Europe, with an eye (again) on Greece

Miguel Jiménez

In the last two months, most of the political hand-wringing in Europe has concerned the referendum on the UK's membership in the EU, but perhaps Obama's visit and a wider margin of victory for the pro-EU camp in England shown in the polls have taken the edge off conversations about a Brexit. Now old stories are creeping back into the news cycle, such as tax adjustments and problems in the periphery.

Overall the peripheral countries have withstood the financial tensions of the last year, which have been mostly caused by China and emerging markets, largely because they have been shielded by the ECB's sovereign bond purchase policy. Ireland, which was one of the first countries to ask for a bailout, is growing at very fast rates. Portugal has raised more doubts lately, given that the new government's deficit reduction plans haven't convinced Brussels, which has asked for additional adjustments in case the measures approved by the Portuguese government don't work. Spain and Italy, for different reasons, are also discussing their budget plans with the European Commission.

However, once again Greece is the greatest cause for concern. Next week, the Eurogroup will discuss the first review of Greece's third bailout package, approved last summer and pending review since last October. This delay is due the fact that that there hasn't been any debt financing pressure. So far Greece hasn't had to make any debt payments (mostly held by European governments and with long grace periods), although two are approaching: one to private creditors and another to the IMF, both in July. Furthermore, the Greek government has dragged its feet on defining the measures needed to achieve a primary surplus of 3.5% starting in 2018, the figure agreed to in last summer's pact.

But the IMF and European authorities hold discordant views, not only on whether an additional haircut is called for (as the IMF has always advocated as a condition for its participation in the program, a position rejected by Eurogroup), but also the opinion of whether the measures proposed by the Greek government to reach the budget deficit target are reliable or not. Regarding this second point, it is the IMF that is suspicious and demands a contingency plan in the event the budgeted measures don't work, opposed to the more conciliatory view of the EC. The agreement with the creditors is important, because if the IMF doesn't participate in the new bailout (it parked its decision last summer), the European countries would have to cover up their share of the financial aid.

Both Greece and the creditors want to find a solution soon to avoid the hasty negotiations held last summer and close a deal before the UK referendum, but an agreement is unlikely next week. The Eurogroup is willing to discuss the subject of Greek debt sustainability (to wit, the possibility of an additional haircut), but it's not likely to give in on this point. And it won't be easy for the Greek government to draw up a plan B for further adjustments with respect to the one it has practically closed with the respective institutions.