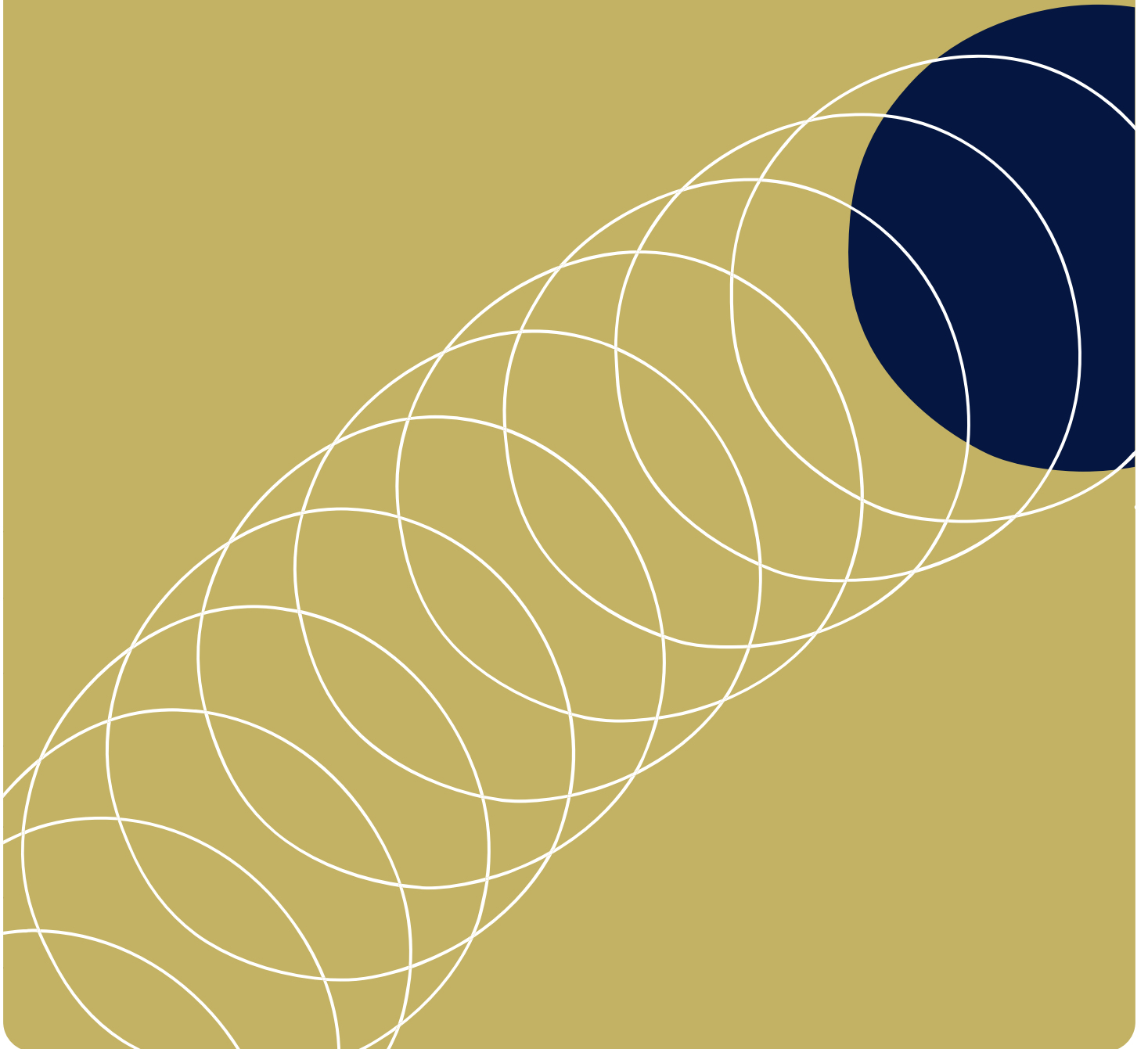


Greece on the path to insolvency

News from the financial markets | 2 November 2011



Greece on the path to insolvency

Dr. Jörg Zeuner, Chief Economist

We expect to see further losses on Greek shares and bonds; any remaining positions should be sold if possible. The proposed referendum represents an incalculable risk for investors. A "Yes" to the Greek government's austerity plan is improbable. With a "No", we reckon that major portions of the Greek economy will become insolvent.

We are reducing our equity market opinion to "Neutral". In Portfolio Management, we are selling European stocks. In the recently agreed euro zone package of measures, there is a lack of viable mechanisms to prevent a further destabilisation of the Italian and Spanish financial markets and economies. The EFSF is too small; any foreign participation in the planned leveraging of the rescue umbrella is indeed illusory at present.

The euro zone's efforts should now centre on Italy and Spain; the European Central Bank (ECB) must at least continue its bond purchases. We still consider a complete collapse of the euro zone to be very unlikely.

