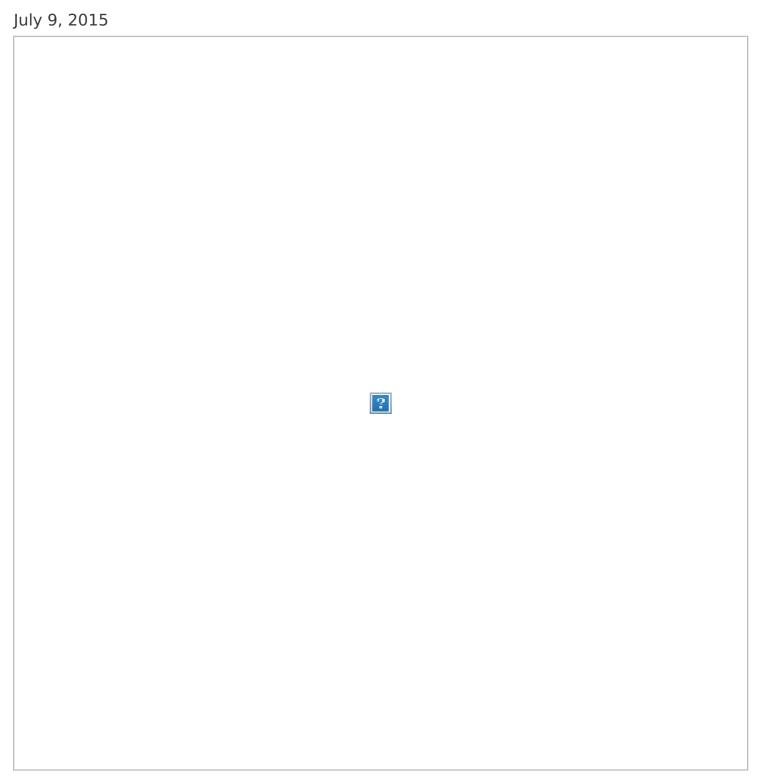
## **Greece's Precarious Position**



Three professionals from Templeton Global Equity Group<sup>™</sup>, Norm Boersma, Cindy Sweeting and Heather Arnold, offer their perspective on the latest developments in Greece.

The strong vote the weekend of July 4<sup>th</sup> against austerity in Greece increases the odds of a "Grexit" or Greek exit from the eurozone, in our view. Greek Prime Minister Alexis Tsipras has interpreted the results as strengthening his position versus creditors in negotiations, but it is possible that Tsipras may be more conciliatory on the margin given the dire circumstances facing Greece and its banking system, and the desire of the majority of Greek voters to stay in the eurozone. Eurozone policymakers, however, will likely hold firm and not make many concessions to Greece. We think they will need to avoid enabling populist movements elsewhere in Europe and are under mounting pressure from their own constituencies who are becoming increasingly unwilling to allow for flexibility in negotiations. The news of Greek finance minister Varoufakis' resignation is being perceived as an incremental positive for negotiations, but we think the "No" vote in Greece over the first weekend in July, the precarious position of the Greek banking system, and eurozone policymaker distrust of the current Greek government have clearly raised the chances of a Greek eurozone exit.

Given how fluid this situation is currently, attempting to assign probabilities to a Greek exit scenario remains a moving target on a daily basis. Our approach is to monitor the situation and evaluate the resilience of holdings should an exit occur. While investors with sizable holdings in the eurozone could potentially suffer at least some short-term volatility should Greek instability inflict contagion on other regional economies and markets, we believe the bloc's strengthened firewalls make this outcome less likely. The formation of the European Stability Mechanism¹ and regional banking union, coupled with the introduction of policy tools like Outright Monetary Transactions² and sovereign bond purchases through quantitative easing, should make Europe far more resistant to contagion than it was during the initial phases of the regional sovereign debt crisis, in our view. Greece represents less than 2% of eurozone gross domestic product,³ and Greek assets have largely been divested from eurozone bank balance sheets, further suggesting that any potential impairment to the wider region could remain limited.

The potential for a Greek exit also raises a broader question regarding the perceived irreversibility of the monetary union undertaken by the other 18 members of the eurozone. As discussed above, the eurozone has more ammunition today to respond to potential contagion but a favorable view of European equities is also supported by the

gradual escalation of institutional integration that is ongoing in Europe. The latest step in this process was the recent European Commission's June 22 announcement of a road map for deepening institutional integration. This plan, known as the "Five Presidents' Report," details a 10-year plan of measures to facilitate a stronger financial and fiscal union.

If Greece slides towards exit, even if the impact is adequately contained by the European Central Bank's (ECB's) monetary and liquidity tools, we could see the scope and pace of the drive for deeper integration accelerate. Such acceleration would likely have a positive impact on investor perceptions of the structural integrity of the eurozone. However, we also remain vigilant in monitoring the potential for European voters to gravitate toward nationalism rather than further integration. Specifically, we will continue to watch closely for current developments potentially emboldening both voters in Germany who are tired of bailing out the weaker players in the eurozone and voters in the periphery experiencing austerity fatigue.

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1. Established in February 2012, the ESM is the permanent crisis resolution mechanism for the countries of the euro area. The ESM issues debt instruments in order to finance loans and other forms of financial assistance to euro area member states.

- 2. Outright Monetary Transactions are a bond-buying program announced in September 2012 in which the European Central Bank would offer to purchase eurozone countries' short-term bonds in the secondary market to bring down the market interest rates faced by countries subject to speculation that they might leave the euro.
- 3. Source: Eurostat. Based on estimated Q3 2014 gross domestic product data in current prices. Data as of January 22, 2015.

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