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Greek knife edge could mean long slow cut

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By Joshua Chaffin in Athens

Greece's national elections were billed as a make-or-break referendum on the country's future in the eurozone – and perhaps the future of the euro itself.

As the centre-right New Democracy headed for a narrow victory over the anti-austerity, anti-bailout Syriza coaltion, Europe's leaders will have breathed a huge sigh of relief.

The defeat of Syriza removes the threat of a quick a quick and chaotic Greek eurozone exit which eurozone policymakers feared most.

Yet the election will still set in motion what could be days – even months – of nail-biting negotiations between Greece and its international creditors.

The prospect of lengthy coalition talks and then further negotiations between a potentially fragile government and Greece's creditors will bring more of the uncertainty that has roiled financial markets in recent weeks, spreading sovereign debt crisis contagion to the much bigger economies of Spain and Italy.

"The expectation that we get resolution of this near-term is mistaken," said Mujtaba Rahman, an analyst at Eurasia Group, predicting that Greece and its creditors could bargain for months over the terms of the country's €174bn bailout.

During that time, markets would be pitched "on a knife's edge", Mr Rahman said, as they scrutinised mixed signals from an incoming Greek government and its creditors with a €3.9bn debt interest payment to the European Central Bank looming in August.

The unpopular bailout supplied by the EU and the International Monetary Fund dominated the campaign, with Alexis Tsipras, the leader of Syriza, promising to "tear it up". His chief rival, Antonis Samaras, the leader of the centre-right New Democracy, subsequently pledged to seek better terms.

A deeper-than-expected recession and months of political paralysis have blown Greece well off course to satisfy the original conditions, which include austere fiscal targets as well as deep structural reforms to the country's bloated public sector and mass-privatisations.

Mr Samaras sought to reassure European leaders on Sunday evening, saying there would be "no more adventures; Greece's place in Europe will not be put in doubt".

As much as Greeks detest the bailout, the country's gaping fiscal deficit means that it would soon run short of cash to pay for even the basics without foreign assistance. Mr Tsipras seemed to recognise this towards the end of the campaign, as he softened his rhetoric.

International help remains vital for Greece's banking system, meaning the ECB will play a central role in determining country's fate. The Greek financial system is reliant on ECB liquidity – and a decision by the ECB to pull the plug would cause its collapse. On Friday, Mario Draghi, president, said the ECB would "continue to supply liquidity to solvent banks where needed".

If the future of Greece's international bail-out is thrown into doubt, the ECB could deem Greek banks ineligible for its support. Germany's Bundesbank has already signalled its impatience with Athens.

The EU has its own "red lines". The easing of the terms that would require more money for Greece would stir outrage among voters in Germany, the Netherlands and other creditor countries.

Nonetheless, Greece's creditors are also likely to come to the bargaining table.

"It's in the interest of both sides to make a deal," said Guntram Wolff, deputy director of Bruegel, a Brussels think tank.

Publicly, EU leaders have studiously avoided comment on their plans. Just by acknowledging that they may be willing to rework the bailout, they feared that they would validate Mr Tsipras' argument, and boost his standing.

Yet behind the scenes, they have been busy debating a package of concessions to dangle before a new Greek government. The catch is that the government would have to recommit to the main outlines of the bailout.

Some of the benefits on offer could include lower interest rates and extended maturities on the loans but not changes or extensions to the fiscal targets, according to senior officials in Brussels and Berlin.

If negotiations bog down, the EU may squeeze Greece. Member states withheld €1bn from a loan disbursement last month, pending the outcome of the elections. Without such funds, Greece will not be able to pay salaries and pensions – let alone bond redemptions.

But squeezing too hard could backfire if it precipitates a debt default that shocks financial markets. Spanish bond yields, which have risen to dangerously high levels, will serve as a stark reminder of the bloc's vulnerability.

Also working in the Greeks' favour is that while many of its eurozone partners now wish it were outside the single currency club, no one wants to be seen giving it the final shove.

Additional reporting by Ralph Atkins in Frankfurt

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