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Considered view **20 Apr 2010 03:01**

Athenian contingency

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Greek banks: With the lights flashing amber for Greece, it is time to develop contingency plans. The country may have succeeded in raising 2 billion euros in 3-month money on Tuesday but yields have kept creeping up since the European Union's bailout deal earlier this month. The market is worried that Greece might default. The country's job isn't made any easier by comments from Axel Weber, boss of Germany's Bundesbank, to the effect that Greece might need an 80 billion euro bailout, nearly double what is so far envisaged.

If Greece defaulted, its banks would be on the ropes. Three of the largest -- National Bank of Greece, EFG Eurobank and Piraeus Bank -- held government bonds equivalent to over 150 percent of their shareholders' equity at the end of 2009. A big writedown on sovereign debt might push them over the edge - and the government wouldn't even be able to help.

A total collapse of Greece's banking system would make things even worse for the economy. It's therefore vital that a proper contingency plan is developed. It would need to have two elements: liquidity support and capital injections. Greek membership of the euro zone makes this harder: it can't just flood banks with newly printed money. But there are other ways to achieve these goals.

On liquidity, the main challenge would be to ensure banks have enough money to keep operating. Ideally, that would involve a deposit guarantee from some external party -- such as the EU -- to stop a run by depositors. But since that would be both politically unpalatable and contravene the treaty establishing the euro, the best alternative would probably be for the European Central Bank to supply lots of liquidity as the lender of last resort.

But for the ECB to be happy with such a role -- and to reassure markets further -- there would also need to be capital injections. Some of the planned bailout money from EU countries and the International Monetary Fund could be used for that purpose, effectively nationalising the banks.

Putting together such a package wouldn't be easy. But it is far better for Greece, the EU and the IMF to have a Plan B in their back pocket rather than have to improvise in the wake of a default.

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Context News

Greece raised 1.95 billion euros by selling 3-month T-bills on April 20 but had to pay twice as much in yield as it did in a comparable auction in January.

The yield on Greek bonds also remained high. At 1pm GMT, the 10-year yield was 7.76 percent and the spread against German bunds was 4.68 percentage points.

Meanwhile, Axel Weber, head of Germany's Bundesbank, told politicians that Greece may need up to 80 billion euros in aid, according to the Wall Street Journal. This is more than the 45 billion euros envisaged in a bailout involving European Union countries and the International Monetary Fund.

The value of Greek government bonds on the balance sheet of National Bank of Greece was 184 percent of shareholders' equity at the end of 2009. For EFG Eurobank, the ratio was 186 percent and 154 percent for Piraeus Bank. For Alpha Bank it was 57 percent (pro forma for a rights issue).