News release

Date	5th March 2015
Contact	Simon Reed, PwC +44 207 804 2836 e-mail: simon.reed@uk.pwc.com More details: www.pwc.com/gew Follow/retweet: @pwc_press

Threat of Greek exit has not gone away, warn PwC economists

Businesses should prepare for the possibility of Greece leaving the Eurozone

Despite the recent agreement to extend Greece's bailout package, the threat of a Greek exit from the Eurozone has not gone away, warn PwC economists.

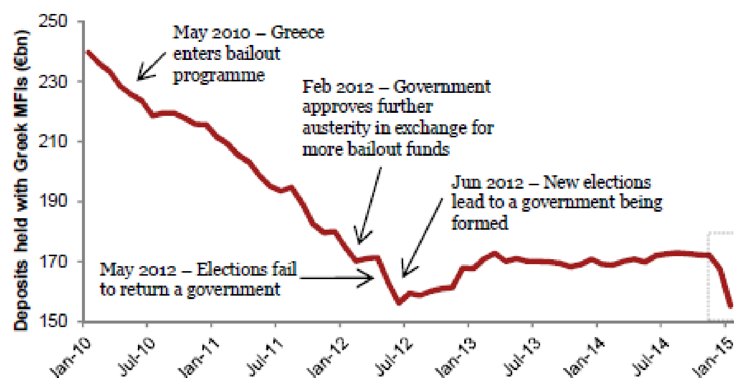
Negotiations are set to run for several months, with the final outcome far from certain. Says PwC senior economist Richard Boxshall: "The Greek government needs to continue to implement reforms and prove to its creditors that progress is being made in order to receive the funds it needs to meet its maturing debt obligations. At the same time, it also needs to keep the support of its own party members and the wider Greek public."

PwC economists have advised businesses to start preparing themselves for the possibility of Greece leaving the Eurozone. They have updated the Greek exit scenario first developed in 2011, outlined two triggers that could set the exit wheels in motion, and identified three channels through which a Greek exit could impact the wider Eurozone.

The two main triggers which could result in a Greek exit are:

- **A Greek credit crunch** – Recent data from the European Central Bank suggests that deposits held by Greek monetary financial institutions (MFIs) fell to around €155bn in January 2015, similar to the level they hit in June 2012 (see Figure 1). Continued capital outflows could squeeze Greek banks' liquidity and make them ever more reliant on Emergency Liquidity Assistance (ELA) funding, which is expensive and limited.

Fig 1: In January 2015, deposits in Greek monetary financial institutions (MFIs) fell by around €12bn, returning to the level they were at in the middle of 2012



Note: Measured as deposits of non-MFIs (excluding central government) held with Greek MFIs
Source: ECB

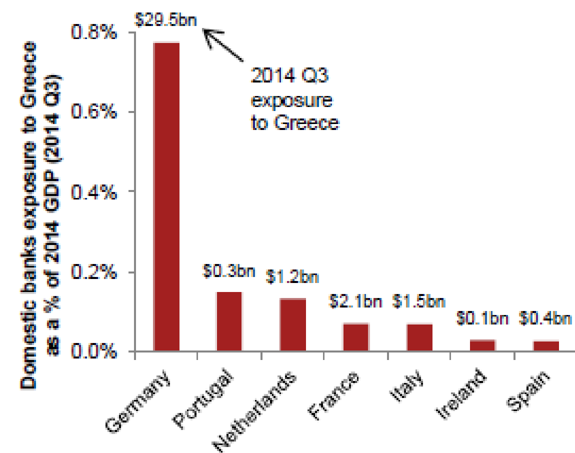
- **Implementation risks** – The Greek government has reached an agreement with other Eurozone governments to extend the current financing package for four months, subject to conditions relating to continued progress on economic and other reforms. According to the Greek Public Debt Management Agency, just under €40bn of Greek government debt matures in 2015. If the Greek government does not meet its reform commitments, then it will not receive the bailout money it needs to make these repayments, leading to a sovereign default.

There are three key channels through which a Greek exit could have an impact on the wider Eurozone:

- **Banking sector** – PwC analysis suggests that the Eurozone banking sector should be able to manage the impact of a Greek exit without severe consequences. The exposure of banks in the four largest Eurozone economies (Germany, France, Italy and Spain) to Greece has fallen from around $104bn in 2010 to $34bn, according to the latest estimates.

  While the German banking system is the most exposed to Greece in absolute terms, this equates to only around 0.8% of its GDP (see Figure 5). For France, Italy and Spain, the direct exposure of their banks to Greece amounts to less than 0.1% of GDP.

