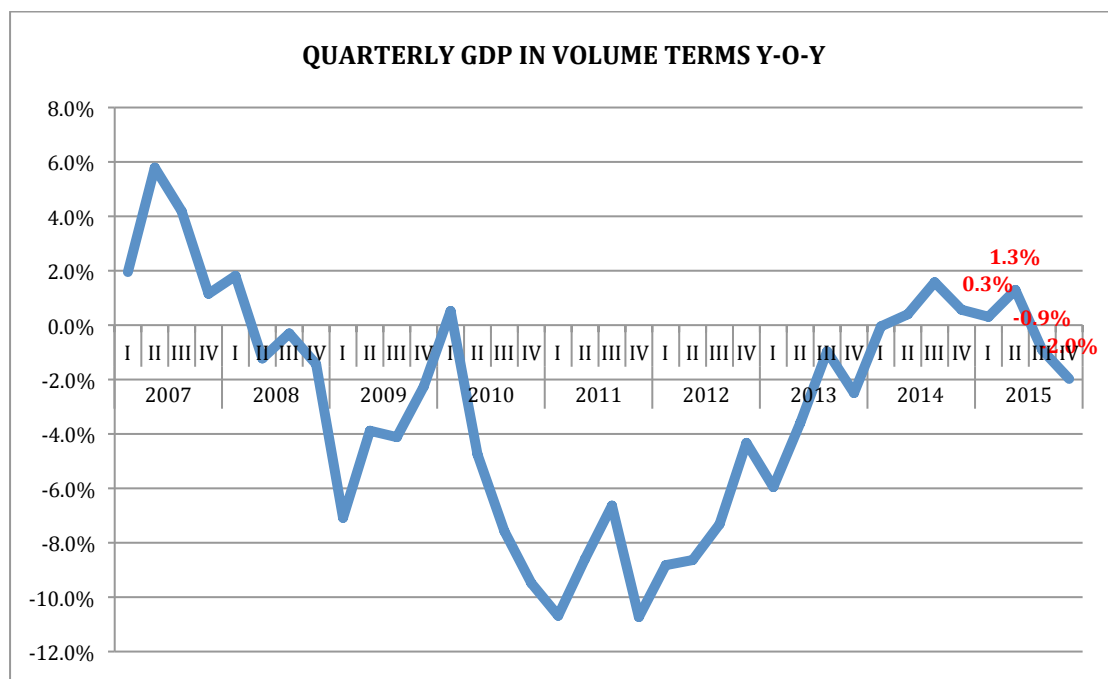


THE OUTLOOK REMAINS DIFFICULT FOR GREECE DESPITE THE POLICY SHIFT

Political developments in Greece over the last decade are determined by the evolution of the crisis and the implementation of the Memorandum with the creditors. The electoral cycle has shrunk so after 2007 and no government has lasted more than two years. Already, the current government is in its second year in power and displays intense electoral wear. The latest polls give a clear lead to the main opposition party, and even the high popularity of the Prime Minister has been undermined and as a result he is now second behind the leader of New Democracy.

The economy has returned to recession following a catastrophic year of experimental negotiations, failed blackmails and inept governance. The decline in the fourth quarter of 2015 is a result of the delayed impact of capital controls.

