

## Euro Area

### Greek Election: Clear Syriza Win, Difficult Negotiations Ahead

- **Syriza landslide paves way for difficult bailout negotiations.** According to an early Interior Ministry estimate, far-left opposition party Syriza clearly won the parliamentary elections, with 36.5% of the vote and 150 seats (out of 300), at the higher end of pre-election polls and at the cusp of an absolute majority. Syriza is therefore very likely to be the first non-mainstream party in the Eurozone to lead a government since the global financial crisis. Syriza's win was largely expected given its consistent poll lead, but its extent was not, and is a repudiation of the previous government's policies. Once a government is formed, difficult negotiations lie ahead to agree on a follow-up bailout with Greece's troika creditors. In our view, it is likely that an agreement will eventually be found due to the strong mutual incentives of the Greek government and its Eurozone creditors to avoid the worst-case scenarios of Greek government default or Grexit, but an agreement requires significant concessions by both sides, so the negotiations will likely be lengthy and could fail.
- **Several options for potential Syriza coalition partners, if needed.** The New Democracy Party of PM Samaras came second with 27.7%. Far-right Golden Dawn came third with 6.3% of votes, ahead of new centrist Potami at 5.9%, the Communist Party with 5.6%, junior coalition party PASOK with 4.8% and the Independent Greeks at 4.7%, with the new centre-left Movement of Democratic Socialists probably short of the 3% threshold for entering parliament. A moderate coalition partner (such as Potami or PASOK) would make it easier for a new Syriza-led government to find a compromise with the troika, while a coalition with the anti-bailout Independent Greeks or a Syriza majority government could further complicate negotiations, in our view.
- **Next steps.** Syriza leader Tsipras will be given a three-day mandate today or tomorrow to form a government. The Eurogroup on January 26 will discuss an extension to Greece's bailout (which expires at end-February), but a formal request for such an extension by the Greek government is required before it can be approved. Negotiations over a follow-up bailout may well take months, in our view, and be associated with some financial market volatility. In this context, it is worth noting that even though an eventual agreement on a bailout is likely needed to keep Greek banks and the Greek government funded, buffers exist to potentially address funding pressures in the interim, such as emergency liquidity assistance for Greek banks or increased bill issuance or arrears for the Greek sovereign.
- **Contagion to be limited, but political risks are rising in the Eurozone.** Many aspects of the Greek situation are unique and we expect the direct implications on other Eurozone countries to be limited in the near term, particularly as the recent ECB's QE announcement probably mutes a potential risk-off move. However, Syriza's victory and its explicit radical orientation will likely lead to wider concerns about Eurozone political risks, and the rise of non-mainstream parties.

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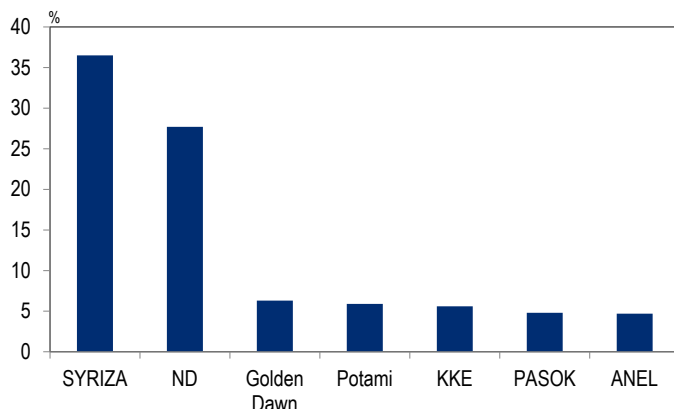
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## Syriza Landslide Win in Greek Election

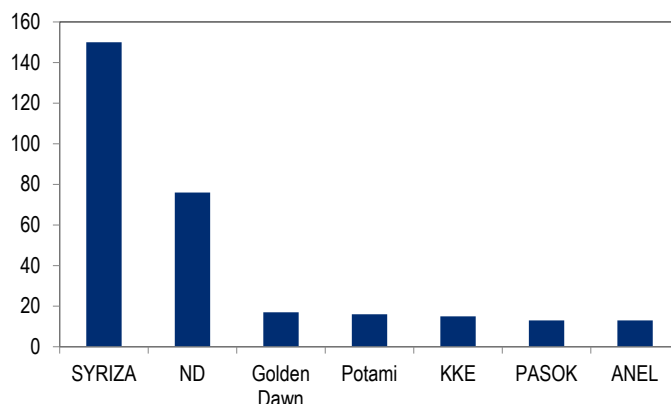
Figure 1. Greece – Vote Shares (%) in 2015 Parliamentary Election



Note: ND is New Democracy, KKE is the Communist Party of Greece, and ANEL the Independent Greeks.

