Investment Insight

The Greece crisis: a summary of what has happened and how our portfolios are positioned

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Greece's financial and economic difficulties have been ongoing for some years now. However, recent events involving Greece and its European partners have raised the risk of default and possible withdrawal from the eurozone.

What's happened so far?

These are the facts that we know to date:

- The Greek government has announced plans to hold a referendum on 5 July on the terms of a proposed euro 7.2 billion bailout package
- This package is conditional on the implementation of a series of new austerity measures affecting pensions, sales tax and budget targets
- The Greek government is encouraging its citizens to vote "no" but the size of the "yes" vote demonstrations on Tuesday led some to question whether the government has misread the situation
- A "yes" vote would likely see Prime Minister Alexis Tsipras resign, potentially paving the way for a more realistic combination of debt forgiveness and agreement of reforms
- The situation is very confusing. Assuming the referendum goes ahead, they will be voting on an offer which has now been taken off the table
- The current debacle is a product of failure of the two sides to understand each other's point of view and an unwillingness to compromise. The eurozone finance ministers refused to extend the current financial assistance agreement (ie bailout package) with Greece beyond its 30 June expiry
- The International Monetary Fund (IMF) has confirmed that a euro 1.6 billion loan repayment due on 30 June has not been repaid. Greece also requested an extension of its repayment obligations
- Last ditch attempts to broker a deal continue, but the outcome remains uncertain
- Faced with growing cash withdrawals by Greece's citizens, the European Central Bank (ECB) will maintain (but not increase at this point) the Emergency Liquidity Assistance to Greek banks. In a bid to contain the risk of a run on Greek banks, Greece's authorities imposed an extended bank holiday (through at least to the 5 July referendum) and placed caps on cash withdrawals
- Tsipras may have underestimated the difficulty of navigating the referendum both politically and economically. Bank closure places increasing hardship on its citizens and a deflationary shock to a country that is already in depression.

While the chance of another last minute compromise and further negotiations between Greece and its creditors can't be ruled out, the risk of a default by Greece on all its debt commitments is high (the failure to meet the IMF payment does not represent a default credit event), as is the potential for its departure from the eurozone. Aside from the euro 1.5 billion loan repayment that is now due, the next crucial date is July 20 when Greece has to make a euro 3.5 billion payment to the ECB. In the absence of an agreement being reached between now and that date, uncertainty will continue and markets are more than likely to be volatile.

Our observations

The situation remains fluid, but we are able to make the following observations:

- Greece's desperate situation is not new news and the eurozone is in a far stronger position to contend with the consequences of default than it was 3-5 years ago. For example, the exposure of European banks to Greece is much lower. The bulk of Greek debt is now publicly owned, including by institutions like the IMF, ECB and European Commission who are in a far stronger position to bear losses in the event of default.
- The economic consequences of a Greek default and possible exit from the eurozone should be very limited (though painful for the Greek population). Greece represents only 2% of euro area GDP and just 0.3% of world GDP.
- The ECB's aggressive Quantitative Easing (QE) program will help dilute the consequences for the eurozone should default occur. The ECB can be expected to expand the QE program as required to protect peripheral countries.
- In the event of a Greek exit, the consensus is that there will be limited fallout for the weaker eurozone nations. However we are aware that monetary unions fail when there is loss of confidence which triggers mass withdrawals from the banks. Depositors need to believe that their country will remain a euro member. A Greek exit would demonstrate that euro membership is not irreversible.
- Market volatility will likely persist while the situation remains unresolved. The potential for volatility is increased by lack of liquidity in some markets as investors stand on the sidelines.

What the Greece crisis means for MLC investors

From a portfolio perspective, MLC investors have a negligible direct exposure to Greek securities. Greek companies are absent from our global shares strategies, while Greek bonds amount to only $2.7 million or 0.009% of total portfolio bond investments.

MLC multi-asset diversified portfolios have generally been "defensively" positioned for an extended period of time. We have been cautious because the reward for risk is compressed and the global environment is very uncertain. As a result, our focus for some time has been on managing risk and searching for ways to insulate client portfolios from significant negative returns.

For our Horizon portfolios, a range of active and innovative strategies have been added to enhance diversification and better manage risk. For our Inflation Plus portfolios where we have more portfolio flexibility, a range of strategies are in place to limit their vulnerability to negative returns, including significant allocations to cash and short term debt.

In addition to the portfolio decisions we have taken to control risk, other parts of the NAB group are also focused on managing the uncertain situation unfolding in Europe. For example, the NAB Group has a Eurozone Oversight Working Group which meets on a regular basis to monitor activities in Europe, the situation in Greece and any contagion effects across the wider markets. NAB Asset Management has established a similar working group.

Important information

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