

## ► Greek drama is deteriorating

Time for manoeuvring fast running out

By Marcello Minenna and Edoardo Reviglio

The tussle between Greek Prime Minister Alexis Tsipras and the Eurogroup of finance ministers is moving to a crucial and worrisome stage. The lenders expect Athens' complete surrender to their requests for reforms, but this would imply a radical change of Tsipras' electoral platform – a great political risk. The alternative seems to be escalation of financial turmoil all the way to the collapse of the banking system, including a serious risk of a Greek euro exit, which some market participants put as high as 50%.

In the last two months Greek banks' deposits have crashed to new lows with capital flight of €40bn. Greek savers are trying to hoard liquidity, preparing themselves for an imminent block on deposits. Memories of the Cyprus episode two years ago are still fresh. The European Central Bank is fuelling the fire by blocking Hellenic banks' access to standard refinancing operations. Since 12 February Greek government bonds can no longer be used as collateral for Greek banks' ECB liquidity operations.

The last line of support is the ECB's emergency liquidity assistance, over which the government has to bargain weekly with the ECB. The credit line has reached over €75bn, with a further increase of €1.5bn agreed only a few days ago. Tsipras' formal request was for an increase of €2bn. So the ECB move was a signal of progressive tightening.

An ECB refusal to increase the ELA would bring a block on deposits, a shutdown of ATMs and imposition of capital controls. An alternative might be unilateral intervention by the Bank of Greece, which could issue new IOUs to guarantee deposits. These would soon be assimilated into 'new drachma' and would formalise Greece's euro exit.

The fundamental requirement for ELA availability is the solvency of the Greek banking system. After passing the European Banking Authority stress tests in November 2014, Greek banks meet the formal requirements of solvency. Yet 'formal' has a clear (and limited) meaning. The banks' balance sheets include €15bn of fiscal credits ranking as capital. An ad hoc law in September 2014 transformed these credits from conditional to certain, fulfilling the Basel III condition for fiscal

credits to count as capital. These credits account for 50% of banks' capital. The four major Greek banks are already owned by the government. So Athens has clearly constructed a dubious house of cards to make banks appear formally solvent.

A letter from Tsipras to German Chancellor Angela Merkel on 15 March, since leaked to the press, contains worrying details as well as bombastic references to a 'humanitarian crisis'. The Greek government is cornered. Many people are speaking of a €3bn liquidity reserve. At the same time the Greek debt agency is frantically trying to sign up repo transactions with public utilities companies and pensions funds and rake in cash.

A week ago the president of the Hellenic Financial Stability Fund, the public agency created to recapitalise Greek banks, resigned after rejection of a controversial request for €1.2bn from the European Financial Stability Facility. The Greek government is demanding the release of €1.9bn in ECB proceeds from Greek bonds held under its securities markets programme. The ECB has said No – yet another sign that the Greek drama is deteriorating towards an unpleasant denouement.

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