On the brink of default and ejection from the Eurozone - can Greece be saved? Does Greece want to be saved? Should Greece be saved? This month we consider the options available and the possible impacts of the current Eurozone crisis.

What a difference a couple of weeks make. It was only two Thursdays ago, with a default deadline looming, that the world was hopeful that a handshake, a smile and lengthy diplomacy would seal a deal between Greece and its creditors to keep Greece's European hopes alive ….and then it suddenly all went so wrong. By the Saturday morning Greece's PM, Alexis Tsipras, had let loose with both barrels, criticising policy makers in Europe and blaming Germany and the rest of the Eurozone (again) for forcing Greece into its current position.

This culminated in a calculated but deeply frustrating move – the calling of a referendum to determine whether or not the Greek people would vote "yes" or "no", ostensibly to more austerity. Calculated, because it forced the Greek people to answer the question instead of the government (and the government probably expected that the answer would be "no" – validating their stance from outset). Deeply frustrating, because the rest of the Eurozone knew that it would lead to major delays and because they suspected and feared that the answer would be "no"! However, the question posed was framed very differently by both sides, muddying the waters as to what the Greek people were actually voting for. Eurozone leaders were pushing Greeks to consider that the vote was over whether Greece would stay in the Euro or not, whereas Tsipras suggested that the question was whether or not Greeks should accept more austerity and cuts in pensions. No wonder this vote was so divisive! German Chancellor Angela Merkel expressed particular frustration because asking any nation to vote on whether or not they effectively want to pay more tax and spend less is tantamount to asking turkeys to vote for Christmas. The result was inevitable, not helped by Tsipras indicating that he would resign if the people voted "yes".

So what next, is Greece really that important to the Eurozone and what does is mean for Greece itself?

What next?

Greece needs a massive default to "balance the books", with the write-down estimated initially to be as much as 50% of its overall debt burden. Whilst some of this has already been restructured and transferred to the IMF and the EFSF (European Financial Stability Fund) along with some being absorbed by the ECB's massive bond buying programme, an enormous write-down is still required.

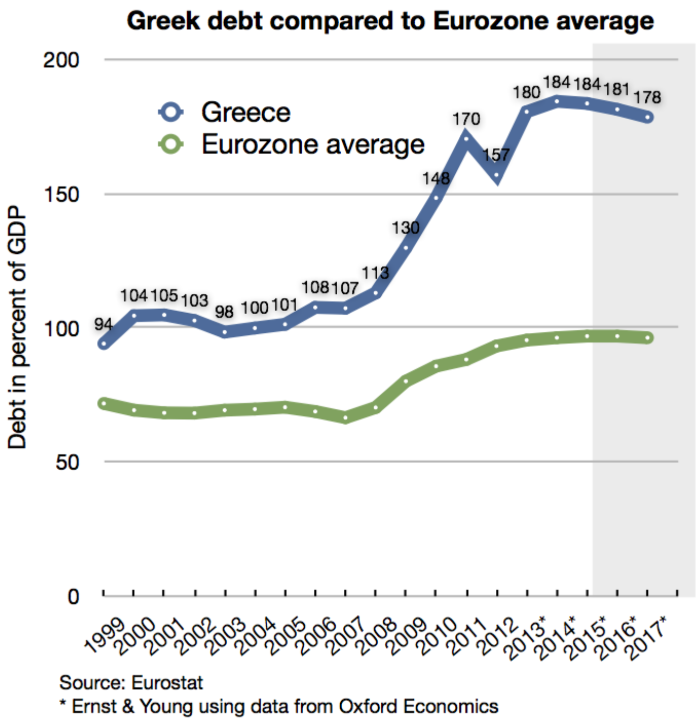
They've already breached the terms of their IMF loan programme by failing to deliver €1.6bn by the end of June and this avenue for further funding has already therefore been cut-off. Of much greater significance however is the EFSF's huge €142bn funding programme that has already been extended twice and which has now expired. Not having access to this bailout package will mean funding is withheld for over €15bn of further bailout capital, at a time when it is most desperately needed. In addition the last resort mechanism, European Liquidity Assistance (ELA), which is designed to provide banks with emergency liquidity to help keep them solvent by preventing a "run on the bank", has now also been frozen given Greece's inability to pay them back.

