Greece and Greece Macro

Research Analysts
Niall O'Connor
44 20 7883 8761
niall.oconnor@credit-suisse.com

COMMENT

A solution likely soon, but to fall short of market expectations?

- **Summary:** In this report we look at the latest macro and micro data releases for the Greek economy relevant for the banking sector. We also posit a non-consensus view of an outcome of the negotiations for financing the sovereign.
- **The macro situation in Greece continues to worsen, with the IMF now forecasting -3.8% GDP growth for 2011**, despite a positive q/q of +0.2% for Q1 (which we find to be a surprising figure). Due to lower than expected revenue collection, the deficit is on track to be higher than the government's target of 7.4%.
- However, **deposit outflows at -1.5%/month remain consistent with cash burn in a declining economy and show no signs of distress. We see loan growth declining to -6% for 2011** as the economy remains in recession reducing demand and enforced deleveraging reduces supply.
- **We see the most likely outcome over the next few weeks as payment of the €12bn tranche of the IMF/EZ programme** (with or without the IMF participating). Because this funds the government until around the August 20th bond maturity, a further "bailout 2.0" isn't necessary until that point. As we see that the various european parties seem far from consensus, and the Greek government has little more to offer (and a decreasing political and popular mandate) we think it highly possible that a full bailout to fund Greece until 2013 will not be decided until possibly as late as September.
- The political situation remains tense both in Greece and in Europe, so other outcomes are also very possible.
- **Stock Calls:** We suspect that there might be a relief rally following at least a partial solution to the Greek crisis at the meetings scheduled for the end of this month. But we feel that the market might be too hopeful of a full solution (to 2013 at least). We see Greek bank shares as pricing in a 35% haircut and a recapitalisation to 9% core tier 1.

Figure 1: **Financing options**
euros in billions

Date	June/early July	August 20th	August/early September
Option 1	+12bn IMF/EZ + 60bn(?) bailout 2.0	-6.8bn bond maturity	
Option 2a	+12bn IMF/EZ	-6.8bn bond maturity	+ 60b(?) bailout 2.0
Option 2b	+12bn IMF/EZ progress on bailout 2.0	-6.8bn bond maturity	+ 60b(?) bailout 2.0
Option 3	+9bn EZ only	-6.8bn bond maturity	+ 60b(?) bailout 2.0

Source: Credit Suisse research

What's going to happen next?

We see the following constraints in play:

- No-one wants a funding crisis either at sovereign or bank sector level. As such we believe it is extremely unlikely that the government will miss an interest payment (anyway, it can issue bills and /or cash payments to e.g. hospital suppliers could easily be deferred), or that the ECB would refuse to accept GGB's or other government-backed collateral, or that the EZ would not release at least their part of tranche 5.
- There does not appear to be a consensus on reprofiling, let alone restructuring government debt.
- There needs to be seen to be "conditionality" to the release of tranche 5. We suspect that the government's latest medium-term fiscal plan and privatisation schedule will prove to be enough. However, there remains uncertainty over whether this will pass parliament.
- The government doesn't, at this time, have much more to offer due to increasingly vocal street protests against austerity and a falling majority in parliament. More austerity would in any case be counter-productive, at least in the short term, in our view.
- The IMF requires 12 months funding in place (or at least comfort that it will be) before it releases its portion of tranche 5 (€3.3bn).
- The monthly financing requirement in 2011 is made up of around €0.3bn/month primary deficit and €1.1bn coupon payments. However, this tends to be front-loaded in the year, with the biggest deficit months in February to August. In 2010 average primary deficit for this period was €0.7bn/month. July interest payments have also been significantly higher in the past two years. We would expect the deficit to be around €2.5bn/month for the next three months.
- The bulk of the refinancing requirement is for maturing debt: €6.8bn on 20th August, a further €5.8bn in December 2011, €31bn in 2012 and €26bn in 2013. To this extent there is a large liquidity issue, of over €100bn to the start of 2013, of which around €50bn covered by the IMF/EZ plan.
- Privatisation proceeds will be minimal in 2011 (max €5.5bn), and 2012 (max €6bn) on the government's own plans.
- The EU and IMF don't seem overly concerned about whether equity markets like the uncertainty or not.

We see the following key dates coming up:

- Greek parliament to vote on new fiscal plan (end June)
- Government has stated it runs out of cash (July)
- €6.8bn bond maturity (August 20th)
- IMF 5th review due; tranche 6 of €8bn to be disbursed (August 30th onwards)

This implies that the €12bn tranche 5 will cover the deficit for around 2 months and the August bond maturity, but potentially not much more. Tranche 6 is not due to be disbursed until mid-September (i.e. AFTER the bond maturity). As we've said, there is no way in our view that the Greek government will miss either an interest payment or a principal repayment, but there is likely to be (once again) increased uncertainty before that time.

