Social Europe

New Countdown For Greece: A Bank Bail-in Is Looming

by Marcello Minenna on 4 November 2015

The debt crisis may no longer be in the spotlight but the financial situation in Greece remains complex. Greek banks continue to survive at the edge of bankruptcy, kept afloat only by Emergency Liquidity Assistance (ELA) from the ECB and by still-enforced capital controls.

After the August “agreement”, the Troika has promised the Greek government €25 billion for bank recapitalization, of which €10bn is in a Luxembourg account ready to be wired. The funds will be disbursed only if the government manages, before the 15th of November, to approve a long list of urgent reforms: the infamous list of the “48 points” that embraces tax increases, public spending cuts and the highly controversial pensions reform.

It is obviously a tough task for the Tsipras government, even if September’s election victory gave him a solid mandate. After a parliamentary marathon, it seems that the government has successfully passed some unpopular measures: the increase from 26% to 29% in income tax, the rise from 5% to 13% in the tax on luxury goods and the restoring of the tax on television advertisements.

The process was not so smooth with the first steps in reforming pensions and slowdowns are on the horizon. Tsipras is also trying to gain time against the pressure of Brussels to modify the laws that still protect primary homeowners from foreclosure. According to some estimates, there are around 320,000 families in Greece that are not paying down their mortgages and obviously these bad loans are dead weights for the banking system. In the questionable strategy of EU bureaucrats, an increase in foreclosures should boost the banks’ assets and in this way should help to reduce the financial demands on the ESM bailout fund.

Anyway, the Greek government is still living for the day, and the Troika has noticed that only 19 of the mandatory 48 reforms have been approved so far. Brussels is unhappy with this situation and has sent a strong “signal” to the Tsipras government by delaying the last €2 billion tranche of loans. At end-October 2015, €13 billion has already been transferred to Greece; these cash inflows alone have allowed the government to guarantee payments of salaries and pensions and reduced the dangerous social tensions experienced in July. Moreover, part of these funds has been diverted to pay down the

ECB and this could allow the Quantitative Easing (QE) programme to be extended to Greece as early as November. This would be an unexpected image success for Mr. Tsipras and would give breathing space to the banking system, where up to €15 billion of government bonds eligible for purchase by the ECB are still languishing.

However, deadlines are looming and the respite could be very short: in the next few days the ECB will release official estimates about the capital requirements needed to rescue the Greek banking system (again). Rumours from the financial industry are forecasting low figures, well below the €20 billion threshold. In this way, the ESM would lend "only" €15 billion to the Greek bailout fund HFSF, while the remaining requirement would be met (in theory) by private investors.

The EU authorities do not seem alarmed by the €12.7 billion of deferred tax credits (DTC) towards the Greek government that are the bulk (over 50%) of the Tier 1 capital of Hellenic banks. This sounds strange, since at the beginning of the year the EU Commission investigated the governments of Greece, Italy, Spain and Portugal for unfair state aid to their own banking systems.

The target of that investigation was precisely the deferred tax credits towards the government that, after some legal changes, had been counted towards the Tier 1 capital of the banks, thus realizing de facto an artificial recapitalization. Moreover, the major Greek banks are controlled by the HFSF fund; this "coincidence" implies a dubious circular scheme between government and banks that inflates the scale of equity capital artificially.

It seems plausible that the European authorities would not proceed in this direction, since a reassessment of the DTC in Greek bank balance sheets would necessarily imply a major involvement of the ESM in the recapitalization process.

In any case, it's in the interest of Tsipras to close off this recapitalization as soon as possible: the 1st of January 2016 will see the new regulation foreseeing a bail-in for the resolution of banking crises come into force. According to the new regulatory framework, private bondholders and depositors should share recapitalization costs together with shareholders. Despite this real threat, depositors cannot simply react defensively by withdrawing their savings owing to the capital controls. Therefore, it's highly probable that yet another compromise between Greece and the EU is on cue.

But a second, more bleak scenario cannot be dismissed out of hand: in any renewed clash between the Eurogroup and the Greek government over the course of the reforms, Greek savers could face being penalized again if only to demonstrate that Brussels is perfectly capable of enforcing its rules over "undisciplined countries". At present, many analysts in southern European countries are sceptical about the real enforceability of the "bail-in" clause, especially when a common EU deposit insurance scheme remains on the drawing board. In this perspective, Greece can once again be the "canary in the mine" – useful to show to other Mediterranean countries that the bail-in rule *can* be and *will* be applied. Whatever happens, the sacrifices for the Greek people have just begun – again.