Source: Greek Interior Ministry and Citi Research

Figure 2. Greece – Number of MPs in New Parliament



Note: ND is New Democracy, KKE is the Communist Party of Greece, and ANEL the Independent Greeks.

Source: Greek Interior Ministry and Citi Research

Greece's early parliamentary elections January 25<sup>th</sup> - the first of 7 EU elections in 2015 - have sparked revived market fears over "Grexit" and the potential for a return to wider Eurozone political risk. The longstanding polling lead of SYRIZA, (which stands for Coalition for the Radical Left) Greece's fragmented political landscape, featuring a large number of new and in some cases extreme political parties - and deep antipathy toward the mainstream parties that have ruled for the past several decades - as well as the election campaign's strong focus on Greece's debt burden and relationship to its creditors have exacerbated market concerns.

We stress that Grexit is not our base case scenario ([Euro Economics Weekly - Is Grexit Risk Back?](#)), even in the case of a Syriza majority or coalition government. We further highlight that the incentives of both the new Greek government and Eurozone creditors to keep Greece in the Eurozone are very high. For the creditors, the desire to avoid Eurozone exit by any member country remains high and any further loans extended to Greece are mainly to repay previous bailout loans. For the Greek government, the risks and uncertainties in a Grexit scenario are very large and an overwhelming majority of the Greek population favour continued Eurozone membership (around 70% of the population according to recent opinion surveys).

Once in office, we expect that Syriza will continue to moderate its policy stance (particularly on the issues of debt relief through face value haircuts), as it has in the run-up to elections, shifting its focus toward Greece's ruling elites and corruption concerns. Reform prospects under a Syriza-led government are, however, limited in our view, and it remains unclear if the new Greek government will have any fiscal breathing room to implement its desired increases of social spending. Disagreements about fiscal plans and structural reforms will likely imply that negotiations over a follow-up bailout can take months.

Tsipras's Syriza is a new and therefore untested political entity, but some observers have noted the numerous historical examples, particularly on the Left, of so-called "firebrand" political leaders who have moved toward the center once in office. Brazil's Lula Ignacio da Silva, a former labor organizer, is one such notable example, and in the Greek context, the example of former PM Andreas Papandreou is sometimes cited.

However, the fragmented Greek political landscape and scale of popular discontent with both the political class and Troika austerity policies warrant close attention. With this in mind, any new Greek government will face significant challenges in balancing the likelihood of limited if any change in the terms of the Troika agreement, and popular discontent with austerity in our view. Such tensions could well shorten the lifespan of any new Greek government, and see a return to new elections before the current term has ended. In this event, new elections would potentially take place in more fraught circumstances, raising the risk of even stronger performance by non-mainstream political parties.

Current pressures revolve around the bailout timeline and funding pressures for the Greek government and Greek banks. The current bailout expires at end-February and at end-December, Greek banks received €65bn of ECB funding, which is in part linked to the existence of a bailout. The Greek government probably needs to raise at least €8bn in 2015, with the major debt maturities (€7bn of ECB-held bonds) in June/July. We note that a bailout extension of up to six months will probably be considered, and that interim arrangements for Greek bank and government funding (emergency liquidity assistance for the banks and increasing arrears or bill issuance for the government) are potentially available.

Syriza's victory and its explicit radical orientation will likely also lead to wider concerns about Eurozone political risks, and the rise of non-mainstream parties, a phenomenon we have long documented as a manifestation of Vox Populi Risk (see [Citi GPS: TAKING IT TO THE STREETS - What the New Vox Populi Risk Means for Politics, the Economy and Markets](#)) as the rise of so-called NEAPs (New/Extreme and/or Alternative Parties).

In Europe the support for non-mainstream parties has continued to increase despite the recovery. In fact, support for NEAPs is growing, not only in other Eurozone countries like Spain, where new far-right Podemos continues to climb in the polls, but in countries with experiencing more robust growth such as the UK and Germany.

In our view, Greece is the only EU country this year that is likely to see a non-mainstream party emerge as the majority party. But the new government's balancing act with the country's creditors will be watched closely not only by Greek citizens discouraged by austerity and the consequences of an economy that has contracted by 25%, but by other EU political hopefuls keen to take on the political establishment. With other highly-indebted Eurozone countries including Spain and Portugal soon to go to the polls, and Ireland and Italy watching in the wings, Syriza's ability to achieve these outcomes, or failure, will bear implications across the Eurozone.

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