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Greece: Referendum called, default risks intensifies.

Holes in summit measures appear

Greek PM Papandreou announced a public referendum to approve a second EU bail-out agreement, less than a week after the latter was agreed at an EU summit. No formal date has been set, but a timetable of mid-January looks likely, with details of what exactly will be the question also unclear. The decision was very much unexpected, not least to other political leaders around the Eurozone, who seemingly had been reassured at the summits last week that Greece was determined to implement the austerity measures being foisted on it.

Domestic politics undermining Greece

Clearly, PM Papandreou is addressing the very adverse politics he faces domestically, including increasingly vocal calls for a general election, pressures that have resulted in the PM being forced to call for a parliamentary vote of confidence sometime in the coming week. All of which are a further reflection of the clear political divides evident in Greece, splits that have been very much evident in the narrow parliamentary majorities in which recent austerity measures have been passed. Seemingly, the PM is trying to build support by by-passing the opposition he is facing in the divided parliament. However, the risks are very high given the fact that opinion polls underscore that the electorate at large are very much opposed to austerity.

The (stock and FX) market reaction has been understandably very negative, as the prospect of a referendum that may be over two months away will merely accentuate uncertainty. But the referendum prospect serves to highlight the more fundamental problems that the summit last week failed to address.

Ability vs willingness to change

Indeed, in regard to Greece, the summit tried to address the ability of the country to service its debt. However, the summit ignored the fact that the key issue is the willingness of Greece to service its debt, a doubt that has become all the clearer in the last few months as protests have intensified in regard to the cuts and reform measures not just from the likes of trade unions, but the actual civil servants who are supposed to implement them. Indeed, aware of this aversion to change, the IMF has been openly reluctant to provide further cash to Greece, with it now likely that Greece may find it difficult obtaining any funds from its existing bail-out it is likely to need in the next month or two.

Contagion risks

All of which raises the question whether Greece can avoid a full-scale default rather than the controlled haircut that was part and parcel of the summit decisions last week. In turn, now very much aware of the importance of the issue of a willingness to reform and stomach austerity, markets are understandably focusing on Italy where its rudderless government and powerful unions are very much obstacles to reforms. In addition, the Italian bond market is suffering from the added problem that there may be a virtual buyer-strike until the insurance aspect of the EFSF is detailed and implemented. Indeed, the latter is symptomatic of the lack of detail in the summit measures. This lack of detail was something that markets were aware of almost immediately but about which were prepared to show some patience. The Greek situation, however, shows that the summit not only lacked details but was also full of holes.