Referendum shocks the markets



Source: VP Bank, Bloomberg

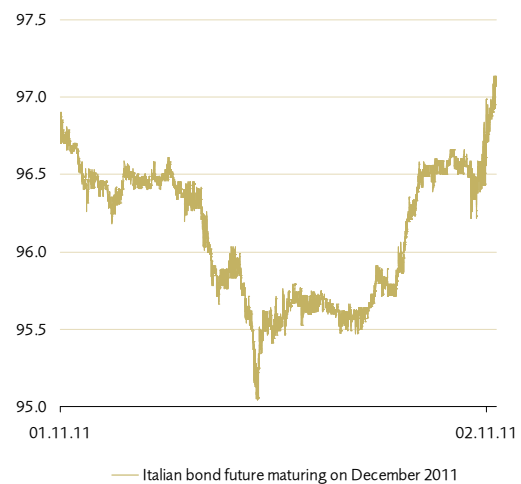
On the path to insolvency

An uncontrolled bankruptcy of the Greek state outside the envisaged procedure is entirely possible in the coming weeks. The announced plan for a Greek referendum at such a late stage in the rescue efforts is just as alienating as it is dumbfounding. It is possible that, especially within the Greek government, there is no longer any support for the path being taken.

Whatever the case, the timetable for the European rescue operation can hardly be met. A swap of Greek bonds combined with a simultaneous 50% haircut for private sector investors *prior* to any referendum strikes us as being impossible, as is in all likelihood the adoption of a second EU/IMF programme. Payment of the next tranche of the existing EU/IMF programme also appears highly questionable under these circumstances. Greece could therefore become insolvent in short order.

With that, the positive effects of the latest Euro summit have dissipated, even though the question to the Greek populace has been "cleverly" formulated (ultimately it is one of "Should Greece remain in the euro zone?") and there remains a miniscule possibility that the referendum is called off entirely. We currently rule out any foreign participation in the leveraging of the EFSF.

Will the ECB take action?



Source: VP Bank, Bloomberg

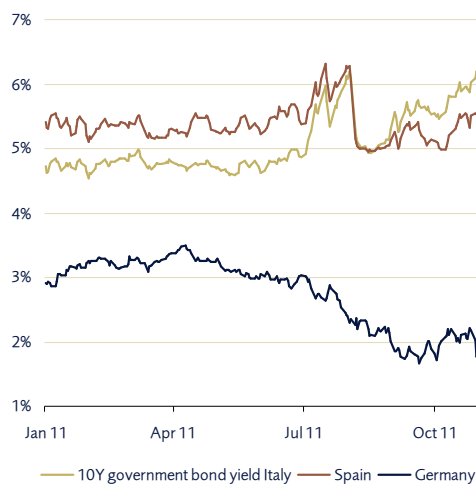
Economically unreasonable

Economic reason argues for a continuation of Greece's austerity efforts. The deficits in the state budget and current account, each in the amount of about 10% of gross domestic product (GDP) can only be financed from abroad. If those capital flows cease, the resulting recession will be harsher by far than presently assumed. In such an instance, we reckon with a GDP decline of at least an additional 10%.

A "Yes" to the austerity measures, however, is improbable right now. We therefore expect that the

Greek banking system will face liquidity problems in the next several weeks and that insolvencies in large portions of the Greek economy are bound to follow.

Continuing contagion

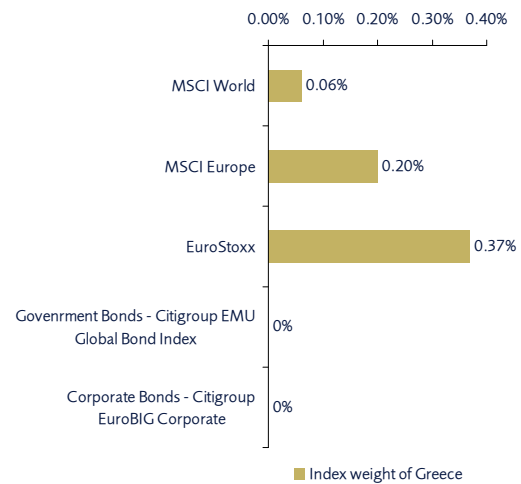


Source: VP Bank, Bloomberg

How will Europe respond?

Potentially, the euro zone will soon have to fundamentally rethink its strategy for rescuing the euro. Under circumstances, it might even only be the ECB that can prevent a complete spreading of the financial epidemic to Italy and Spain. To that purpose, the central bank must significantly broaden its bond buyback programme, ideally without any limits whatsoever. We anticipate the first statements in this regard to come at earliest following the next ECB Council meeting on Thursday. The EFSF stands ready to support European banks if Greece were to become insolvent.

Greece's representation in the key indices



Source: VP Bank, Bloomberg

The bottom line:

Across the board, we advise against any financial exposure to Greek securities at present. Greece's weighting in index-based equity products varies, but in the most important instruments it probably lies considerably below the 1% mark. Given that negligible influence, a sale of those products is perhaps not worthwhile. Greece has already been eliminated from the key bond indices. You should ask your financial advisors for precise information on the products you hold.

We have reduced our equity market opinion to "Neutral" and increased the cash and cash equivalents quota in our mandates.

We are waiting to see the initial reactions to the new point of departure from today's EU crisis summit, the ECB Council meeting on Thursday, and Friday's G20 summit in Cannes. The possibility still exists that the euro states and ECB will soon respond decisively in effort to avert a system-wide crisis once and for all.



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