We see three possible options for financing over the next few months: tranche 5 combined with "bailout 2.0", tranche 5 with bailout 2.0 in September, and finally EZ-only (i.e. non-IMF) tranche 5 with bailout 2.0 in September.

Figure 2: Possible financing options
euros in billions

Date	June/early July	August 20th	August/early September
Option 1	+12bn IMF/EZ + 60bn (?) bailout 2.0	-6.8bn bond maturity	
Option 2a	+12bn IMF/EZ	-6.8bn bond maturity	+ 60b(?) bailout 2.0
Option 2b	+12bn IMF/EZ progress on bailout 2.0	-6.8bn bond maturity	+ 60b(?) bailout 2.0
Option 3	+9bn EZ only	-6.8bn bond maturity	+ 60b(?) bailout 2.0

Source: Credit Suisse research

Option 2a seems unlikely to us: the IMF has already stated that it will not fund without 12-months clear financing.

Option 1 also seems unlikely to us. The Greek government has already pushed both parliament and the public as hard as it can, and seems to have little more to offer beyond what is in the latest medium-term plan, and this in our view seems to be enough to get tranche 5, but not a larger second bailout. There is a wildcard that parliament votes against the plan at the end of June of course, which we would regard as highly negative.

Option 3 seems politically unappealing: carrying on without the IMF on board doesn't look good. Given the few alternatives however this option might become the least bad.

Option 2b seems the most likely compromise option to us. Tranche 5 is likely to be released in order to finance Greece until the autumn in exchange for voting through the new medium-term plan (itself not a given). An agreement in principle to provide further financing might be enough to bring the IMF on board for tranche 5. Then the "can can be kicked down the road" once more until the autumn, when the Greek government can pass politically tougher measures while most voters are on holiday, and there is more time for the various parties involved to reach consensus on bailout 2.0 and more time for banks and other institutions holding GGBs to build capital.

Figure 3: Detailed calendar

Date	Event
30 May	IMF review #4 (for tranche 5) was due to be completed
~15 June	IMF review was due to be published
15 June 2011	Greek parliamentary committee reviews new fiscal plan
19 June 2011	Eurogroup/Ecofin meeting
24 June 2011	EU heads of state meeting
27-28 June 2011	Greek parliament to review new fiscal plan
30 June 2011	Greek parliament to vote on new fiscal plan (possible one week delay)
June 2011	Greek cabinet reshuffle?
end June?	EZ/IMF due to disburse €12bn
July 2011?	EBA banks' stress tests published
July	Government has stated it runs out of cash
20th August	€6.8bn bond maturity
30th August	IMF 5th review due; €8bn to be disbursed by EZ/IMF around 2 weeks later
September	According to a euro zone official, a new bailout programme for 2011-14 could be agreed
October	Trichet leaves the ECB
November	Independent review of Greek banks loan books due
May-12	French general elections due
Apr-13	Greek parliamentary elections due
Jul-13	ESM operational
May-13	Italian elections due
Oct-13	German parliamentary elections due

Source: Credit Suisse research, press

"Bailout 2.0"

We see around €60bn being required to finance Greece until the start of 2013. As we do not see a plan forming imminently we do not discuss it in much detail in this report. The funding could come from a number of different sources in our view.

- Privatisation proceeds. Although the government has earmarked €15bn for sale over the next 3 years, we think achieving that amount will be hard in the face of pressure from both the public and employees of companies slated for sale. We also see few obvious buyers of these assets. We see one solution as using the assets as collateral against further loans.
- Debt reprofiling/restructuring. CS fixed income team has discussed this issue in "Greece: A restructuring scenario analysis", 16 May 2011. We note that a maturity extension would probably not have any capital impact for the Greek banks HtM holdings, so is logically a likely step to take at some point in the future.
- Further loans from other sources, e.g. EFSF or IMF/EZ.