Therefore the next few weeks are clearly pivotal. The dreaded "capital controls" have been put in place to prevent bank customers from making withdrawals of more than €60 per day. Public sector employees, from nurses to bin men, all need paying. In addition summer holidays to Greece are already being shelved by worried foreign tourists. One study estimated that tourism accounts for over 17.6% of Greece's GDP, accounts for 727,000 jobs (19.7%) and contributes a massive €30.3bn directly to the Greek economy. This is revenue that they can ill afford to lose at a time when the coffers are empty.

How important is Greece to the Eurozone?

Put it this way, Greece is not the Eurozone's "Lehman Brothers" of the banking crisis. Apart from the very distressing humanitarian impact on the Greek population, the precedent set by this crisis is arguably more crucial than the economic impact of Greece exiting the Eurozone (Grexit). Greece accounts for only c2% of total Eurozone GDP and European banks don't have significant exposure to the Greek economy. Moreover Greece accounts for only 0.3% of world GDP (this has halved since 2008). Exports into Greece from other Eurozone economies are tiny and it is unlikely that a Grexit would have a material effect on the private sector. Also Greece is no longer considered large enough to be a constituent of the MSCI World Index or the European Eurostoxx index, having fallen in value to such an extent that it now forms part of the MSCI Emerging Markets index. Admittedly, Greece's Eurozone government partners would have to be prepared to write-down up to €240 billion of debt and the Greek banks would default on over €89 billion of emergency liquidity provided by the ECB, but compared with other Eurozone nations the risk of major contagion into the private sector is unfounded.

That said, the power of investor sentiment cannot be underestimated and the precedent set by such an exit would undoubtedly shake the markets. This is because investors would fear that the likes of Portugal may follow Greece out the door.



However we believe that such fear is irrational for two reasons. Firstly, Portugal successfully exited its own €78bn bailout programme in May and has been able to borrow from the international capital markets ever since, moreover at record low rates. Secondly, the Germans have taken a tough stance with Greece since the decision to offer a referendum and this sends a strong message to other nations looking to call Angela Merkel's bluff. We feel therefore that the chance of contagion into other nations is small.

What about the impact on Greece?

A Grexit may well trigger another election and this would be de-stabilising although perhaps symbolically significant for future creditors. They'd also have to create a new currency. This could be administratively very expensive in the short-term and in addition it has been estimated by Capital Economics that a newly founded Drachma would need to devalue by up to 40% in order to keep Greece competitive. A devaluation would definitely spur some growth (and make for very cheap holidays!).

Greek depositors would need to "bail-in". In other words, Greek bank deposits would be used to prop-up the economy, leading to the loss of some of those deposits. Further additional capital controls would also need to be introduced to ensure that existing deposits were controlled and maintained. This would make it very difficult to allow the economy to grow, yet this type of action worked in Iceland and also helped to return Cyprus to recovery. However, release of these controls would need to be well signposted.

The longer term implications of a Grexit are much more difficult to predict. No matter what happens the Greeks will need to prepare themselves to pay more tax and spend less. The OECD estimates that uncollected tax receipts in Greece in 2010, as a percentage of total tax receipts, was an unbelievable 89.5%, compared with 2.3% in Germany.

Youth unemployment is running at over 50% (Germany's is under 8%) and according to RBS Economics, from 2008 until now Greece has suffered one of the largest % falls in GDP of any advanced nation over any time period since 1870. When you can't borrow from capital markets, the IMF or from other nations and when you've already devalued your brand new currency, the only place to turn is tax receipts and spending cuts from your nation's citizens, exactly what they were trying to avoid in the first place.

Our view

We're a long way from a resolution to this latest Eurozone debacle. We have never held any direct exposure to Greece and have had only a small exposure to European equities, with this focused exclusively on larger companies that are export "heavy" thus benefitting from a weakening Euro. Whilst we firmly believe that Greece is an isolated case that will not feed contagion into other peripheral Eurozone states, the uncertainty surrounding the latest news has only helped to make investors more nervous.

Given its limited economic significance relative to the rest of the Eurozone there are arguments to hope for an imminent Greek exit rather than to prolong the agony that a "death by a thousand cuts" will create. Regardless of the outcome, the bigger question remains as to whether this might be a warning that the Euro project itself will ultimately fail, as so many other monetary unions have failed so spectacularly in the past.