COMMENTARY

July 3, 2015

Dear clients and colleagues,

The Greek crisis escalated to a new dimension over the past weekend. Here is a summary of the current situation and our assessment of the risk of contagion for other European members.

Latest Developments:

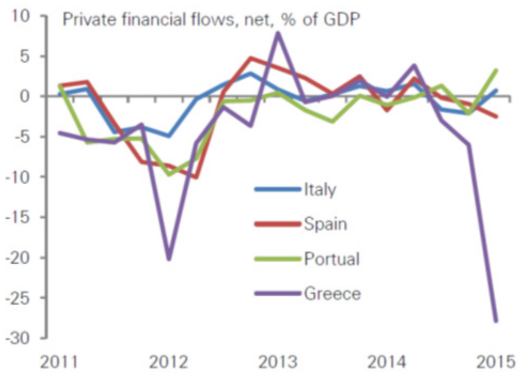
- The Greek Parliament has decided to hold a referendum on July 5th. The question of the referendum may be ambiguous given membership to the euro will most likely not be mentioned.
- The referendum concerns the creditors' proposal submitted on the 25th of June. This proposal was amended on Friday to include several concessions from the creditors. Examples of such concessions are tax reductions on basic foods and hotels.
- The President of the European Commission warned that neither this latest version of the document, nor an outline of a comprehensive deal could be formally finalised and presented to the Eurogroup. This is due to the unilateral decision by the Greek authorities to abandon the process.
- A "Yes" vote would mean an acceptance of the bailout terms and likely lead to a change of government.
- A "No" vote could lead to a "Grexit" if creditors are not prepared to give Greece any concessions.
- On June 30th, Greece defaulted on its €1.5B payment to the IMF and saw its aid program expire.
- On July 1st, Greek Prime Minister Alexis Tsipras sent a letter to the Eurogroup, agreeing to most of the demands made by Greece's creditors. So far, the reaction from the Eurogroup has been rather cold.

The Eurogroup could support Greece until July 20th, at which point Greece will have to repay €3.5B of bonds held by the ECB. A default would lead to the insolvency of the Greek banking system and likely to the introduction of a new currency.

Risk of Contagion:

Here are some reasons why we believe that the risk of contagion will be contained:

- Direct trade between euro-area countries and Greece is fairly limited. Exports to Greece represent less than 0.5% of euro-area countries' exports. Germany, Italy, and Spain each exports less than 0.2% of GDP to Greece.
- As opposed to 2012, there are no signs of other European countries suffering from capital flight at this time.



Source: Deutsche Bank

- Although the outcome of the referendum is uncertain, the latest opinion polls suggest that a majority of Greeks would like to remain in the Eurozone. Polls conducted between June 24th and 26th show that 68% of Greeks would like Greece to remain in the Eurozone and 57% would like the Government to reach an agreement with its creditors.
- The economic downturn of a "Grexit" could potentially deter European voters from supporting other populist parties. Euro-skeptic supporters in Spain (the Podemos party) account for only 20% of the total vote.
- Since 2008, the global banking system has considerably reduced its exposure to Greece from $300B to $54B last year.
- Unlike the events of the 2008 financial crisis, a Greek default has been widely expected.
- The private sector exposure to Greece is fairly limited. Public institutions own 80% of Greek debt, which should limit the risk of contagion.
- The ECB has the ability to accelerate its asset buying program if needed.

Have a great weekend.

The Global Alpha Team