

Markets could stumble after France, Greece votes

By DANIEL WAGNER, AP Business Writer – 2 days ago

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WASHINGTON (AP) — Financial markets will likely stumble this week after elections in Greece and France cast a pall of uncertainty over Europe's efforts to solve its debt crisis.

On Sunday night, the euro plunged to \$1.2988, a nearly five-month low.

Greek voters on Sunday voted mostly for two parties that want to change the nation's international bailout terms or even overturn its rescue deal, according to early projections of the election results. Greece won't have a government until parties with divergent worldviews can form a governing coalition.

Greek voters are reacting against spending cuts imposed on the recession-weary nation by the international lenders whose bailouts are keeping it afloat.

Also Sunday, French President Nicolas Sarkozy lost in a runoff election to Socialist candidate Francois Hollande. Hollande has criticized France's austerity program and wants to encourage growth by boosting government spending.

Sunday's votes raise serious doubts about whether voters will swallow the current plan of international bailouts coupled with severe cost-cutting, economists said.

Many believe the austerity program is necessary to keep bond investors from panicking about the possibility that more European nations will default or require bailouts. But a growing number, like Hollande, say the cuts have been too much, too fast. They say the region's economy can't return to growth unless governments stop tightening the fiscal noose and start spending again to create demand.

Uncertainty about the path forward in Europe may mean a return to extreme market volatility after several months of relative calm.

Here's a look at what Sunday's elections might mean for global investors.

GREECE

— How much does it matter?

A great deal. The financial mess in Greece has rocked financial markets for years. To stay afloat, Greece's government depends on loans from international creditors, and it must meet strict targets on cuts if it wants to keep receiving money. But Greek voters elevated two parties that rejected terms of the bailout. If Greek leaders refuse to stick to terms of the bailout deal, the International Monetary Fund may pull the plug on supplying funds.

"Given the degree of uncertainty that is going to enter Greek policymaking after these elections, I suspect the prospects of Greece being able to undertake serious reforms has been reduced even further," said Cornell University professor Eswar Prasad.

— Best-case outcome: Greek parties build a governing majority that negotiates successfully with international lenders. Greece's lenders will dial back some demands for austerity to quell political unrest and allow the Greek economy to recover. Greece will continue to use the euro.

— Worst-case outcome: Greece's new leaders are unable to find common ground with international lenders. The IMF pulls the plug on future bailouts and richer European nations refuse to step in. Greece defaults and leaves the euro currency or is expelled. There is panic among holders of bonds issued by other financially troubled countries, creating a cascade of defaults and requiring more bailouts.

— Market outlook: It could take weeks for Greece's political parties to form a governing coalition, experts said. And the country is expected to take yet more austerity measures in June. Parliamentary developments will likely drive trading in the coming weeks, especially if investors begin to fear that a new government is unstable and the bailout program at risk.

Yet even if Greece defaults and leaves the euro, the impact on international markets might be small, said Jacob Kirkegaard, a research fellow at the Peterson Institute for International Economics. Bond investors already know that Greece is in a fiscal mess, and have marked down the value of their holdings, he noted.

"It wouldn't be without waves, but it would be a manageable situation," Kirkegaard said.

FRANCE:

— How much does it matter?

Experts disagree. Some say Hollande emphasized his differences with Sarkozy for political reasons, but will pursue a similar path of budget cuts once he takes power. Others believe Hollande's strong rebuke of the austerity plan could change the minds of European politicians currently focused on deep cuts to spending on social welfare programs and worker benefits.

— Best-case outcome: Hollande teams up effectively with German Chancellor Angela Merkel, who has led the crisis response with Sarkozy. His proposal to soften austerity measures is embraced by France's parliament and bond investors, allowing France to balance its budget on a slower schedule. His view that government spending will combat the recession proves accurate, other nations follow suit and Europe returns to growth in the next couple of years.

— Worst-case outcome: In parliamentary elections next month, French voters elevate far-left politicians. To assuage them, Hollande boosts spending sharply and rejects austerity and other reforms aimed at stabilizing France's debt load. France falls deeper into debt and faces further downgrades by credit rating agencies. Renewed fears about a French default kick off a fresh wave of crisis fears, destabilizing global markets.

— Market outlook: Hollande's ability to reshape French and European policy hinges heavily on the upcoming parliamentary elections. Markets are unlikely to react strongly to his election until they have a clearer sense of what Hollande will be able to do, experts said. But traders will want an answer soon, said Cornell's Prasad, who studies trade policy.

"I don't think markets have the patience to string this out until summer," he said. If France's finances appear less stable, traders would have one more reason to abandon stocks and other risky investments.

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French president-elect Francois Hollande and his companion Valerie Trierweiler wave to supporters after greeting crowds gathered to celebrate his election victory in Bastille Square in Paris, France, Sunday, May 6, 2012. France handed the presidency Sunday to leftist Hollande, a champion of government stimulus programs who says the state should protect the downtrodden - a victory that could deal a death blow to the drive for austerity that has been the hallmark of Europe in recent years. (AP Photo/Francois Mori)

Map

