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4

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Athens vote threatens bail-out deal

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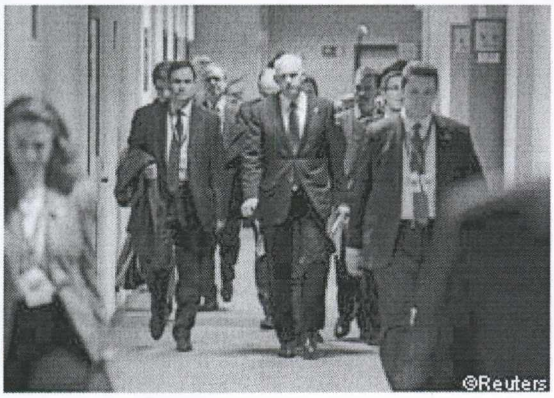

Out of step: Greek prime minister George Papandreou's actions have taken his fellow eurozone leaders by surprise

When European leaders emerged bleary-eyed from a closed-door meeting in Brussels in the wee hours last Thursday, it seemed they had at last turned the tide in a nearly two-year battle to contain a raging debt crisis.

But at a stroke, Monday evening's stunning announcement by George Papandreou, the Greek prime minister, that his nation would hold a referendum on the package has thrown the Eurozone back into turmoil.

"The surprise was total," Elena Salgado, Spanish finance minister, said of the referendum announcement. In a radio interview on Tuesday night, she described it as "a bad decision".

Bankers warned that Mr Papandreou's gambit had potentially unravelled one of the core elements of last week's agreement – a plan for holders of Greek bonds to voluntarily accept a 50 per cent loss on their paper in order to lighten the government's weighty debt load.

The parties had set a timetable to complete negotiations on the so-called "haircuts" before year end, with a bond exchange to take place in January.

"Important planning of details in the aftermath of the euro summit will now be delayed, and in the worst case put on ice," said Michael Kemmer, managing director of BdB, the German banking association.

The Institute of International Finance, which has represented the banks in those discussions, sounded more reassuring, pledging to work with Greek and Eurozone officials "to finalise and move toward implementation of the details".

The fate of the bank negotiations has the potential to unpick other elements of a three-pronged deal whose pieces are intimately entwined, according to analysts. Without knowing how much of a loss banks will take, for example, it is impossible to know what Greece's future borrowing needs will be.

"One of the biggest upsides from Thursday's deal was an explicit timetable on each pillar of the comprehensive strategy. Papandreou's decision to hold a referendum undoes much of that," said Mujtaba Rahman, an analyst at the Eurasia Group.

A person advising on the bond exchange put it more bluntly, saying: "We are all going to hell in a handcart."

Another unsavoury consequence of the referendum, according to analysts, is that it will make it even more challenging to persuade non-European members of the International Monetary Fund to contribute to a "special purpose investment vehicle" to shore up the continent's sovereign borrowers. China, in particular, has shown scant enthusiasm for Europe's sales pitch. It is likely to be even less enticed with the prospect of a Greek government collapse.

Adding to the uncertainty, officials in Berlin were speculating that the referendum could even hold up an €8bn loan payment from the "troika" of Greece lenders – the European Commission, the European Central Bank and the IMF – that Athens was relying on to pay its bills this month.

Under IMF rules, Greece's funding must be in place for the next 12 months before it can go ahead with the payment. That is no longer certain since Athens has not signed off on the new rescue package agreed last week.

All those factors conspired for a rough first day on the job for Mario Draghi, the new European Central Bank president, who will be pressured to buy bonds to offset the higher yields facing Eurozone governments, particularly his native Italy, which is now the front line in the crisis. They will also cast a cloud over Thursday's G20 meeting in Cannes, which European leaders had hoped would be an occasion to build on the success of last week's agreement.

In a joint communiqué on Tuesday, Angela Merkel, the German chancellor, and Nicolas Sarkozy, the French president, said that they were "determined with their European partners to ensure the implementation without delay of the decisions adopted at the eurozone summit of October 27, which are today more necessary than ever".

Officials in Berlin made clear that the offer on the table for Greece was "the best offer we can make them". "We think, as do the French, that it is more important than ever to swiftly implement the decisions of the summit," a senior official said.

Although there is some sympathy in Berlin for the political dilemma facing Mr Papandreou, Ms Merkel is understood to be dismayed at not having received any advance warning of the Greek prime minister's decision.

The worry in Germany is that the uncertainty created will upset the whole timetable of the rescue plans, even if it does not block it for technical or legal reasons. It is seen as "psychologically disruptive" – not least for banks being asked to take a 50 per cent haircut on their Greek bond holdings.

"Will they say 'Yes' if they don't know whether Greece will stand by its obligations?" the official said.

BAIL-OUTS AND HAIRCUTS

November 3-4 G20 summit in Cannes

November 4 Greek vote of confidence

Early November Sixth €8bn Greek bail-out tranche due

Mid-November Greece starts to run out of money to pay pensions and salaries. Sixth €8bn bail-out tranche needed beforehand

Before end of November Eurozone finance ministers to agree on models to leverage the eurozone rescue fund – the European financial stability facility – from €440bn ($600bn) to more than €1,000bn

November 28 US-EU summit in Washington

December Seventh €5bn bail-out tranche for Greece due

December International Monetary Fund, European Commission and European Central Bank to finalise details of €130bn second Greek rescue package

December 9 Summit of EU leaders in Brussels

January Private creditors to finalise agreement on Greek debt to achieve a 50 per cent haircut, leading to maximum debt level of 120 per cent of gross domestic product by 2020, with a €30bn “sweetener” from the EFSF

January Possible date for Greek referendum

June 30 Deadline for European banks to raise more capital on the markets or seek state help