

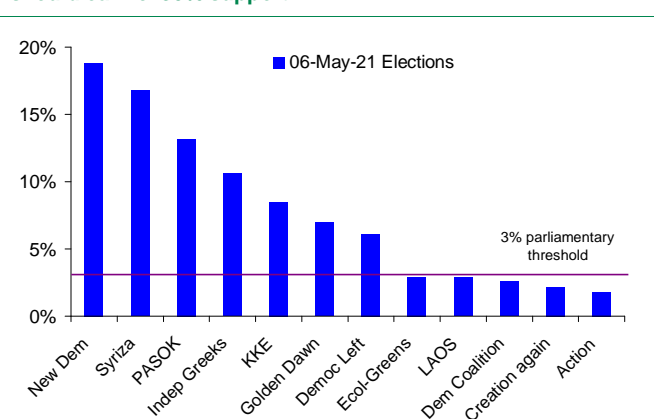
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## The Great Greek Derby

### 2 days left

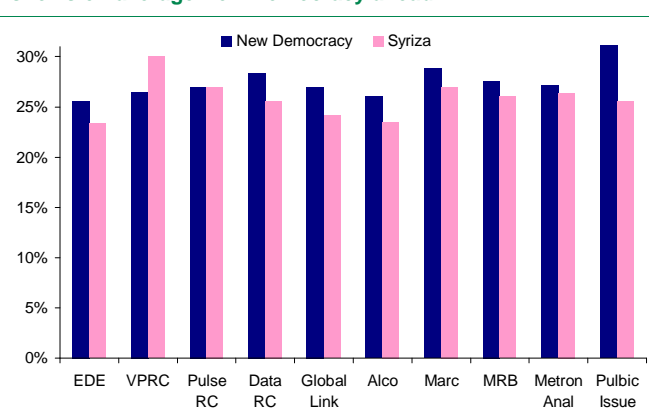
- The repeat parliamentary elections in Greece are held on Sunday 17<sup>th</sup> June. The country failed to agree on a coalition government after the 6<sup>th</sup> May elections which saw surprise strength of smaller parties, propelling the left-leaning Syriza party into 2<sup>nd</sup> position, and an emphatic weakening of the traditional 'government' parties of New Democracy and PASOK.
- The most recent opinion polls date back to 3<sup>rd</sup> June and showed New Democracy ahead but the difference from Syriza party was within the statistical error. However, New Democracy was ahead in 8 out of the last 10 opinions polls.
- Parties are having a final push to convince the c.35% of the public that abstained at the last elections (record high for Greek parliamentary elections) and the c.19% of voters that selected smaller parties (that did not make the 3% threshold at the last elections and did not elect MPs).
- The New Democracy party is attempting to exploit and highlight the continued divergence of opinions among Syriza party members (consists of 12 different subgroups with diverse political beliefs) while the Drachma threat is kept at the top of the agenda. Additionally, it continues to push the profile that it is the only party that can guarantee law and order in post-elections Greece.
- Syriza on the other hand carries on with its anti-austerity and anti-bailout rhetoric (cancel the austerity measures and negotiate the funding agreement) and now attempts to benefit from the Spanish developments and the fact that the Spanish financial aid will come at no apparent extra expense to the public finances. Syriza's leader, Tsipras has tried to somewhat moderate his anti-Europe austerity stance (e.g. recent FT article) while he made a strong push to advertise the party's lighter past in terms of corruption compared to the 'old' parties.
- The PASOK party, 3<sup>rd</sup> at the recent elections, is anxiously trying to maintain the 6<sup>th</sup> May support of 13.2% as it is intensely squeezed by the polarization around Syriza and the resurgent Dem Left. A failure from PASOK to earn a respectable level will cause another party crisis and could affect post-elections developments for the formation of a coalition government. PASOK is viewed at the main partner of New Democracy for a coalition government.
- The Democratic Left along with LAOS and the Creation Again parties (if they have MPs elected) are considered possible coalition partners and hence signs of increased support for these parties should be considered a positive for the upcoming negotiations

