World markets plunge as Greek credit downgraded to “junk” status

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Stock markets in Europe, the US, and other regions closed sharply lower yesterday after ratings agency Standard & Poor’s downgraded its sovereign credit rating for Greece to “junk” status and also lowered Portugal by two notches. The downgrades reflected growing fears that the southern European governments will prove unable to implement promised austerity measures in the face of determined domestic opposition, raising the danger of the sovereign debt crisis spreading to the world’s major economies.

World markets were reportedly surprised by S&P’s decision to downgrade Portugal, but only plunged after the announcement was made on Greece. In Europe, the euro lost more than 1.5 percent against the US dollar, dropping below $1.32 to its lowest in more than 12 months. The pan-European Stoxx Europe 600 dropped 3.1 percent. The British FTSE 100 and German DAX finished 2.6 and 2.7 percent lower respectively, despite better than expected corporate reports from Deutsche Bank and BP. In France, the CAC-40 lost 3.8 percent.

Sharper losses were recorded in the eurozone economies now under pressure from world markets—Greece’s ASE equity index dropped 6.7 percent to a new one-year low, Portuguese markets fell 5.4 percent, Irish by 4.5 percent, and Spanish by 4.2 percent.

In the US, the Dow Jones industrial average closed 1.9 percent lower, and the S&P 500 index lost 2.3 percent, while the Nasdaq composite index dropped 2 percent. Commodities, including oil, lost value as investors favoured gold and treasuries. The Vix index—which measures expected equity market volatility and is often described as the “fear index”—leapt 31 percent, its sharpest single-day increase since the Lehman Brothers collapse in October 2008.

The MSCI Emerging Markets Index fell 2.1 percent, with Brazil and other Latin American markets among the hardest hit. In Asia, the Shanghai Composite index lost 2.1 percent, finishing at the lowest level since last October. Japan was one of the few major economies to yesterday record a modest stock market gain of 0.4 percent.

S&P downgraded Portugal from A+ to A-. In a statement, the ratings agency explained: “Fiscal and economic structural weaknesses in our view leave the Republic of Portugal in a comparably weak position to address the significant deterioration in its public finances and expected lacklustre economic growth prospects over the medium term.”

S&P complained that the country’s “rigid labour market” could “prolong the adjustment in wages we view as necessary to regain external competitiveness”. It added that the government had committed to only “limited [deficit] consolidation measures in 2010”, and that even with these initial austerity measures, “there is implementation risk”.

The Greek economy’s long-term sovereign credit rating was lowered from BBB+ to BB+, and its short-term rating from A-2 to B. S&P explained: “The negative outlook reflects the possibility of a further downgrade if the Greek government’s ability to implement its fiscal and structural reform program materially weakens in our view, undermined by domestic political opposition at home or by even weaker economic conditions than we currently assume.”

The ratings’ agency added: “We believe that the dynamics of this confidence crisis have raised

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uncertainties about both the government's administrative capacity to implement reforms quickly and its political resolve to embrace a fiscal austerity program of many years' duration... The government's resolve is likely, in our opinion, to be tested repeatedly by trade unions and other powerful domestic constituencies that will be adversely affected by the government's policies."

The entire Greek working class is to be "adversely affected" by the measures being implemented by the government of Prime Minister George Papandreou. Despite the treachery of the trade unions, which are doing everything in their power to prevent the emergence of a political movement aimed at bringing down the government, working people are increasingly determined to oppose being forced to pay for a crisis not of their making.

Yesterday's Greek credit downgrade coincided with the announcement of the date for the country's next general strike—May 5. The 24-hour action is to include members of the private sector union GSEE and the public sector union ADEDY. Together the two organisations cover about 2.5 million workers, half the working class. Next month's general strike will be the third staged this year.

Strikes in particular sectors are continuing with greater frequency. On Monday, dock workers established pickets at several ports in protest against the government's shipping reforms, which are aimed at driving down labour costs. Yesterday, public transport workers in Athens halted buses, trams, and metro transport for six hours. Their Portuguese counterparts struck at the same time, with most trains, buses and ferries stopped in Lisbon and Porto. About 20,000 train conductors, engineers, bus drivers and ferry operators were involved in the action, protesting the public sector pay freeze imposed by the social democratic government of Prime Minister José Sócrates.

The class struggle in the southern European countries is intensifying amid heightened speculative activity on the world's financial markets. Carlos Andrade, chief economist at Portugal's Banco Espirito Santo, insisted that Portugal was not on the verge of default and was instead a victim of speculation driven by the situation in Greece. "The spreads [value of Portuguese bonds] don't reflect the country's economic fundamentals," he told the Associated Press. "They reflect market speculation. It's a problem of contagion."

The Greek and Portuguese credit downgrades immediately make it more costly for their governments to raise money from international investors to cover budget deficits, thereby heightening the risk of default. Greek 5-year bond yields yesterday hit 10.6 percent. The BBC noted that this figure is higher than that of many "emerging market" economies, including Ecuador at 10.5 percent and Ukraine at 7.1 percent. Standard & Poor's yesterday declared that debt holders could expect to recover only 30-50 percent of what they are owed in the event of a Greek debt restructuring or payment default.

The German government is continuing to insist that the Greek government provide detailed long-term plans for even deeper austerity measures before it will release funds from a €45 billion ($US60 billion) rescue package. According to media reports, negotiations between Athens, the EU, and the International Monetary Fund on the terms of the emergency payment are due to be completed by May 2. Then a May 10 summit of eurozone heads of state and government is scheduled to reach agreement ahead of the May 19 deadline for Greece to make payment on a large portion of its debt. According to the *Financial Times*, the IMF is considering an additional €10 billion amid concerns that the initial sums discussed may not prevent an even worse crisis.

"The biggest risk now is that the market speculates against every single indebted peripheral country, and that could lead to a sovereign debt crisis," Axel Botte, a fixed-income strategist at AXA Investment Managers in Paris, told *Bloomberg*. "The contagion risk is real."

Fears are mounting about Spain, Europe's fifth-largest economy, which is among the most severely indebted. However, none of the advanced capitalist countries is immune. The *New York Times* yesterday noted: "Some even worry that the next debt crisis may materialise closer to home—in the United Kingdom or even the United States, where budget deficits and debt burdens are growing."

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