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TD Economics

Data Release: Tentative Greece agreement dowses exit fears

- At the end of a round of drawn-out weekend negotiations, a tentative agreement on a new bailout deal of €82-86bn for Greece was reached with euro area partners. Bridge financing is expected to be provided to cover Greece's near-term debt funding needs, with additional funds set aside for bank recapitalization. Discussions on extending the maturities of Greece's debt or providing longer grace periods on payments would begin once a first review of the programme has been approved, likely to be later this year. However, all indication from the Euro Summit is that debt-forgiveness will not be part of these discussions.

- With the framework hammered out, the near-term risks now lie in implementation. For the new bailout deal to move forward, the Greek parliament must first ratify a number of measures, including VAT and pension reforms, by this Wednesday. The deal must also be approved by euro area national parliaments, which is likely to happen towards the end of this week. Chancellor Merkel's endorsement should see it passed in the Bundestag. While there will almost assuredly be dissent within Syriza's ranks, the agreement should also pass Greece's parliament with the help of the mainstream opposition parties.

- Many details remain relatively obscure. It appears that some funds (up to EUR 35 bn) will be earmarked towards raising investment in Greece to help the ailing economy. Nonetheless, the deal is largely seen as Greece giving in to creditor's demands. The current deal also appears to have more stringent oversight than that struck before the referendum. Moreover, IMF involvement is also slated to continue for at least the duration of the program.

Key Implications

- The deal is positive for market sentiment, but several hurdles yet remain. Overall, there has been relatively little movement in the euro crosses. Equity markets have risen, while German-periphery sovereign bond spreads are largely unchanged.

- With financial risks in China and Greece subsiding (at least for the time being), we now expect the theme of central bank divergence to reassert themselves. In the case of the U.S., this removes some global risks and paves the way for Fed hikes later this year. For the euro area economy, our base-case of further economic improvement remains unchanged, with real GDP growth of 1.6% in 2015 and 1.9% in 2016.

- Compared to where Greece was last year before market turbulence was kicked-up on debt negotiations, the country's economy went from one that was improving to one that is now stuck in reverse. The recent debt negotiation outcome sends a signal to other anti-austerity parties in peripheral countries that European creditors will take a hardline, particularly when it comes to debt forgiveness. In this context, the Greece experience may reduce some of the political risks around anti-austerity parties in the Spanish elections later this year, but time will be the test.

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