Article: Increased uncertainty over the situation in Greece

The uncertainty over developments in Greece has in recent days increased substantially. The negotiations between Greece and its international lenders (the EC/ECB/IMF) have broken down and a referendum has been announced, whereby Greeks will decide whether to accept the bid made by the creditor institutions on 25 June. Capital controls have been imposed and Greek banks are staying closed at least until the referendum has been held. It is difficult to judge now what the consequences of a Greek failure to fullfill its commitments to its creditors will be for the euro area as a whole and for Sweden.

The negotiations between Greece and its lenders broke down after the Greek government announced a referendum on 5 July on whether to accept the creditors´ bid. Greece's request for a temporary extension of the loan agreements until the referendum has been held was not granted, whereby the loan programme expired on 30 June. The June repayments to the IMF have not been made. *The forecasts presented in this report are based on the course of events in Greece not preventing the recovery in the euro area, but the developments of recent days have increased the uncertainty in the forecasts.*

ECB support an important factor for future developments

In February this year, the ECB ceased accepting Greek government bonds as collateral for ordinary ECB loans. Since then, the Greek banks have been dependent on emergency liquidity assistance (ELA). There are lower quality requirements for collateral when granting ELA. As bank withdrawals have gradually increased, the level of liquidity support has been gradually raised. When it became clear that the negotiations had broken down and that the loan programme would expire, the ECB decided to freeze the level of ELA. The ECB will thereby not cover for outflows taking place after 26 June. To prevent a total collapse of the Greek banking system, the Greek government decided to hold the country's banks closed until the referendum has been held, and to impose capital controls in the form of limitations on withdrawals and foreign transfers. The Greek banks are still dependent on liquidity assistance to be able to meet continued withdrawals.

There are many question marks regarding the referendum. Regardless of the outcome, there is a risk of major political turbulence and a Greek exit from the monetary union cannot be ruled out. However, the legal situation here is unclear, as membership of the monetary union is irrevocable according to the EU treaty.

The consequences of a Greek bankruptcy are negative, even if the euro area is now better equipped

The aborted negotiations between Greece and its creditors have led to increased uncertainty on the financial markets. The interest rate differential between the peripheral euro area countries and the core countries has increased. The euro has weakened somewhat against other major currencies and stock markets around the world have fallen. However, the market movements have so far been relatively muted, given the critical situation for Greece. It is difficult to assess the longer-run developments. The recovery in the euro area has increasingly gained firmer ground and is broadening. But if the Greek government defaults on its debt and Greece leaves the monetary union, it is likely that confidence in economic developments would worsen and that the effects would be more serious. At the same time, economic-policy measures have meant that the euro area is now better equipped to mitigate contagion effects from a Greek default, than it was a few years ago.

Potential impact on Sweden

The direct effects of a Greek default and its possible consequences, including exit from the monetary union, would probably be minor. Trade with Greece is limited, and Swedish banks' exposures to Greek households and companies are small. Nor has the Swedish government taken part in the loan programmes to Greece, other than through our share in the IMF. However, the indirect effects of a poorer development in the euro area are all the more serious. Poorer economic developments in the euro area would have a negative impact on the Swedish economy through lower demand for exports. In this type of situation there is a risk that confidence in the Swedish household and corporate sectors would fall, which would in turn lead to lower resource utilisation and lower inflationary pressures.

In addition, the krona exchange rate is very uncertain. During earlier major crises the krona has tended to weaken as a result of being connected with greater uncertainty and risk in its capacity as a small currency. If this happens, the negative effects on exports and inflation are lowered. But it is also conceivable that Sweden and the Swedish krona are considered a safe haven in the event of a severe depreciation of the euro. This would lead to the opposite effect, where more expensive export goods and cheaper import goods further burden Swedish growth and inflation.[16]

[16] For a more detailed discussion of the significance of the exchange rate, see for instance Chapter 2, *Monetary Policy Report July 2013*, Sveriges Riksbank.