicly-owned companies.

This would give the government the chance to hammer out a deal that triggers payment of the last trance of the bailout programme that was extended to June 30. They could also agree the details of a new, third bailout. Optimists should probably not expect anything really positive until the end of June or mid-July.

While there is a chance that a deal might be reached, I think it is more likely the negotiations will falter.

The least of Athens problems is the finance minister Yanis Varoufakis, who doesn't play by accepted rules and has become a lightning rod in Brussels and Frankfurt. "A time-waster, a gambler and an amateur", was how his colleagues described him after Friday's Eurogroup meeting in Riga. His flamboyant days are numbered.

The biggest problem is the economic mandate that Tsipras won the election on. It is the antithesis of what Brussels, Frankfurt and Washington rightly demand. If the programme is implemented, it will cause misery in Greece, and an inability to pay old and new debt.

It may be that Tsipras has a Damascene conversion on one of his trips to Brussels, eradicates the hard core left of Syriza, ditches the Independent Greeks and forms an austerity and structural reform coalition with Pasok and the New Conservatives. Costas Karamanlis, a previous New Conservative premier, who bears much of the responsibility of the current fiscal mess, is on good terms with Tsipras, and may play the role of kingmaker. But I doubt this will happen. And if the government is determined to pursue a policy that will lead Greece to the abyss, why should the Eurozone and the International Monetary Fund give him a golden parachute?

Importantly, and contrary to the outlook before the last election, Athens is not likely to run a surplus before interest expenditures this year, i.e. the government will have to borrow money to pay non-interest expenses. Being unable to tap funds in the market at affordable interest rates, and with limits on how many treasury bills the Greek banks can swallow, means Alexis Tsipras needs fresh official loans to keep his government afloat.

So, in my view, the odds are that Greece will default on its sovereign debt. Instead of paying out interest, it will use all incoming revenues to pay salaries, pensions and other current public expenditures. It could well be, therefore, that July 20, when €3.5 billion is due to be paid to the European Central Bank, is D-day.

How kind of default should we expect? A sovereign default is legally and financially much more complex than we often think. Few governments extinguish all their debt at once. And if you stop servicing the debt, that does not necessarily mean it will be written off. We are more likely to see missed payments and grace periods followed by partial write-offs.

The Greek government owes 6 percent of its debt to the European Central Bank. Here I expect missed payments, but no write-off. The Greek Loan Facility and the European Financial Stability Fund own the lion's share of Athens debt - 60 percent. This will probably be written off.

Greek banks hold just 1 percent of the severing debt, which will probably be honoured. After a default, the banks will need to be recapitalized, probably with public funds, after first having been nationalised. So, aside from the fact that bankruptcy might be pre-requisite for nationalisation, it makes no sense to default on their bills and bonds. Also, the banks must be kept afloat in order to have access to European Central Bank funding, either in the form of ordinary central bank credit or as Emergency Liquidity Assistance from the Bank of Greece.

Defaults on International Monetary Fund loans are rare. I do not think that Greece will be an exception. The IMF owns 10 percent of Athens's debt and I expect that to be served in full. With the prospect of primary deficits, Tsipras needs at least one official lender of last resort.

Private investors, especially foreigners, are probably going to get bald, though, after a swift encounter with a Greek hairdresser.

A default doesn't necessarily imply an adieu to the Eurozone. If the European Central Bank allows the Bank of Greece huge amounts of Emergency Liquidity Funding and accepts huge imbalances in its interbank payment system, euros will continue to oil the wheels of Greek commerce.

The Greek electorate wants to stay in the Eurozone and the government says it does. It is hard to see how Greece would gain from a voluntary exit. Also, the EU Treaty does not provide a framework for forcing a country out of the single currency. A default provides no legal grounds for a forced exit. Not even a default on debt owed to the European Central Bank. The central bank's vice-president has said that the government default on its debt to the European Central Bank does not exclude Greek banks from using the Eurozone's intra-bank payment system and the Bank of Greece as their local branch of the central bank.

Even if Greece exits the Eurozone, the euro is probably not going to check out of Greece.

Having citizens pick up, hold and use a new currency backed by a dodgy Treasury is difficult when there are plenty of euros notes around and citizens have euro-denominated demand deposits in foreign banks. The Hellenic Republic will likely be "montenegronised", i.e. the euro will probably remain in widespread use, just as it is in some other continental territories outside the Eurozone.

Alexis Tsipras might issue IOUs, and try to dress them up as a new Greek currency, but people are unlikely to honour them with a tie.

While there would be short-term turbulence after a default, I expect on net positive spillover effects for the rest of Europe, at least in the long run. Frankfurt and Brussels should by now be well prepared for a default, and also, if that happens, an exit from the Eurozone. A deteriorating Greek economy will teach Spaniards and Italians the necessity of a more liberal economy. This will shrink the electoral prospect of Podemos and the Five Star Movement.

Is Portugal the next domino? "No, is being my answer". Lisbon is actually way ahead of Athens in instituting sound structural reforms. France too might gain from Greece's pain, as populist Marine Le Pen's electoral base likely will shrink. A return to economic sanity in France might be the most important political

consequence of what's going to happen in Greece - if their economy goes where Syriza leads.

Letting Greece go sour in order to teach other Europeans a lesson is of course not worth it. It's a tragedy that Athens seems intent on creating economic havoc. Lately Syriza has dipped in the polls. One can hope that this will cause them to cut their economic left-wing populist credo. Then, whether there is a default or not, Greece commerce might be reborn as the bird phoenix.

The Greeks must crawl out of Plato's cave and face the real world. Syriza's red banners are shadows of past failures. Government supremacy and a hampered economy is a poor substitute for Troika hegemony.

Hoien is a portfolio manager with Skagen Funds in Stavanger, Norway and was on the executive board of the Norwegian central bank from 1998-2002.