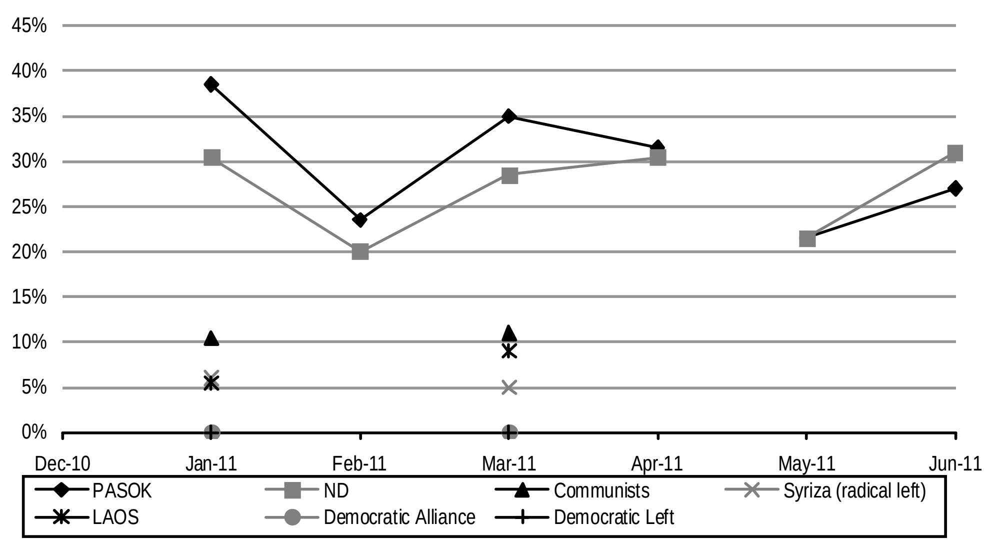
Politics getting increasingly fractious

Opinion polls now show that PASOK has lost its lead over ND. The fact that it has taken this long suggests public dissatisfaction with the opposition to us. A June poll showed that 87% of Greeks think the country is going in the wrong direction.

PASOK's majority has now dropped down to 4 (out of 300) after two more politicians said they would not vote for the new austerity measures.

Kathimerini is also reporting that the government is looking a cabinet reshuffle imminently.

Figure 4: Polling in Greece



Source: Press reports

Syntagma square protestors

We continue to watch the scale of the protests in Greece, and the 10's of thousands in Syntagma square in particular. In contrast to earlier protests in Greece they appear to be not union organised, non-politically affiliated, and most importantly non-violent.

We see the crowd as very different in make-up and behaviour to earlier union-led protests. For now the protestors are largely young, often unemployed and there does not yet appear to be any single unifying theme. However, we believe in general that the feeling is pro-default, anti-austerity and anti-corruption.

Until there is a key message of what (at least a large minority) of the crowds want, we do not believe that they yet represent a significant driving force for any of the processes under way, with perhaps the exception of making politicians more nervous about voting in favour of the austerity plans. But we don't doubt that there is a real risk of a strong, well-defined, politically active movement coming from within the crowds that could well have much greater influence in future. And of course we hope (and believe) that the crowds will remain peaceful.

Deposits still in "cash burn mode", but still sticky

Deposit growth has correlated much less well with GDP historically than loan growth, and also it appears to lag GDP growth. This theory fits with NBG's assessment of the economy being in "cash burn" mode, i.e. people and companies running down their savings or working capital to finance day-to-day living. NBG sees system deposits falling a further 6-7% in 2011. We put in -6% for 2011, and we could envisage as much as 1% per month for the (seasonally weaker) first half of the year.

However, to date we see no indications of deposit flight: in fact the opposite has been the case; we simply see a steady draw-down of deposits.

For reference the Greek deposit guarantee scheme is €100k per customer, backed by the government.

Figure 5: Greek Corporate and household domestic deposits
euros in billions

End of period	2009 Q4	2010 Q1	2010 Q2	2010 Q3	2010 Q4	2011 Q1	April
Deposits	238	227	216	213	209	199	197
q/q	0.1%	-4.5%	-4.8%	-1.7%	-1.9%	-4.6%	

Source: Central Bank

If we apply our own seasonal factors to deposit inflow data we can see that the trend of deposits appeared to worsen in December 2010. However, almost all of this can be accounted for by the lower Christmas bonuses paid in 2010: we estimate the impact is between €1bn and €2bn.

Outflows did look slightly worse in March and April, but still remain controlled in our view.

We do not expect to see inflows until June when positive seasonal factors could outweigh a likely continued downwards underlying trend.

Figure 6: Domestic Corporate and Household Deposit inflows

	2009		2010		2011	
Month	Inflow	Inflow, sadj	Inflow	Inflow, sadj	Inflow	Inflow, sadj
1	1,229	3,869	(5,163)	(2,523)	(4,083)	(1,443)
2	569	1,274	(3,302)	(2,598)	(2,604)	(1,899)
3	890	879	(2,167)	(2,178)	(2,992)	(3,004)
4	3,806	3,655	(5,230)	(5,381)	(2,429)	(2,580)
5	(1,809)	(801)	(2,272)	(1,263)	(4,009)E	(3,000)E
6	5,213	3,035	(3,417)	(5,594)	178E	(2,000)E
7	(2,966)	(2,027)	(4,153)	(3,214)		
8	1,845	1,703	739	596		
9	1,427	1,067	(195)	(555)		
10	(2,324)	(1,876)	(1,354)	(905)		
11	(1,054)	(504)	(2,612)	(2,063)		
12	3,542	94	3	(3,445)		

Source: Bank of Greece, Credit Suisse estimates

Domestic loans continue to decline

Domestic loan growth in Greece has now reduced to small y/y declines, driven by m/m declines in every month in 2011.

