Sovereign debt fears signal new stage of global crisis

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Stock markets in Europe and Asia fell sharply Friday in the second day of a near-panic selloff fueled by fears that the debt crisis facing weaker European economies will throw the world economy into a "double-dip" recession.

Commodity prices—oil and gold, in particular—also fell sharply.

In the US, triple-digit losses on the Dow Jones Industrial Average were recouped in the final hour, resulting in small gains for the Dow and the other major indexes in volatile trading, following a sharp selloff on Thursday.

The Dow ended the day with a 10-point gain, following a 268-point plunge on Thursday. The index, which was below the 10,000 mark for most of the day, has lost 6.5 percent over the past two weeks.

All of the major European indexes closed down, with France's CAC-40 falling the most—3.4 percent, its biggest one-day drop since November 26. The Pan-European Dow Jones Stoxx 600 Index was off 2.2 percent, its lowest close since November 3.

Japan's Nikkei fell 2.89 percent and the Shanghai Composite was off by 1.87 percent.

Stocks were down for the second day in Greece, Portugal and Spain, three heavily indebted eurozone countries whose ability to redeem bondholders—including major European and US banks—is increasingly in doubt. Prices of government bonds of all three countries continued to fall and interest rates rose further, as global investors increased pressure on the three governments to impose draconian austerity measures on their respective populations.

The cost of credit default swap (CDS) contracts on the debt of the three countries rose even more dramatically. Credit default swaps—now a multi-trillion-dollar market—are a form of unregulated derivatives in which CDS sellers guarantee the value of bonds held by CDS buyers. Rising CDS prices reflect eroding confidence in corporate or government bonds insured by the sellers of the CDS contracts.

The CDS market is a hotbed of speculation, since investors, including banks and hedge funds, can bet on the price of CDS contracts without holding the underlying bonds. The threat of sovereign default, most immediately by Greece, but also by Portugal and Spain, has provided an opportunity for speculators to drive up the price of insuring the countries' bonds by speculating on the likelihood of a default, thereby further undermining confidence in the countries' debt and increasing the prospects of such an outcome.

All three countries have pledged to impose sweeping cuts in public-sector jobs and wages and in social benefits, along with new consumption taxes, in line with demands from the European Union that they sharply reduce their budget deficits, currently 10 percent or more of their respective gross domestic products.

Greek President George Papandreou of the social-democratic PASOK party, who was elected last year on the basis of promises to reverse the right-wing policies of the preceding conservative government, this week announced plans for an across-the-board freeze on public sector wages along with a cut in allowances, which amounts to a wage cut of 4 percent. He also called for a pension "reform," which entails raising the retirement age, as well as higher fuel taxes.

The social-democratic Portuguese and Spanish governments have pledged to impose similar austerity measures.

Signs of mounting resistance by the working class in these countries are playing an enormous role in the tremors rippling through the global financial markets. There is a growing sense in governments and board rooms around the world that a major confrontation with the working class is coming, with potentially revolutionary implications.

The banks and the media are demanding that heads of state and parliaments demonstrate the "political will" and "political consensus" necessary to impose historic attacks on the working class. These phrases are euphemisms for a degree of ruthlessness that implies a readiness to employ state repression. However, the financial markets are at once skeptical over the willingness of political leaders to employ the required measures and anxious over the outcome of such a confrontation.

On Thursday, Greek workers launched the first in a series of strikes to protest the government's austerity package. Customs and tax officials began a 48-hour strike that shut ports and border crossings throughout the country. Strikes by other public and private-sector workers have been called for next week.

Greek farmers have been blockading highways in protest against government austerity proposals.

A major cause of the global stock selloff that began Thursday was the announcement by the Greek unions of a one-day general strike set for February 24. The unions had initially indicated their willingness to assist the PASOK government in carrying out its austerity plans, but have been forced by pressure from the working class to call the strike actions.

Union leaders hope to use the partial labor mobilizations to defuse popular anger and channel it behind nationalist slogans, while they maneuver to work out a deal with the government acceptable to the banks and the European Union. However, there are fears within ruling circles that the unions may not be able to contain the anger of workers and young people, who are already facing mass unemployment and declining living standards.

Portuguese and Spanish unions are also threatening to call strikes and protests.

Among other factors that precipitated the stock selloff was the failure of the Portuguese government to find buyers for the full amount of a government bond offering on Wednesday, and the defeat of its austerity package at the hands of opposition parties in parliament.

The debt crisis of the weaker countries in the 16-nation eurozone, including Ireland and Italy in addition to Greece, Portugal and Spain, is raising questions about the viability of the euro itself. There is increasing public speculation that the 11-year-old currency could collapse under the pressure of the economic and financial crisis.

In recent weeks, the euro has fallen precipitously against the US dollar and the yen. On Friday, it fell to $1.3620. It has declined 9 percent against the dollar since December.

This does not reflect any inherent strength of the US currency. On the contrary, looming above the debt crisis in Europe is the far greater crisis of the world's biggest debtor—the United States. It is no accident that the European crisis has erupted in the aftermath of last week's budget announcement by President Obama. The US budget plan revealed that the current deficit is $1.6 trillion, equivalent to 10.6 percent of the country's' gross domestic product, a record high since the end of World War II.

This approaches Greece's deficit ratio of 12.7 percent of GDP, is higher than that of Spain and twice the eurozone average. The US budget, moreover, projects trillion-dollar deficits for years to come.

As in every other industrialized country, the American state responded to the financial crash of 2008 by taking on the debts of its banks and essentially bankrupting its treasury in order to preserve the wealth of its financial elite. The Obama administration, no less than the governments of Europe, is demanding that the cost be borne by the general population in the form of sweeping cuts in basic social programs and a reduction in consumption—i.e., a permanent and dramatic decline in working class living standards.

Unlike in previous international financial crises, such as the Asian debt crisis of the 1990s, the United States cannot play the role of lender of last resort. The United States has irretrievably lost its previous position as the dominant world economic power, and its decline is reflected in growing challenges to the role of the dollar as the world reserve and trading currency.

At last month's World Economic Forum in Davos, French President Nicolas Sarkozy in his keynote speech said he would use his upcoming presidency of the Group of 20 nations to push for a new international monetary system in which the dollar would no longer be the primary reserve currency. And on Wednesday, Moody's Investors Service warned that the United States faces the loss of its triple-A sovereign credit rating unless Obama moves to slash the federal deficit by carrying out more draconian spending cuts than he has thus far announced.

It is the erosion of US economic power and solvency that lends to the sovereign debt crises in Greece, Portugal and other European countries such an explosive and universal character.

The recent rise in the dollar is the result of a "flight to safety" by investors who fear a collapse in world asset bubbles and consider US Treasury bonds, along with German government debt, to be a temporary haven. In important respects, the short-term reversal in the dollar's decline is an expression of a deepening of the crisis on world financial markets.

As a number of economists warned last year, the US policy of flooding financial markets with cheap credit on the basis of near-zero interest rates and the electronic equivalent of printing a trillion dollars—designed to prop up the major US banks and enable them to record bumper profits despite double-digit unemployment—fueled a huge wave of speculation on risky assets such as stocks, bonds, commodities and currencies. These economists predicted that a major rise in the value of the dollar would pull the rug out from under this speculation, which was based on the assumption of a continued decline in the dollar, and force a rapid and destabilizing selloff of inflated assets.

It now appears that this collapse in asset bubbles has begun.