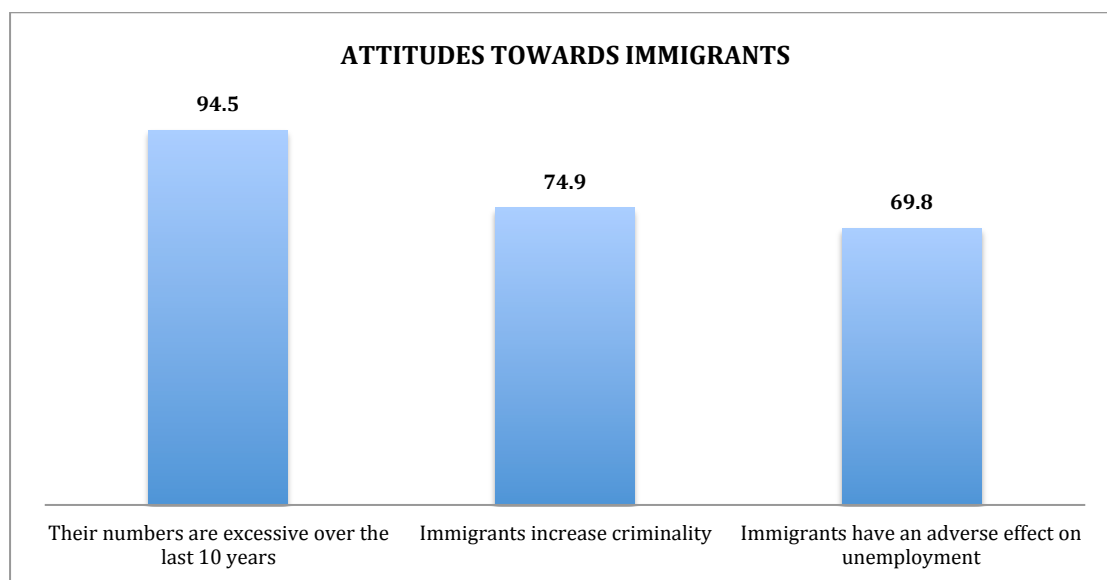


Delays in the evaluation of the program generate more uncertainty and therefore the financial credibility of the country is damaged. Investors are fleeing from the stock exchange. Bank shares of the recently recapitalised banks have collapsed.

The mobilization of a wide range of social forces further destabilizes the government and poses new dilemmas on how to handle the negotiations with creditors. The requested social security reforms are painful and ultimately will affect both existing retirees (for the 13th time since 2010) and existing employees some of whom are facing increases in contributions by 100% to 300%. Especially, a large part of the middle classes (doctors, lawyers and other professionals) are particularly affected by the measures and thus are moving en masse to the New Democracy. For the first time since January 2015 MPs of the ruling party are not able to freely move in their constituencies especially in the regions.

At the same time, the refugee crisis illustrates not only the government's failure to address the problem but also the deterioration of relations with a significant number of European countries annoyed by the inability of Greece to control refugee flows. The reality is that the government delayed the implementation of agreed actions while it tried to blackmail European countries threatening largest refugee flows towards the EU. The probability of the border closure will create new problems in the economy and is expected to hit the government as well.

We should take into account the fact that Greeks are in general very hostile to towards the immigrants and they do not consider that they offer any positive contribution to either the economy or society of the country. In a recent social survey the majority of Greeks have (DIANEOSIS 2016) expressed grave reservations about immigration. Therefore, the continuing incompetence of the government in addressing the immigration flows does not only irritate our European partners but also the voters.



The timing of political events is determined by the negotiation and evaluation of the program in conjunction with developments in the handling of the refugee problem. We expect that the government will complete the assessment by the end of March 2016. By then the government will have to vote through the social security law, agree to the new necessary budgetary measures and finalise the structure and operation of the new Fund for Privatization. From April the new negotiation on debt restructuring will begin with final decisions expected to be taken by June 2016.

Although the schedule seems predictable, major obstacles lie ahead. First, the IMF has a very distinct agenda and they will push Greece for a more vigorous fiscal consolidation and the Europeans for a deeper debt restructuring. What consequence this is going to have on current negotiations is difficult to predict. Second, the pension reform is intrinsically related to debt reduction and thus the approach taken to finish first the evaluation and then move on to the second plate does not make sense. Third, the balance of power between the Europeans and the IMF is not predetermined as some (northern) Europeans will not participate in any program without the IMF while at the same time they are reluctant to commit themselves to any meaningful reduction in debt.

Therefore, the road ahead has a number of major uncertainties but this has always been the case with Greece. Developments were never linear. Although, the end result is important the process to get there also remains crucial. The IMF is actually implying that the existing program is inadequate and numbers do not add up. But how is possible a new program to be imposed on Greece with the current government having its back on the wall? Further fiscal consolidation will be a nightmare as it is likely to hit the public sector with compulsory redundancies. Moreover, the reform effort in Greece during the crisis has been considerable compared to the past but the economic system remains rigid and attitudes have not changed by many stakeholders. Attitudes on privatisation are indicative of the difficulties that lie ahead. Important ministers undermine the effort raising obstacles whenever possible.

In this context predictions about the future remain a precarious job. In the basic scenario of things working out as currently planned by the Europeans the government is likely to survive. We expect that the government despite the pressure from social groups will be able to get through Parliament the required measures in early March (60% chance). Should this not be possible we cannot rule out a quick recourse to new elections (30% chance) or even the creation of a technocratic government of broad consensus by this parliament (10% chance). However, in the more demanding scenario with IMF imposing its will the chances of survival are minimal. Then new elections are the dominant scenario (70% chance) with a government of broad consensus being the only viable alternative (30% chance). The alternative of GREXIT cannot be ruled out, but at this stage it is only a potential threat like a nuclear option, which will play into the hands of the negotiating teams. We all know how the Greek side has used that. Let us hope that the Europeans do not push it that far this time around.

The government is paying the price of generating too many expectations in a broad range of social groups. Promises made before the January 2015 elections and even after the September elections are now haunting Mr Tsipras.

S. TRAVLOS 14/2/2016