Enterprises saw continuing small y/y growth whereas the big declines came in Household lending, particularly Consumer Credit.

Figure 7: **Greek domestic credit data**
euros in billions

End of period	Dec-09	Mar-10	Jun-10	Sep-10	Dec-10	Jan-11	Feb-11	Mar-11	Apr-11
I. TOTAL (rh axis)									
Outstanding amount of credit	253.4	254.8	262.4	261.6	257.8	256.7	255.4	255.4	253.7
y/y reported	4.2%	3.5%	3.1%	1.2%	0.0%	-0.3%	-0.4%	-0.4%	-0.5%
m/m (est)		0.0%	2.6%	-0.2%	-1.5%	-0.4%	-0.5%	0.0%	-0.7%
II. ENTERPRISES									
Outstanding amount of credit	133.8	135.2	128.7	127.0	123.2	123.0	122.2	122.2	121.2
y/y	5.1%	4.3%	3.1%	2.3%	1.1%	0.9%	1.1%	1.1%	1.2%
III. HOUSEHOLDS									
Outstanding amount of credit	119.6	119.7	119.8	119.1	118.1	117.3	116.8	116.8	116.4
y/y	3.1%	2.7%	1.6%	0.1%	-1.3%	-1.6%	-2.0%	-2.0%	-2.2%
1. Housing loans									
Outstanding amount of credit	80.6	81.2	81.4	81.1	80.5	80.0	79.8	79.7	79.7
monthly net flow	507	140	(165)	(66)	(49)	(125)	(118)	(118)	(171)
y/y	3.7%	3.5%	2.3%	1.0%	-0.4%	-1.1%	-1.4%	-1.4%	-1.6%
2. Consumer credit									
Outstanding amount of credit	36.0	35.5	36.3	35.8	35.1	34.7	34.5	34.4	34.1
monthly net flow	144	(105)	234	(167)	(267)	(92)	(221)	(221)	(239)
y/y	2.0%	1.0%	0.4%	-2.1%	-4.2%	-4.2%	-4.6%	-4.6%	-4.9%

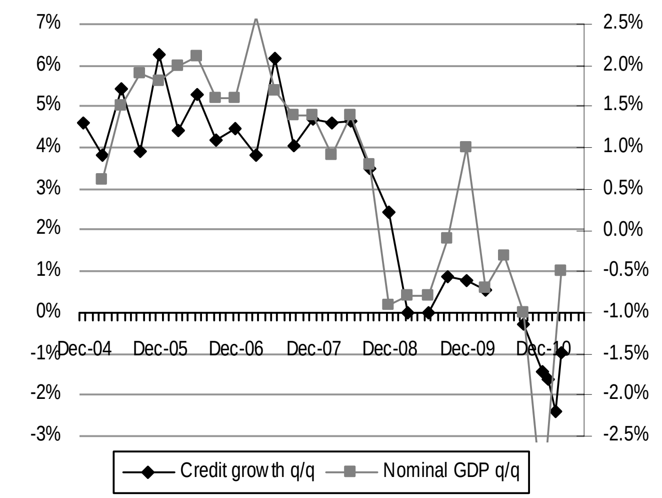
Source: Central Bank. Credit Suisse estimates

Greek loan growth has shown a good correlation with nominal GDP growth historically.

Consensus estimates suggest GDP will be around -4% for 2011, and CPI is dropping fast now that the VAT increase effect is dropping out. If we had a +1% GDP deflator nominal GDP could be -3%. This implies around -4% loan growth y/y in 2011. The IMF and us are looking for -6% due to enforced deleveraging.

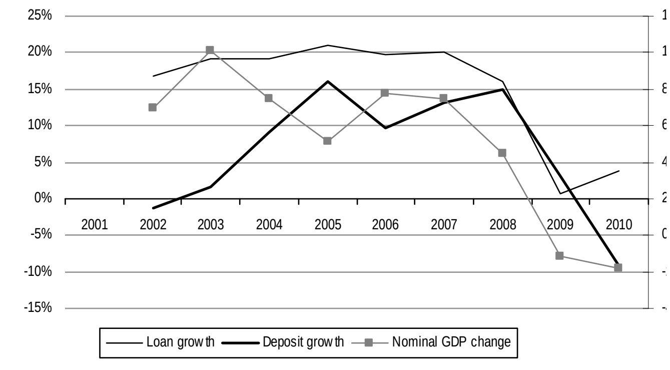
For 2012 where nominal GDP growth should be slightly positive (real +0.6% +0.4% inflation on IMF numbers) we could see loan growth of around 4%. However the IMF forecasts -5% due to deleveraging. We are slightly more optimistic but still look for -1%.

