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Greece: Too much damage done?

Despite winning a parliamentary confidence vote on Friday, PM Papandreou has been forced by political pressure to cede power, with it looking as if a government of national unity will be formed, led by a technocrat such as ex ECB VP Papademos. The hope is that it will start to implement the € 130 bln bailout plan agreed at the EU Summit at end of October and then take the country to elections, most likely in February.

It therefore appears that a five-day political standoff may have been resolved, or at least some time has been bought back. Regardless, it is still somewhat unclear whether the country is committed to carrying out fiscal and structural reforms agreed with the EU and IMF: the opposition (New Democracy) party could quite easily revive demands that the bail-out details are renegotiated, with the prospect of elections in the new year hardly likely to lead to a new government with clear mandate or quell public protests in regard to reform and/or austerity. Notably, lasting damage may have been done: the possibility of Greece leaving the euro remains evident with the country likely to find it difficult to shake off the spectre of this possible threat now that politicians elsewhere in the Eurozone have openly pointed to such a development.

In addition, the Greek stand-off last week, and the seemingly similar political impasse in Italy, clearly hardly helped the mood at the G20 meeting last Thursday/Friday where (crucially) there was no progress in vamping up the EFSF or persuading foreign investors to stump up fresh cash. However, it seems that the G20 may try again. Indeed, press reports suggest that another G20 Summit may be held in the near future, rather than awaiting the next scheduled gathering set for next February, with the hope of cobbling together resources that may help contain the Greek situation. Markets, however, are worried that the damage may have been done, with the risks of contagion growing given worries that Italian PM Berlusconi may narrowly hang onto power or trigger a snap election only adding to the pressure on peripheral bond markets.