**Chart A: 6<sup>th</sup> May election result – this time the two main parties should earn c. 30% support**



Source: Bloomberg, LBWBM

**Chart B: Battle for 1<sup>st</sup> spot is still open – polls up to 3<sup>rd</sup> June shows on average New Democracy ahead**



Source: Bloomberg, LBWBM

### Process

- The polls will close at 5pm BST and the first exit polls will be published immediately after that. While this could give an indication of the result they are expected to show a very close battle. We will have to wait for a representative portion of the actual votes which should come around 7.30-8.30pm BST. It is worth being aware that the early pattern of votes can be misleading as the polling stations in the urban areas (and especially Athens where Syriza had an 8% lead over New Democracy at the last elections) tend to report their results last.
- No party is expected to win an outright parliamentary majority (a party needs at least c.35% and the least possible number of parties meeting the 3% threshold in order to secure 151 MPs) and therefore the formation of a coalition government is the most likely outcome. The unity or technocratic government options are seen as low probability scenarios, especially if Syriza is the winner of these elections.

- Following the official announcement of the final results (midday Monday), a process similar to the 6<sup>th</sup> – 15<sup>th</sup> May will be underway. The Greek president will call the leader of the 1<sup>st</sup> party and give him 3 days to attempt to form a coalition government.
- The possibility of a 3<sup>rd</sup> round of elections cannot be entirely ruled out. However, we are confident that parties under the pressure of depleted public coffers and Europe to finally form a government will not seek this path. Negotiations can continue for up to 10 days but have to be completed by the official opening of parliament on the 28<sup>th</sup> June. There is very low probability scenario for a minority government. However, it will be the very last option in order to avoid renewed elections.

## Scenarios:

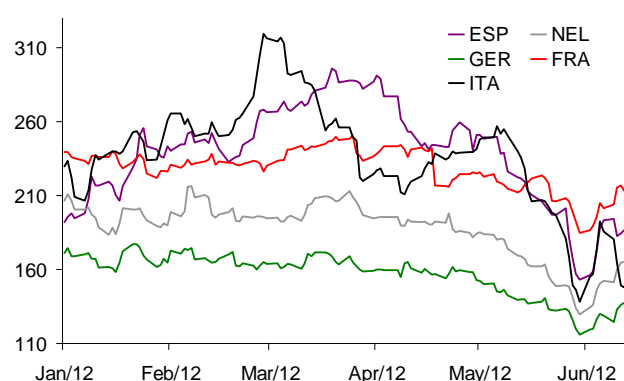
### 1) New Democracy win:

- A New Democracy win will earn them the 50 MPs bonus and allow them to negotiate the formation of a new government. New Democracy and PASOK need a minimum combined 34-35% support to have a sufficient number of MPs. The most likely outcome would be a New Democracy-PASOK-Democratic Left (even if the 1<sup>st</sup> two parties have sufficient MPs for a majority). This government has good chances to be formed before the 21<sup>st</sup> June Eurogroup meeting.
- The formed government will be highly dependent on the progress made. Its main aim would be to renegotiate the bailout terms. New Democracy's leader Samaras' possible willingness not to be the next PM could prove the catalyst of a successful and swift outcome of the negotiations.
- An effort will be made for a unity government including Syriza however this is unlikely to work out positively. Syriza will want to remain in opposition and hope to benefit from a failure of the formed government to deliver on its mandate.
- A New Democracy-led government is the best outcome for Europeans as i) they will negotiate with a pro-Euro coalition, ii) they will be spared from having Syriza as counterparty. They will be inclined to provide further relief to Greece including extensions of the timeframe to meet the fiscal targets (a 3yr extension is the most plausible scenario along with extra funding), project bonds (to be rolled out at the end-June EU summit) for infrastructure projects and increased access to EU funds. This was also explicitly stated by France's Hollande at a recent interview.
- Market reaction: A strong sell off in core bonds will be expected on Monday however its continuation will depend of the speed of the government negotiations and on expectations for the FOMC decision on Thursday. However, despite the initial breather, the market pressure on Spain and Italy will remain potent.
- The EUR could be expected to rally as short positions are reduced, primarily against the USD and JPY. Initial scope for gains will be limited both by the uncertainties surrounding the exact make-up of a government and continuing negative sentiment about other aspects of the euro area debt crisis (Spain). However, we believe some of these concerns are now overdone, and a EUR rally could extend as far as 1.30 against the USD over the next month.