Figure 8: **Credit growth and nominal GDP growth (rh axis), q/q**



Source: Central Bank data

Figure 9: **Credit and deposit growth and nominal GDP growth, annual**



Source: Central Bank data

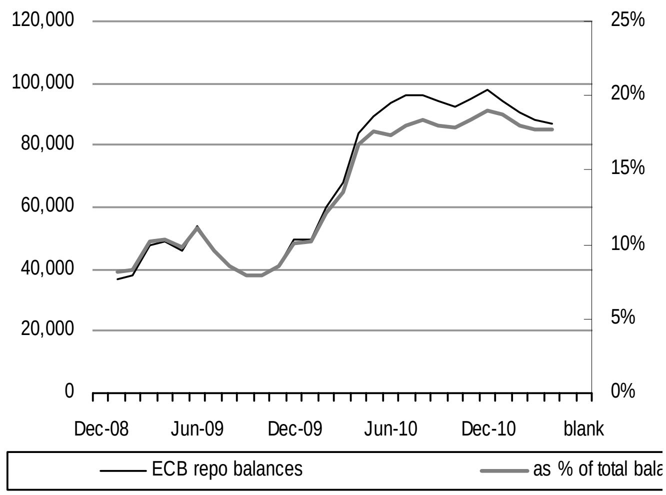
Greek ECB repo

Greek banks decreased their aggregate ECB repo amount from a peak of €97.8bn in December to €86.8bn/18% of balance sheet in April 2011.

The very small amount of outstanding debt in the Greek banking system means that the ECB repo amount is a good indicator of the difference between total balance sheet size and deposit base. i.e. it will decrease only when either the balance sheet is delevered or deposits grow.

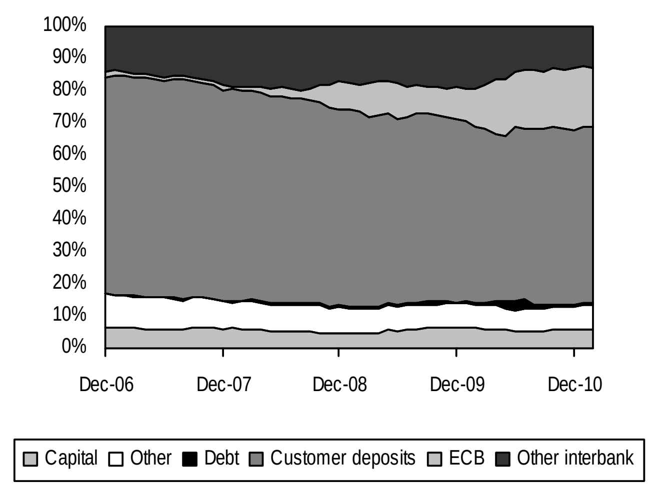
With deposits continuing to flow out of the system at around €2-3bn/month the decline is coming mostly from balance sheet deleveraging: the aggregate balance sheet has shrunk by €15bn in Q1 2011, half of which has come from a fall in loans.

Figure 10: **ECB repo, €bn and as % of balance sheet**



Source: Company data, Credit Suisse estimates

Figure 11: **Greek banks' funding structure**



Source: Company data, Credit Suisse estimates

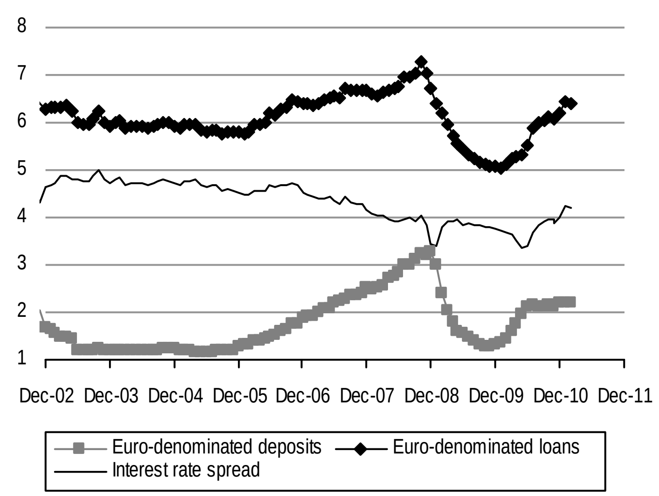
Bank interest rates: loan rates up but deposit rates up too

Loan rates on new business have been rising since January 2010 as the Greek banks have sought to reprice the book, and this rise has continued in 2011. Back book rates have been rising since March 2010 and were still rising at December 2010. Most of the rise appears to be coming from corporate loans.

Deposit rates also rose over the same periods, but now appear capped at just over the all-in cost of ECB repo (around 2.25%). New business rates have stabilised at around 2.2%, with back book rates also stable at 2.2%.

