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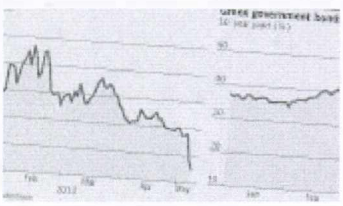
Greek-led fall points to euro exit worries

By David Oakley

Greek stocks have fallen more than 10 per cent and government bond yields have jumped more than 200 basis points in the space of two days. The markets, say analysts, are gearing up for a Greek exit from the euro.

Investors and strategists warn that the failure of the Greeks to deliver a majority government in parliamentary elections at the weekend has raised the stakes over the country's future and revived fears that Athens will leave the single currency.



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Indeed, almost three years after Greece's spiralling debt triggered the wider eurozone crisis, some market participants are putting the probability that the country will leave the euro at 90 per cent, with a disorderly exit now seen as possible this year.

John Stopford, head of fixed income at Investec Asset Management, says: "The next month is absolutely critical for Greece. If there is another election in the middle of June and voters reject austerity again, a euro exit could come soon."

Harvinder Sian, euro rates strategist at RBS, says: "I think the chance of Greece leaving the euro is about 90 per cent and quite possible in the next few months, if the politicians do not agree to austerity measures."

These concerns have been felt most strongly in Greek asset prices, with the wider financial markets unsettled but not in turmoil. Greek 10-year bond yields, which have an inverse relationship with prices, have jumped to 23.16 per cent, while Athens' stock market has fallen to it lowest level since November 1992.

The overriding worry for many investors and strategists is political risk. Greek voters have sent a strong message: they are fed up with tough austerity measures and many have responded by backing more extreme parties, the far-left benefiting in particular.

Investors are doubtful that Alexis Tsipras, the head of Syriza, the leftwing coalition, will be able to form a government after the country's two main pro-bailout parties failed to win a parliamentary majority.

If Mr Tsipras is unable to form a new government, then new parliamentary elections are likely to go ahead on June 17.

As long as the political stalemate lasts, it puts in doubt Greece's next loan tranche from the EU and the International Monetary Fund, which needs to see parliamentary approval for deep cuts in healthcare spending and public sector employment, as part of the country's second €174bn bailout.

Without the EU and IMF money, Greece will be unable to meet pension, salary and debt commitments next month and, in such a scenario, strategists say a euro exit could be triggered.

"If the Greeks cannot pay pensions and wages, then that could speed up an exit," says Mr Sian.

He fears the first forcible exit of a country from the currency bloc would create profound uncertainty and difficulties for the entire eurozone. It could pressure other peripheral government bond markets and even lead to other countries leaving the single currency.

Yet others in the markets are unconvinced Greece is heading for an exit. Malcolm Barr, strategist at JPMorgan, says the chance is less than 50 per cent.

He says two stages lie ahead before any Greek exit. The first is the creation of a Greek government with demands to renegotiate the second package, considered a high probability as all parties want some form of renegotiation.

The second stage is for that renegotiation process to reach a point where the Greek government decides it is in its best interest to leave the euro area. The hard bargaining over this is yet to begin and unlikely until at least the end of June, says Mr Barr.

For other strategists, the markets are no longer relevant because Greece does not rely on them for financing and is unlikely to for years to come.

Padhraic Garvey, global head of rates strategy at ING Financial Markets, says: "The markets gave up on Greece a long time ago. It does not really matter whether yields go higher as it is all down to politics now. If the politicians are not prepared to accept cuts, then they have little choice but to the leave the eurozone."

Mr Stopford says: "If the Greeks do end up outside the euro, then that will make their bonds even less appealing. It is difficult to see international investors returning to the Greek bond markets in such a situation, but then it is difficult to see international investors returning to the Greek bond markets for a long time whatever the politicians decide over the euro."