The Moscow Times
30 YEARS
INDEPENDENT NEWS FROM RUSSIA

Analysis: Russia Not Immune To Greek Contagion

By Howard Amos

February 19, 2012

An HSBC investment report released Friday made a glowing case for Russian equities, ridiculed concerns about political risk ahead of the March 4 election and said macroeconomic support was flowing Moscow's way.

The bank lauded the imminence of a "cyclical sweet spot." But there was one dark cloud. "A disorderly default in Greece," the HSBC strategists wrote, "could create an interruption to this story."

The European debt crisis is the specter that has stalked the Russian market amid recent stock market gains and resurgent global flows into emerging market funds. Europe is Russia's biggest trading partner and 40 percent of Russia's foreign currency reserves are held in euros.

European Union finance ministers are due to meet Monday to approve a 130 billion euro ($170 billion) bailout package for Greece that would avoid chaos on March 20 when the country has a debt repayment it cannot make.

The rhetoric between Athens, Brussels and Berlin last week failed to exclude the possibility of a messy default. A scheduled meeting of finance ministers on Wednesday was canceled on fears that it could end in failure.

"If the default is planned and well anticipated, then it will actually end up being a boost to the Russian market," said Roland Nash, chief strategist at Verno Capital. "The real risk is that there will be a mistake made, there won't be an agreement and there will be a forced default."

The result would be dramatic stock market declines, he said. "And in the event of a global and European sell-off, Russia will sell-off more than anywhere else."

When European civil servants last week appeared to question the consensus view that an uncontrolled Greek default was unthinkable, Russian markets wobbled.

Up almost 13 percent in 2012 on the back of optimism that Europe would solve its crisis, the MICEX Index closed down 0.4 percent Friday, its first daily fall in four days. The dollar-denominated RTS was down 0.1 percent.

"The dangers concerning Greece have again become an excuse for selling on equity markets," Nomos-Bank wrote in a note Friday.

If Greek debt was voluntarily restructured, it could provoke a relief rally on markets that have already partly priced in a worst-case scenario, experts said. But a disorderly default could trigger a crisis on a scale not seen since 2008.

"If we have a disorderly default, then there's no safe havens," said Peter Westin, chief strategist at the Aton brokerage in Moscow. "If you have to be in Russia, you will have to go defensive — and if you don't have to be in Russia, then you probably shouldn't be there."

He added that the pace of events would be rapid. "From what we saw in 2008 and 2009, Russia just gets crushed."

There have been some calls for emerging markets to contribute to a rescue package to save Europe from its sovereign debt problems. Finance Minister Anton Siluanov said Friday that Russia was prepared to contribute up to $10 billion in extra funding to the International Monetary Fund, pending similar commitments from other major donors.

"We are following the situation in the euro zone," Siluanov said Friday, Interfax reported, "because we don't want the problems of the euro zone to hit Russia."

Though Russia has little exposure to Greek debt, a disorderly default could directly affect Russian banks, said Jochen Wermuth, founding partner of Wermuth Asset Management.

"For the large state-dominated banks that will not be a problem, but the smaller private banks may need Central Bank support," he said.

Wermuth put the chance of a disorderly Greek default as high as 40 percent. But others said stakeholders in the process of Athens' debt restructuring have too much to lose to allow a destructive chain reaction to begin.

"Greece as an economy on the global scale is irrelevant," strategist Nash said. "The problem is contagion."

A default in Athens could trigger Greece's exit from the euro zone and an increase in problems for other debt-afflicted nations including Portugal, Italy, Spain and Ireland.

"If Greece were to exit, I don't think it would be big surprise," said James Cooke, founder of the Aurora Russia Investment Fund.

But aside from tumbling equity markets and a wave of problems in the financial system, the main route of contagion to Russia from a euro-zone meltdown would be through the oil price.

The break-even oil price for Russia's budget in 2012 is about $120 a barrel of Urals crude. And while petroleum has risen on the back of tensions between the United States and Iran, a financial crisis that caused a recession in Europe or the United States could trigger a collapse.

Kingsmill Bond, chief economist at Citibank in Moscow, gave a traditional response to the question of how a Greek default will impact Russia. "As usual, the answer is how it affects the oil price," he said.

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