### 2) Syriza win

- Firstly, a Syriza win should not be automatically translated into a Euro exit although the likelihood will increase. Syriza's rhetoric is indeed aggressive but we do not expect the 'full attack' mode to continue post-elections. Syriza will propose a coalition government with the Democratic Left and Communist parties along with any other parties willing to follow its agenda. The most realistic scenario would be a coalition with the Dem Left and if needed (if insufficient MPs to form a majority) with PASOK or the Independent Greeks.
- Negotiations under Syriza will last longer - than under the New Democracy-lead scenario - which means that Greece will be once again under-represented at the Eurogroup meeting on the 21<sup>st</sup> June.
- A unity government is less likely under a Syriza win scenario however New Democracy would be willing to participate if Euro membership is guaranteed. The possibility of a grand coalition of Syriza-New Democracy only is regarded as extremely low.
- It is worth noting that despite the recent rhetoric, no action will be taken before the 28<sup>th</sup> June as the parliament will be closed. As this date coincides with the EU summit (held on the 28/29<sup>th</sup> June), the new government will evaluate the reception from fellow member states in order to decide the next course of action.
- Market reaction: The fear of a possible Euro exit will increase on Monday causing a severe risk off move in the market. Core will rally possibly to new yield lows while Portugal and Ireland will be under extreme pressure and presumed to be next in line to abandon the Euro project after Greece. Spanish and Italian yield will be pushed to new highs and hence increase speculation for a full-sovereign bailout for Spain. However, a Syriza win will increase pressure on policy makers and central bankers generally to react and counter such an extensive hit on confidence.
- EUR/USD can be expected to drop rapidly, with a quick move to 1.20 probable. While there is uncertainty about the eventual outcome, it seems likely that the EUR will continue to weaken at least until there is greater clarity. Other G10 currencies are also likely to decline against the USD and JPY, but this time should more than hold their own against the EUR.

**Chart C: Curve flattening to continue in case of Syriza-win**



Source: Bloomberg, LBWBM

**Chart D: 10yr ESP flirting with 7% - a positive result from Greece should reduce – in the s/t – pressure**



Source: Bloomberg, LBWBM

## Our expectations

- For the first time in decades, the election outcome is too close to call. New Democracy continues to have the upper hand and hence is marginally more likely to win. However, Syriza has developed a dynamism that cannot be ignored despite numerous mistakes from its party members (e.g. comments on utilizing Greek bank deposits for growth pushed a c. €10-15bn outflow since early May).
- A possible Euro exit could become the main market scenario on a possible Syriza win. However, such a decision will not be taken lightly by the new government and hence the uncertainty will carry on. Even if Tsipras' administration makes this decision, a referendum should be considered as the most likely avenue to rubber stamp the public's intention. However, according to the opinion polls the public remains strongly in favour of the euro membership even during these tough times.
- Regardless of the Greek election outcome, it is evident that the Eurozone has to lay a specific path to a banking union, fiscal union and eventually a political union. The 28/29<sup>th</sup> EU summit could prove the decisive meeting for the future of the Euro area as the pressure on Merkel et al to deliver is mounting. Project bonds, EIB recapitalization, the inauguration of a Eurozone deposit guarantee scheme and the creation of a common bank supervisory authority should be considered as the immediate steps to 'calm' the markets. The 'muddle through' approach has clearly failed as pressure on Spain intensifies and Italian yields have come under the spotlight.

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