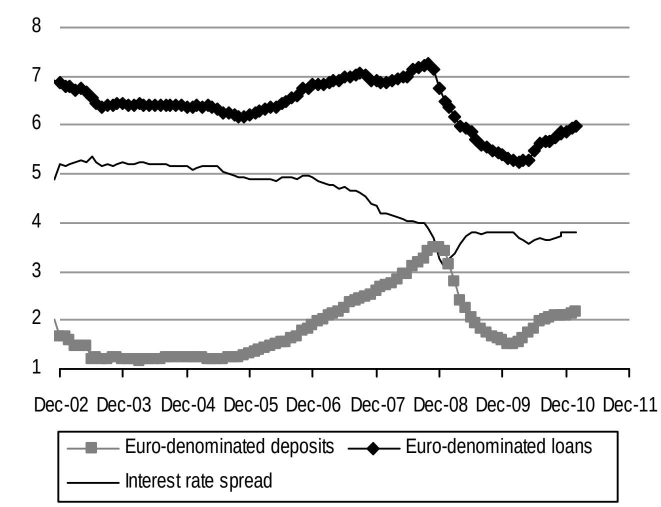
The interest rate spread (a good indicator of the direction of NIM in our view) has remained risen more slowly, and was up 7bp in Q1 and a further 7bp in April.

Figure 12: **New business spreads**



Source: Central bank data

Figure 13: **Back book spreads**



Source: Central bank data

BoG 10% Core Tier 1 requirement

Bloomberg carried a story on 14th June saying that the Bank of Greece met with all the Greek banks yesterday and will require Greek banks to maintain a “10% Core Tier 1 ratio from 2012”.

At the present time the details are surprisingly unclear. NBG believes the implementation timeframe is still flexible and may be either September 2012 or December 2012.

Nor is it clear whether the 10% is designed to provide a buffer against further NPL rises and a markdown on GGB’s, or whether this minimum will be required post such eventualities. We have worked with a 9% Core Tier 1 including government prefs.

The story also suggests Core Tier 1 will include government prefs (€3.5bn total), confirmed by one bank.

All the Greek banks will have a 10% Core Tier 1 by the end of 2012 on our estimates, with the possible exception of Eurobank which might have around a €250m shortfall. (If we assumed the figure is ex-prefs then there would be around a €2.6bn capital shortfall for the system.)

The Greek government already has a €10bn fund allocated for recapitalising the domestic banks in place.

Greece Macro

Government deficit

The State budget deficit continues to slip against target, and more worryingly to us, last year's actual outcome.

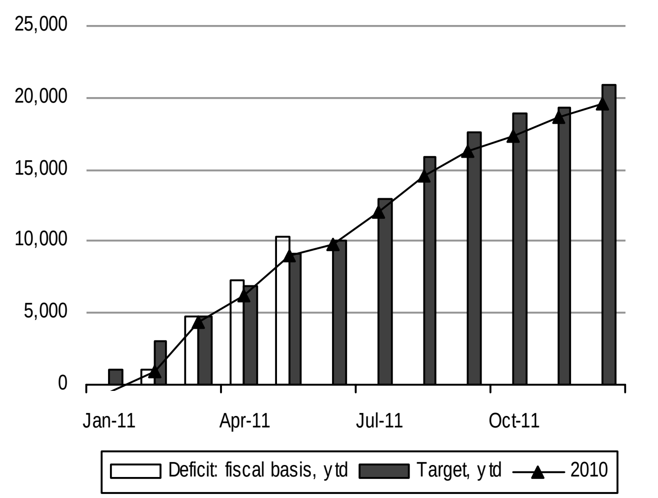
For the first 5 months of the year:

- Revenues are 10% below target. This is due mostly due to the unexpected depth of the recession, but also due to the perhaps (un)surprising success of the government's scheme encouraging people to collect receipts in order to show costs by providing tax rebates against them.
- Expenditures are running fractionally ahead of target.

Note that these figures are on a cash basis, not an accruals basis as the General Government deficit (the basis for the IMF plan) is.

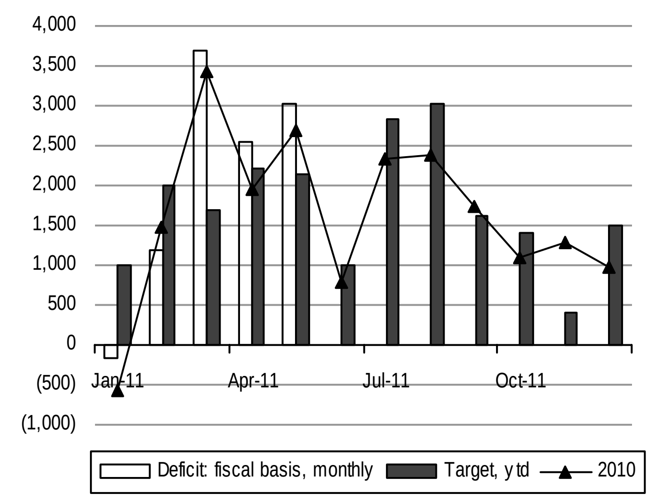
However we would still not be at all surprised to see a 10% deficit for 2011 vs the latest plan's 7.4% and 2010's 10.5%.

