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Greece fails to form unity government

By Kerin Hope in Athens and Robin Wigglesworth in London

Greece is heading for a fresh general election after its political parties failed to form a national unity government because of opposition from the anti-bailout Syriza coalition.

President Karolos Papoulias, who chaired three failed meetings with political leaders in as many days, was unable to bridge differences between Syriza and the two pro-euro parties, the centre-right New Democracy and PanHellenic Socialist Movement (Pasok). A caretaker government will be chosen on Wednesday to oversee the election, expected on June 17.

The prospect of a stronger electoral backlash against the terms of Greece's rescue programme in a second election, potentially jeopardising the cash-strapped country's euro membership, roiled financial markets on Tuesday.

European bank shares were hammered for a second day running as the FTSE Eurofirst banking index slumped below its 2009 financial crisis nadir to the lowest since at least 2004, when the measure started.

Italian and Spanish benchmark 10-year bond yields also climbed, to 5.83 per cent and 6.3 per cent respectively, as investors fretted that uncertainty over Greece could infect larger, more systemically important eurozone members.

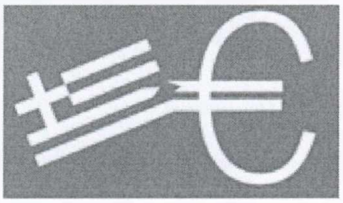
"Unfortunately, the country is on the road to elections under very negative conditions," said Evangelos Venizelos, the Pasok leader, after an acrimonious two-hour meeting at the presidential mansion.

The socialists finished third in an inconclusive election on May 6 after voters abandoned them in droves for Syriza, which pledges to reverse wage and pension cuts imposed under Greece's second €174bn bailout programme and reduce unemployment by hiring 100,000 additional civil servants.

Greece faces deepening political instability as the second election is also unlikely to produce a clear result. Christine Lagarde, managing director of the International Monetary Fund, warned on Tuesday that a Greek exit would be "quite messy".

FT series

If Greece goes ...



Greece is back on a knife edge. The FT looks at the potential consequences of it leaving the eurozone

She said that while the IMF hopes it would not happen,"we have to be technically prepared for anything".

Alexis Tsipras, the Syriza leader, accused the pro-euro parties of trying to blackmail Greek voters into supporting further austerity measures, saying his party would "not betray the hopes and expectations of voters who rejected the bailout". Some 70 per cent of votes cast in the previous election went to anti-austerity parties.

An opinion poll by Rass published on Monday indicated that Syriza would finish first in the next election, increasing its share of the vote from 16.8 per cent to 20.5 per cent.

Yet 54 per cent of respondents said Greece should continue to implement reforms agreed with the European Union and IMF in order to stay in the euro.

Several Athens bankers voiced concern on Tuesday over a sustained outflow of deposits of more than €5bn since May 6, reflecting increased political uncertainty.

Deposit levels have fluctuated during the two-year crisis, yet about €2bn returned to the banks in March and April after Greece's international lenders agreed to provide €40bn of funding for their recapitalisation.

Although Greece does not produce quarterly gross domestic product figures in line with other EU output data published on Tuesday, calculations by Barclays showed that its economy expanded in the first quarter compared with the previous three months. But GDP was still more than 6 per cent lower than a year before.