Fig 5: The German banking sector has the largest exposure to Greece



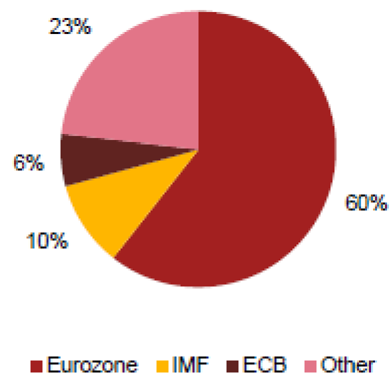
Note: Italy number based on latest data from 2013 Q3
Sources: PwC analysis, BIS, IMF

- **Greek debt holders** – Figure 6 shows that around 60% of Greek government debt is held indirectly by Eurozone governments. If the Greek government defaults on its obligations, then that debt will be written off (at least in part). This could pose a risk to countries which already have a relatively large public debt burden.

  For example, a Greek exit could have negative implications for Italy, which guarantees around 20% of the Eurozone's bailout funds, and has a ratio of gross government debt to GDP of around 130%. Italy's exposure to Greek government debt is equivalent to around 2% of its GDP meaning a default could lead to a fiscal squeeze in Italy as the government attempts to fill the hole left in its finances.

Fig 6: The majority of Greek government debt is held by official bodies and institutions

Holders of Greek government debt

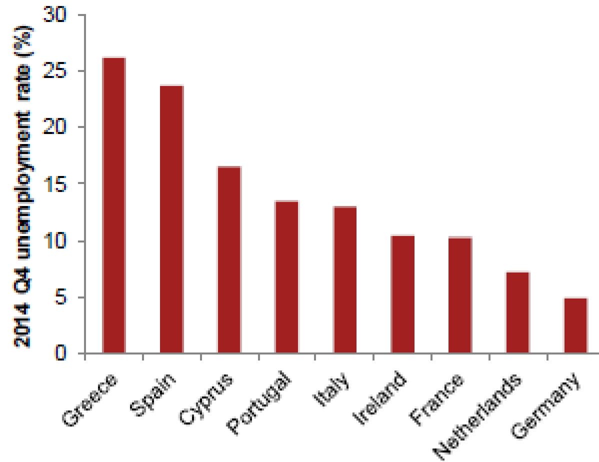


Source: Open Europe

- **Unexpected contagion** – A Greek exit could also have effects outside the realm of economic data and financial statistics. It would likely add to political uncertainty as other countries may push for concessions on their commitments or it could set a precedent that sees other countries leave the Eurozone. For example, Spain and Portugal are both experiencing double digit jobless rates (see Figure 7) and must hold general elections by the end of 2015.

  While the domestic consequences of Greece leaving the Eurozone could deter voters in other countries from seeking to leave the single currency area, there remains a possibility of surprising developments occurring in the Eurozone. A Greek exit could also call Greece's role in the EU and NATO into question, spurring even more uncertainty.

Fig 7: The peripheral economies continue to feel the pain from the Eurozone crisis



Note: Greece data is from 2014 Q3
Source: Eurostat

Greek exit scenario:

In this scenario, it's assumed that the respective governments fail to reach an agreement to extend Greece's bailout programme and as a result, Greece leaves the Eurozone in the third quarter of 2015. The economists assume that:

- *the Greek government defaults on its debt obligations;*
- *capital controls are put in place to prevent the outflow of deposits from Greek banks to other Eurozone financial institutions; and*
- *the Greek government replaces the euro with a 'new drachma', initially introduced at parity to the euro but then allowed to vary in value.*

In practice, PwC economists would expect the 'new drachma' to depreciate almost immediately and inflation to rise sharply to around 6% on average in 2015.

In this scenario, the Greek economy shrinks in both 2015 and 2016, driven primarily by a sharp contraction in business investment and personal consumption, before returning to growth in 2017.

PwC economists expect the Eurozone as a whole to survive a Greek exit relatively unharmed. If Greece leaves, the rest of the bloc are likely to strive to ensure that no other countries follow suit and therefore the currency union is expected to remain solid. The ECB's QE programme is also expected to provide short-term stimulus to the wider bloc. Hence, the Eurozone would maintain positive GDP growth rates in 2015 and 2016 despite the Greek exit.

Concludes Richard Boxshall: "The Greek government must keep focused on its economic growth agenda, with the top priority being to bring down unemployment, which currently stands at around 26%. A return to growth would not just benefit the Greek people, but could also pave the way towards finding a solution to securing Greece's place in the Eurozone."

ends

Notes:
The March edition of PwC's *Global Economy Watch* can be found at www.pwc.com/gew

About PwC
PwC helps organisations and individuals create the value they're looking for. We're a network of firms in 157 countries with more than 195,000 people who are committed to delivering quality in assurance, tax and advisory services. Find out more and tell us what matters to you by visiting us at www.pwc.com.

PwC refers to the PwC network and/or one or more of its member firms, each of which is a separate legal entity. Please see www.pwc.com/structure for further details.

©2015 PricewaterhouseCoopers. All rights reserved.