Figure 14: **YTD deficit, €mn**



Source: central bank data, Credit Suisse estimates

Figure 15: **Monthly deficit, €mn**



Source: central bank data, Credit Suisse estimates

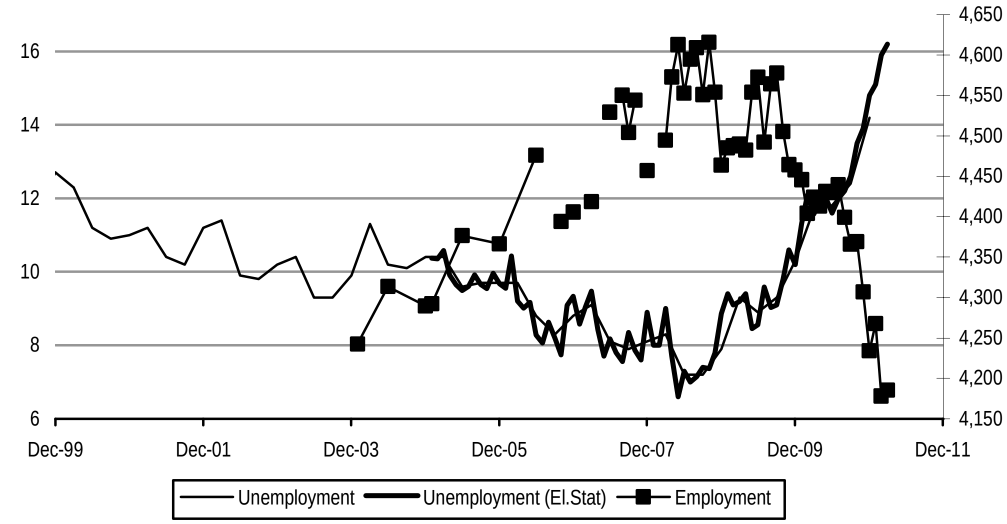
In a way we shouldn't be too surprised at the revenue shortfalls: the majority of tax revenues for most countries come from income tax and VAT (typically 1/3 each) and incomes are down by up to 15% in the public sector whilst Q1 2011 retail expenditure was down by 10% y/y. (Luxury/big ticket spend is down even more: 29% for furniture and household equipment, 44% for cars in the first five months as unemployment, and even more so the risk of future unemployment grows).

Unemployment

The unemployment rate for March rose to 16.2%. unemployment in the 15-24 year old group was 42.5%.

Employee numbers have fallen 9.3% from the peak in 2008.

Figure 16: **Unemployment rate and employment (rh axis) in Greece**



Source: El.Stat, Credit Suisse estimates

Nor do we suspect that unemployment is anywhere near a peak. The public sector has seen wage cuts, but so far only the private sector has seen job cuts. Public sector job cuts are an area that the Greek government has so far promised, but yet begun to act on. And unemployment tends to be a lagging indicator of the economy.

Q1 GDP revised down, but still doesn't look right to us

Q1 q/q GDP growth was revised down from an unlikely +0.8% to +0.2%. Even this latest figure seems unlikely to us given other evidence (declining loans, shrinking employment, falling industrial production). The stats office admits it has not fully adjusted to new methodology on government expenditure and seasonal adjustments.

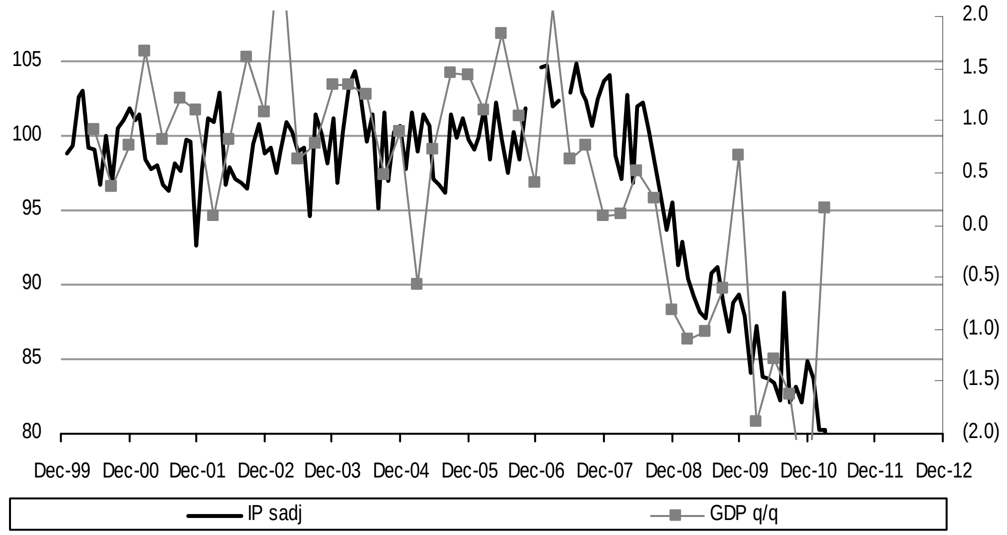
Figure 17: **Quarterly GDP to get to -3.8% 2011**

