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Capital controls squeeze a suffocating Greece economy

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The steep price of government's extraordinary financial measures is becoming increasingly evident

Continuing uncertainty may be a boon for supermarkets as panicked consumers fill their cupboards

Greek authorities imposed sweeping capital controls to prevent a collapse of the banking system that threatens to push Athens out of the eurozone.

But with economic activity grinding to a near halt and the country's banks still bleeding deposits, the steep price of these extraordinary measures is becoming increasingly evident.

In the absence of a long-term agreement with its international creditors, economists warn that capital controls are not a long-term remedy for Greece. Without fresh support, the government or the banks will inevitably run out of money, they say, and then be forced to resort to an alternative currency to meet their obligations, leading to "Grexit".

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"This week is some kind of very long Christmas holiday, when most economic activity comes to a halt," Guntram Wolff, director of Bruegel, the European think-tank, explained. "The longer capital controls last for, the bigger the damage."

Greece's capital controls — which include a strict €60 daily limit on all ATM withdrawals and tight limits on payments abroad — are affecting both domestic transactions and dealings with foreign suppliers.

While credit card payments and electronic transfers within Greece are not affected, analysts warn that large segments of the population have had to scale back consumption as they rely on cash for their daily shopping.

"We expect consumption to fall, as well as investments and exports," said Manos Giakoumis, head analyst at MacroPolis, a consultancy. "For many economic activities, volumes and turnovers will be subdued."

In the short run, Mr Giakoumis adds, uncertainty may be a boon for supermarkets and petrol stations, as panicked consumers fill their cupboards and tanks fearing worse shortages in the future.

In a central Athens supermarket, Mariana, a supervisor, was checking orders on Thursday for supplies of pasta, rice and pulses — all staples that Greeks have been buying in larger quantities than usual since the announcement of a national referendum on Sunday that some fear could push the country closer to a eurozone exit.

"We haven't seen anything you could call panic buying but our older customers are definitely stocking up on dry foods and tinned goods," she said, pointing to a nearly empty shelf usually stacked high with tins of tuna and sardines.

Greeks in their 60s and 70s, who lived through periods of political and social turmoil when food was in short supply, still tend to stockpile basic foodstuffs ahead of an election of any kind. "It's my grandmother's knee-jerk reaction," Mariana said.

Andreas, a purchasing manager for the same supermarket chain, said the company placed "much bigger orders than usual" last month.

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"We were already worried that capital controls would happen, so we pulled cash out of the bank and bought imported goods that might be hard to get later," he explained.

Meanwhile, foreign companies are also having to adapt to the new normal in Greece. On Wednesday, Ryanair, the airline, announced it would allow Greek customers to pay in cash after capital controls caused problems with credit card transactions.

A more pressing question is whether foreign suppliers will continue to sell goods to Greek businesses, as transactions abroad require approval from the Greek authorities.

"Greek companies without a foreign subsidiary are finding it difficult to make payments abroad," said Dimitris Paraskevas, managing partner at Elias Paraskevas Attorneys, a law firm. "Unless the company has very good relations with its foreign suppliers, this is bound to have an impact."

Such uncertainty will inevitably deepen the Greek economic slowdown, which has already worsened in June. The closely watched purchasing managers' index for manufacturers fell to 46.9 from 48 in May. This is the lowest reading in two years and well below the crucial 50 mark that separates a contraction from an expansion

The downturn is bound to curtail tax revenues, worsening the Greek government's already dire finances.

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"Historically, a large portion of taxes is paid at the end of the month and the bank holiday coincides with this period," said Mr Giakoumis. "There will also be incentives to delay tax payments because of uncertainty."

Analysts warn that while it is impossible to have an exact picture of the government's cash flow position, it may become impossible for Athens to meet its obligations in a matter of days.

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"In a situation of severe financial distress, the government may have to decide whether to issue IOUs to cover its expenses," said Daniele Antonucci, senior European economist at Morgan Stanley. "Some kind of a 'dual currency' would start to circulate domestically."

The other source of vulnerability is the banking sector. The European Central Bank froze the amount of emergency loans it provided to Greek lenders on Sunday, meaning that banks have no sustainable source of liquidity.

Capital controls can reduce their deposit outflows but not stop them. As cash is drained from the ATMs, the authorities will be obliged to lower the maximum amount savers can collect. Even this is only a temporary fix.

"At some stage the Greek central bank will have to provide liquidity to its banks," said Mr Wolff. "And if there is no new [ECB support], there will have to be a new currency".

Additional reporting by Kerin Hope in Athens