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Focus notes: Greece

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Local elections: Outcome & Implications

Highlights

- Greek Prime Minister rules out early election
- Election results show PASOK maintains lead; distance from main opposition party narrows
- Greek sovereign debt spreads tighten on local election's outcome; still at elevated levels

Greek Prime Minister rules out early election

In a closely watched televised address broadcasted on Sunday Night, Greek Prime Minister George Papandreou effectively ruled out calling an early parliamentary election, stating that his government will continue to work towards the crucial goal of safeguarding political and economic stability in the country. Mr. Papandreou said that he has both a credible plan and a strong resolve to succeed on that aim and predicted a return to positive economic growth from 2012.

The news was received with a considerable degree of relief by investors in the Greek equity and sovereign debt markets, which came under significant pressure following a surprise suggestion by the Greek Prime Minister in late October that he might call a snap general election, if his party fared poorly in the November 7 municipal polls[1] . The yield spread of the benchmark 10-year Greek government bong (GGB) against its German counterpart stood at 890bps in late European trade on Monday, down some 15bps from levels recorded late last week. Bank stocks also rallied strongly yesterday, with the Athens main equity market index (ASE) recording gains of 1.26 %.

The positive market reaction to Mr. Papandreou's speech last night did not come as a surprise to us. Indeed, we have long been of the view that a) the government's strong majority in Parliament (157 our of a total of 300 MPs) and b) the fact that social resistance to the austerity measures has been relatively contained thus far constituted key factors supporting the case for a successful implementation of EU/IMF-backed stabilization programme and the gradual improvement in market sentiment towards Greece.

It goes without saying that the government's credible commitment to implement aggressive austerity measures and painful reforms is key for influencing market perceptions regarding medium-term fiscal sustainability, especially in view of the country's poor track record on reforms and the magnitude of its current structural problems.

On the latter point, note that according to the EU/IMF baseline projections, the generation of primary surpluses as high as 5% to 6% of GDP is needed for a number of years (2013-2020) so as to reduce the public debt ratio to levels around 110%-of-GDP by the end of the forecasting period. Our baseline scenario for the evolution of the debt ratio is more optimistic than that of the EU/IMF, mainly because we forecast higher GDP growth and inflation rates in the years ahead.[2] Yet, the upcoming Eurostat revisions to past deficit and debt figures for Greece (expected by mid November) may well induce certain upward revisions to our debt and deficit projections, especially if they deviate significantly from what was recently suggested in a number of press reports and news wires.[3]

The above points imply that a strong government with a firm commitment to fiscal austerity and structural reforms is a key prerequisite for the successful execution of the country's stabilization program. In our view, a government decision to call early elections would risk to intensify pressures on Greece's equity and government bond markets with adverse consequences for the domestic economy. That is especially true taking into account a number of recent reports suggesting that an early election might open up the possibility of a coalition government with slim majority in Parliament, an outcome that could hurt the drive for reforms.

Election results show PASOK maintains lead; distance from main opposition party narrows

With more than 95 percent of the vote being counted thus far, the ruling PASOK party appears to be

[1] *For more analysis on the reasons and potential implications of Greek PM's treat of early elections please read Focus-Greece, Domestic environment deteriorates on rising political uncertainty, rumors about a significant overshooting of the 2010 fiscal target, Eurobank EFG Research, Nov 3, 2010.*

[2] *For a detailed set of forecasts of Greece's main fiscal ratios and other key macroeconomic variables please see: The Greek Economy and Its Stability Programme, Eurobank EFG Research, June 2010, 2010.*

[3] *For more on that issue please see Focus-Greece, Domestic environment deteriorates on rising political uncertainty, rumors about a significant overshooting of the 2010 fiscal target, Eurobank EFG Research, Nov 3, 2010.*

leading the race for the new regional governor posts, including in the Attica region. Specifically, PASOK seems to be ahead in seven of a total of 13 regions, with main opposition part, New Democracy (ND), leading the race in the remaining 6 regions. Crete and Southern Aegean regions are expected to be resolved (respective leading candidates won more than 50% in y-day's vote), but the other regions are likely to go to a run off on November 14th.
Estimates regarding the results in the country's 325 municipalities did not delivered major surprises, with most expected to be resolved in a runoff ballot at the end of this week. In Athens, the incumbent conservative mayor Nikitas Kaklamanis is leading the race with around 35% of the vote, with PASOK-backed independent candidate, Giorgios Kaminis, getting ca 28.4%. In Thessaloniki, a New Democracy-backed candidate is leading the race, having received 37.9% against a PASOK-backed independent candidate who won 33.58% of the vote. Finally, in Piraeus, a PASOK-backed candidate is ahead with 29.58%, with the contender supported by ND receiving ca 23.05%.

It has to be noted that around one half of all candidates who run for the local elections are not directly affiliated to existing political parties and thus, it may be difficult to draw direct political conclusions from the election results. Yet, some of the points one can make about Sunday's ballot are the following:

a) Neither PASOK nor New Democracy has managed to maintain (or increase) the total number of votes they received in the October 2009 parliamentary elections.
b) Yesterday's vote showed a significant decline in PASOK's lead over New Democracy to ca 1.8ppts vs. 10.44ppts in the October 2009 parliamentary elections. PASOK appears to have received around 34.6% of y-day's vote, with ND trailing the race with 32.8%. The respective percentages in the October 2009 vote were 43.92% for PASOK and 33.48% for New Democracy.
c) Y-day's election result showed an unusually high level of abstentions, as more than 40% of the electorate decided to stay home, compared to 29% in last October's general elections.

Note that for each region and municipality that will go to the runoff ballot, the two candidates who have received the largest percentage of votes will compete, with the final winner being required to get more than 50% of the vote.

Greek sovereign debt spreads tighten on local election outcome; still at elevated levels

Greek government bond prices regained some composure across the entire spectrum of maturities early this week on market relief over diminishing risks of early parliamentary elections. In a closely watched televised address to the nation on Sunday night, Greek Prime Minister George Papandreou ruled out calling a snap election after the results of Sunday's local & municipal polls showed that his party continues to lead its main opposition counterpart, albeit with a much thinner margin. Short-dated Greek government bonds outperformed yesterday with the 2/10-yr yield curve undertaking some bullish steepening. The corresponding spread was trading close to 112.2bps in late European trade on Monday, some 3bps wider from two-month lows recorded late last week. In the EU sovereign debt space, Greece was among the outperformers with yield premiums of sovereign bonds vs. their German peers reversing some of their recent widening. The 10-yr Greek government bond (GGB)/Bund yield spread was standing close to 890bps, some 15bps narrower from multi-week closing highs recorded in the prior session in the wake of the Prime Minister's recent threat of an early national election.

Speculation that euro area countries may push for a new permanent bail-out mechanism involving an orderly debt restructuring scheme and a string of press reports suggesting that a debt restructuring/rescheduling of Greek debt could provide as a viable solution to the country's problems had recently added to the negative tone in EMU periphery debt markets. But, despite today's tightening of Greek sovereign bond spreads, they still stand well above multi-month lows touched a couple of weeks earlier (10-year spread hit levels around 650bps October 18th). With EMU jitters (Ireland, Portugal) continuing to have an impact on market sentiment, short-term risks for periphery debt yield spreads remain skewed to the upside. Lingering anxiety ahead of the upcoming (upward) revisions to Greece's past deficit and debt data suggests limited room for a further material narrowing in Greek sovereign spreads in the coming sessions. The technical picture for the key 10-year GGB/Bund spread suggests risks for a retest of late last week's closing high of 904bps, with the 850-800bps region containing the downside ahead of mid-November data revisions.

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