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Greek stocks sink, bond yield surge threatens bailout exit

By Marius Zaharia

LONDON, Oct 15 (Reuters) - Greek stocks posted their biggest one-day loss since the height of the euro zone crisis on Wednesday, while bond yields soared to levels that may threaten government plans to quit an international bailout a year early.

Ten-year borrowing costs shot up by more 80 basis points to 7.85 percent, their highest since February, partly reflecting a lack of faith in Prime Minister Antonis Samaras' ability to ensure Greece can fund itself in the market.

Investors also fretted about a possible snap election in a country that has been at the heart of the euro zone debt crisis since 2010, when the first of its two international bailouts -- together worth 240 billion euros -- was agreed.

"Investors are worried that Greece cannot survive alone ... At this level the market is closed for Greece," said Alessandro Giansanti, senior rate strategist at ING.

The Athens stock market plunged 6.8 percent to 884.06 and was on track for its biggest one-day loss since July 2012. Shares have lost 11.5 percent in the past two days, their biggest fall since October 2008.

In seeking to end the unpopular bailout early, the under-pressure Samaras hopes to revive his political fortunes enough to remain in power beyond the first quarter of next year.

Lacking sufficient support for his nominee in a presidential vote in February, he faces the prospect of early elections which recent opinion polls show are likely to be won by the leftist anti-bailout Syriza party.

Investors fear that without the constraints of an aid programme, Europe will have less control over government policy and Greece could squander the progress it has made in curbing its budget deficit and ending a six-year-long recession.

Political deadlock could block further reforms, while a shift towards the radical left would bring policy uncertainty -- something bond investors dislike.

Government officials said on Tuesday that plans in the draft 2015 budget to issue seven- and 10-year bonds next year remain in place.

THE 7 PERCENT

Market concern over Greek borrowing costs have grown as they have approached 7 percent, though analysts say this does not necessarily mark the tipping point beyond which the costs of servicing its debt would become unsustainable.

Indeed, some analysts argue that Greece's debt of over 1.7 times economic output would be impossible to roll over even at lower cost. The European Union charges only 1.5 percent interest on its loans and Greece is still expected to initiate talks over some form of debt relief in the near term.

But charts show that any rise in yields has historically picked up pace above 7 percent and forced countries such as Ireland, Portugal and Greece itself to seek bailouts. Only the European Central Bank's promise in 2012 to do "whatever it takes" to save the euro prevented Spain and Italy having ask for financial help when their yields topped 7 percent.

"With yields above 7 percent we are back in that very dangerous area again," Eleni Dendrinou-Louri, professor at Athens University of Economics and Business and a former deputy governor at the Bank of Greece, said in a speech in London.

"I believe that if you can borrow from the market is decided by the spreads that you see every day on the screen."

As Greek yields soared, German 10-year borrowing costs plunged to record lows as investors fretting about faltering global growth shed risky assets and sought shelter in top-rated government bonds.

As a result the Greek yield premium over the euro zone benchmark reached 710 bps, its widest since January.

WRONG TRAJECTORY

If Greece were willing to borrow from the market at current yields, some investors may be interested in returns that are not available on many other assets. But the market would have to stabilise first.

"Right now it's not necessarily the level so much as the trajectory of yields," said Robert Tipp, chief investment strategist at Prudential Fixed Income, which holds Greek bonds. "The political backdrop is a real problem ... (and) not having the discipline and the support of the programme is a loss."Greece did sell bonds to private investors earlier this year, making one of the fastest market comebacks by a sovereign that had defaulted, with a sale of five-year bonds that drew strong bids and was considered a great success.

Some of the investors that bought then say they would be unwilling to participate in other auctions, however.

Martin Wilhelm, founder of IfK, a bond boutique based in Kiel, Germany, which runs a bond fund with Acatis, said that when the five-year debt was offered, the price was attractive because investors were still reluctant to buy.

"When you buy when the market is anxious you can make money. Now you can only make money on the fundamental story and we don't like the fundamental story."

(Additional reporting by Lefteris Papadimas; Editing by Catherine Evans)

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