Greece's Herculean Challenge

PERSPECTIVES

Time is running out fast for Greece to conclude a debt deal that will help it avoid default and a potential exit from the eurozone.

Short-term timeline:

Today onwards
As talks draw on bank withdrawals are accelerating

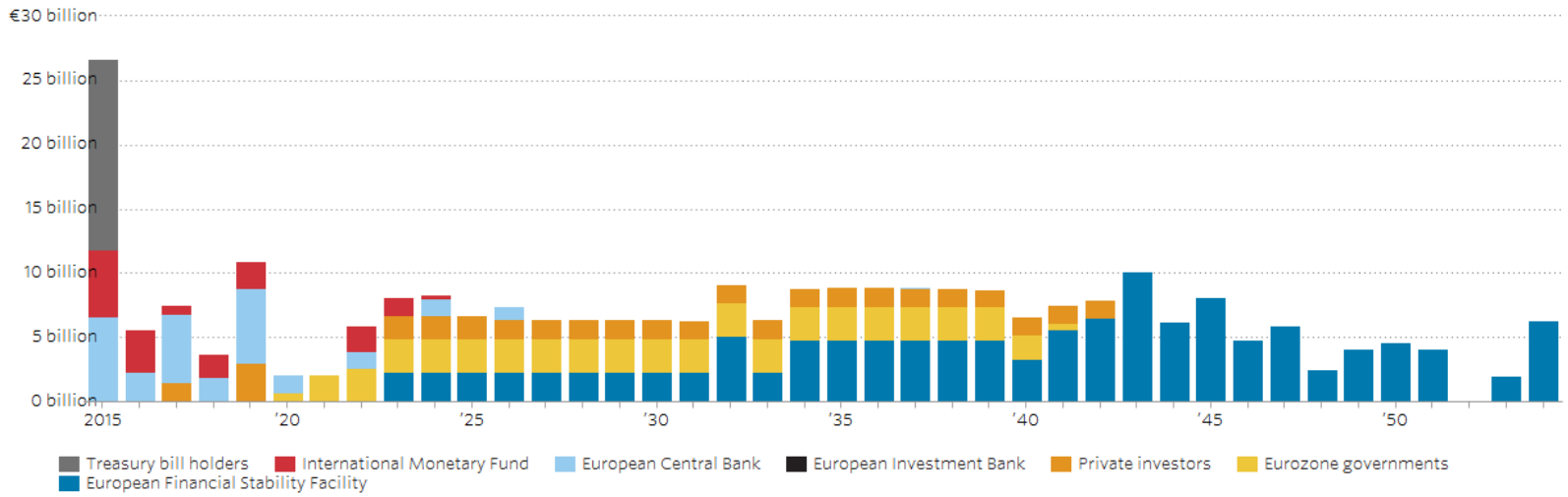
25 June
EU summit. A last chance to hammer out a deal?

30 June
Greece's bail out expires
Greece owes the IMF €1.5bn

1 July
Unclear how long the ECB can maintain support for Greek banks

20 July
ECB owed €3.5bn
GREXIT almost certain if not paid

Long-term: Greece has significant debt repayments well into the future



Source: Wall Street Journal 'Greece's Debt Due: What Greece owes when' Data from Greece's Public Debt Management Agency; International Monetary Fund; the Irish Statute Book; European Commission 21/06/2015