Year	Quarter	qoq %	yoy %	Real GDP annual	GDP y/y
2009	Q1	(1.1)	(1.0)		
	Q2	(1.0)	(1.9)		
	Q3	(0.6)	(2.5)		
	Q4	0.7	(2.5)	179,730	-2.3%
2010	Q1	(1.9)	(2.8)		
	Q2	(1.3)	(3.1)		
	Q3	(1.6)	(4.1)		
	Q4	(2.8)	(7.4)	171,905	-4.4%
2011	Q1	0.2	(5.5)		
	Q2E	(0.7)	(4.9)		
	Q3E	(0.4)	(3.7)		
	Q4E	0.0	(0.9)	165,398	-3.9%

Source: El.Stat, Credit Suisse estimates

The EZ/IMF team subsequently increased its estimate of GDP contraction for 2011 from -3% to -3.8% and projected a +0.6% growth in 2012. To get to -3.8% in 2011 implies that positive growth will not return until around Q4 2011, and the total peak to trough fall in GDP will be around 11%.

Figure 18: **Greek IP sadj and GDP q/q (rh axis)**



Source: El.Stat, Credit Suisse seasonal adjustment

Appendix: Key figures

Figure 19: **Key IMF programme forecasts (March 2011)**
euros in billions

	2008A	2009A	2010A	2011E	2012E	2013E	2014E
Gross debt/GDP	**111%**	**127%**	**143%**	**153%**	**159%**	**158%**	**154%**
Gross borrowing needs	na	70	60	59	67	61	78
Refinancing requirements M&Long-term					27	38	67
Total GGBs			**327**	**344**	**358**	**376**	**395**
ow IMF/EZ			32	78	102	110	110
ow ECB (CSE)			70	53	35	18	0
ow Greek and Cypriot banks (CSE)			56	50	46	41	36
ow other			169	163	176	208	249
IMF/EZ as % of total			10%	23%	28%	29%	28%
Haircut to get to 90% debt/GDP (ex-IMF, EZ) (CSE)			48%	56%	61%	62%	60%
ECB repo	41	50	98	93	69	51	30
ECB repo as % of balance sheet	8.7%	10.1%	19.0%	19.8%	15.6%	11.1%	6.2%

Source: IMF, Credit Suisse estimates

Companies Mentioned *(Price as of 14 Jun 11)*
EFG Eurobank Ergasias (EFGr.AT, Eu3.07, NEUTRAL [V], TP Eu4.40, MARKET WEIGHT)

Disclosure Appendix

Important Global Disclosures

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Outperform (O): The stock's total return is expected to outperform the relevant benchmark* by at least 10-15% (or more, depending on perceived risk) over the next 12 months.

Neutral (N): The stock's total return is expected to be in line with the relevant benchmark* (range of ±10-15%) over the next 12 months.

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Relevant benchmark by region: As of 29th May 2009, Australia, New Zealand, U.S. and Canadian ratings are based on (1) a stock's absolute total return potential to its current share price and (2) the relative attractiveness of a stock's total return potential within an analyst's coverage universe, with Outperforms representing the most attractive, Neutrals the less attractive, and Underperforms the least attractive investment opportunities. Some U.S. and Canadian ratings may fall outside the absolute total return ranges defined above, depending on market conditions and industry factors. For Latin American, Japanese, and non-Japan Asia stocks, ratings are based on a stock's total return relative to the average total return of the relevant country or regional benchmark; for European stocks, ratings are based on a stock's total return relative to the analyst's coverage universe**. For Australian and New Zealand stocks a 22% and a 12% threshold replace the 10-15% level in the Outperform and Underperform stock rating definitions, respectively, subject to analysts' perceived risk. The 22% and 12% thresholds replace the +10-15% and -10-15% levels in the Neutral stock rating definition, respectively, subject to analysts' perceived risk.*

***An analyst's coverage universe consists of all companies covered by the analyst within the relevant sector.*

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Overweight: Industry expected to outperform the relevant broad market benchmark over the next 12 months.

Market Weight: Industry expected to perform in-line with the relevant broad market benchmark over the next 12 months.

Underweight: Industry expected to underperform the relevant broad market benchmark over the next 12 months.

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