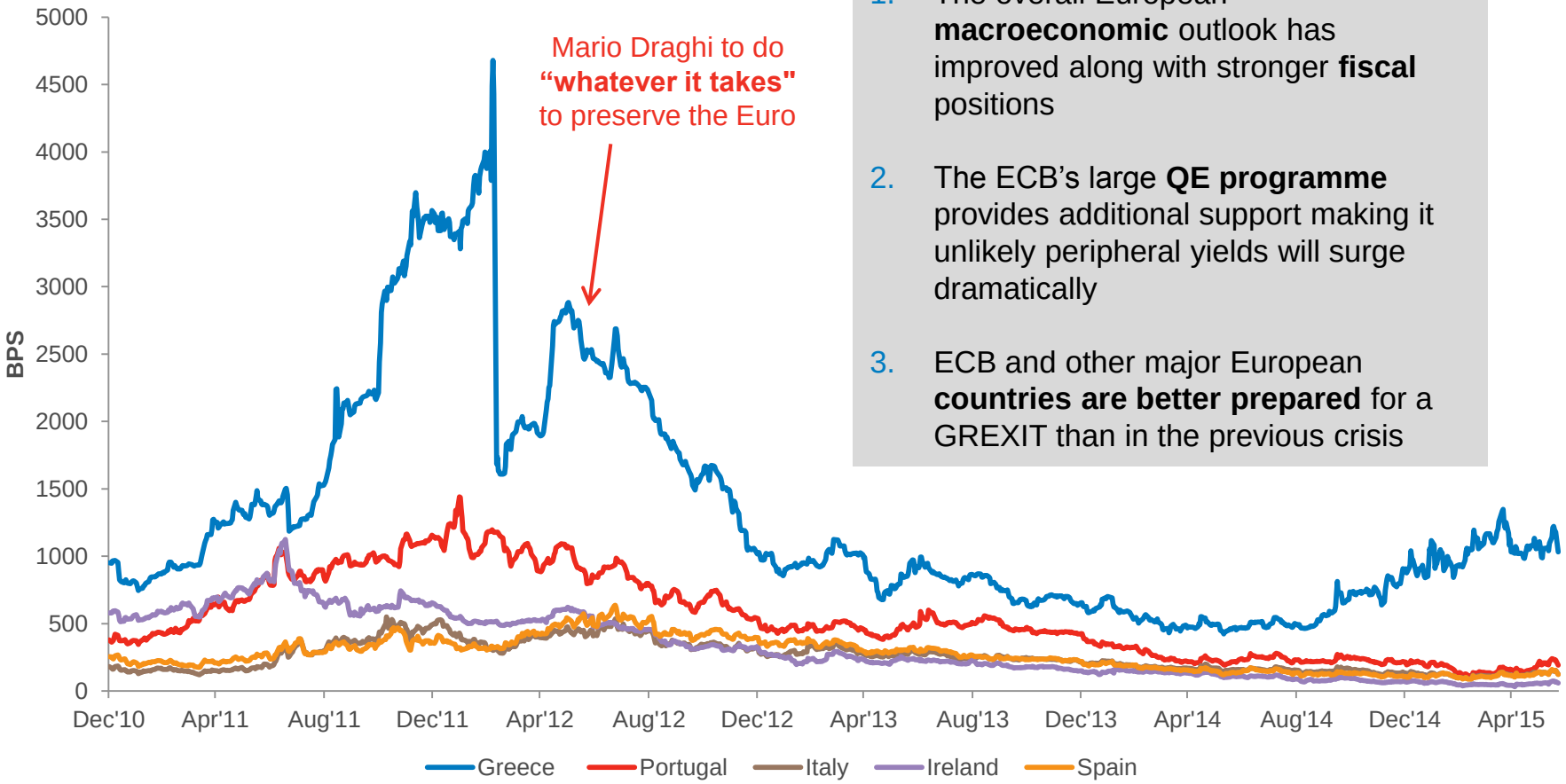
Fidelity WORLDWIDE INVESTMENT

Limited contagion risk

PERSPECTIVES

Compared to the Greek crisis of 2011 bond markets are **relatively calm** with only **a relatively modest pick up** in peripheral yields. **Why is this?** in short, it is less likely that the Greek crisis will spread to other countries because:

Peripheral spreads vs. 10 year bund



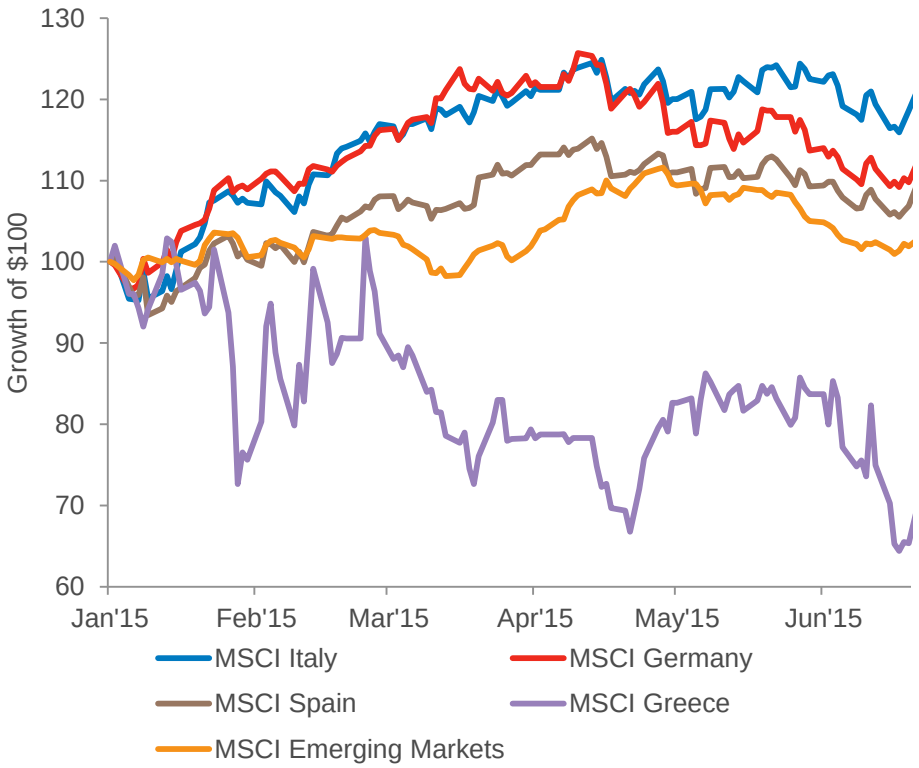
1. The overall European **macroeconomic** outlook has improved along with stronger **fiscal** positions
2. The ECB's large **QE programme** provides additional support making it unlikely peripheral yields will surge dramatically
3. ECB and other major European **countries are better prepared** for a GREXIT than in the previous crisis

Source: Datastream 23/06/15

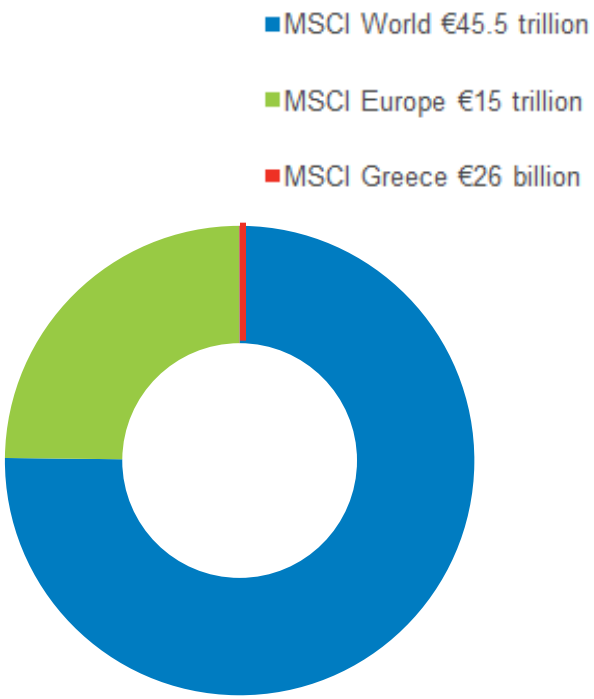
Equity markets largely unaffected

PERSPECTIVES

Globally equity markets are **unlikely to be fundamentally affected** by Greek performance but in the very short-term we could see sentiment based volatility



Greece accounts **for less than 1.5% of EU GDP**. The equity market is even smaller in comparison to European and global indices:



Despite the political significance a GREXIT is unlikely to have a large economic impact globally

Source: Datastream 23/06/15

Views from our investment teams

PERSPECTIVES

Dominic Rossi, Global Chief Investment Officer, Equities

The objective will be to keep Greece in the eurozone if it defaults. Unlike Cyprus, this may not work. Greece is a much larger economic entity with land borders and a much more porous financial system. Thus a debt crisis is likely to turn into a foreign exchange crisis which could have been avoided. However, I think it will be contained. The Greek economy is small, its trade with other countries minimal. Its financial markets are equally small, with its sovereign debt held by public institutions rather than private. Therefore, the scope for financial markets contagion is low.

Dierk Brandenburg, Sovereign Analyst

Risking a Grexit is in nobody's interest as it would result in further loss of output in Greece, which in turn requires more financial aid and debt write-downs from the EU going forward. However, a deal would have to be found fast as the end of the existing program approaches and there is a risk that Greek banks may lose access to ECB funding.

We regard the position of the government bonds as safe because they play only a small part in the Greek capital structure. Unlike the large official sector debt, which has already been restructured. Post exchange in 2012, the government bonds have strong indentures under international law with collective action clauses that prevent acceleration or redenomination unless it is in the interest of bond holders. Apart from a small payment in July, the next coupon payments are due only in 2016. Especially after an exit from the eurozone, the Greek government would have every incentive to service these bonds to ensure access to external financing.

Should the negotiations fail, we believe that, unlike in 2012, the eurozone will be in a position to mitigate the contagion on wider financial markets through its support mechanisms and the quantitative easing policy of the ECB. However, it will not be possible to shake off the precedent set by a Grexit for other eurozone members should their respective economies suffer another severe recession. Thus, additional political steps would be required towards closer fiscal and economic policy coordination in the eurozone.

Views from our investment teams continued

PERSPECTIVES

Paras Anand, Head of European Equities

Whilst there is no certainty of how the current situation will play out, the risk of economic contagion across the eurozone may be mitigated not only by the low ownership of Greek government bonds outside the institutions but also by the capital rebuild of the financial sector across the region.

If anything, the near term cost to Greece of trying to hold its ground in a political context - bank deposit withdrawal, falling tax receipts and reliance on external funding rising – may act to reinforce the economic benefit of protecting the status quo. I think it is also worth considering the likely longevity of the Syriza party even if 'acceptable' compromise (or more likely a deferral) is reached; splits within the party are bound to grow and voters will learn that there are no economic quick fixes.

Eugene Philalithis, Portfolio Manager, Multi-Asset

Above all, markets hate uncertainty, and I'd expect a period of increased volatility to follow Thursday's meeting if there is no clear resolution to the crisis. As with any unfolding political situation, it's important to consider the implications of a Greek default and possible 'Grexit' on the wider geographical region. I think the EU is generally in better shape than it was a number of years ago, and so other European countries should be relatively well placed to cope with such an outcome.

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