Global markets plunge as eurozone crisis deepens

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Global markets yesterday plunged for the third day in a row as concerns grow that the eurozone crisis is threatening the stability of the entire international financial system.

A day of sell-offs, starting in Asia, concluded with Wall Street's Dow Jones index falling 376 points, a drop of 3.6 percent, amid expectations that the plunge will continue when markets open today. The cumulative three-day fall on Wall Street is 825 points.

The market is approaching levels reached during the so-called "flash crash" of May 6, when it plunged by 1,000 points in less than 20 minutes. That plunge was initially put down to a "fat finger" error—incorrect data being typed into a computer trade—but an investigation by the Securities and Exchange Commission has found no evidence of such an event.

According to one financial trader cited by Reuters: "The primary mover [in the Wall Street fall] is coming from Europe. There are still fears of a debt crisis over there and the fact that it could spread to the banking system."

Federal Reserve governor Dan Tarullo told the US Congress that as a result of the eurozone crisis US banks could "pull back on their lending, as they did during the severe financial market dysfunction that followed the bankruptcy of Lehman Brothers". He noted that 10 large US banks have $60 billion in exposure to European countries, an amount equal to 9 percent of their tier one capital, a key measure of their financial strength.

With the temporary boost to the markets provided by the European Union's €750 billion ($US1 trillion) rescue package having completely dissipated, Tarullo said investors were "aware that this package cannot ultimately relieve the need for real, and likely painful, fiscal reforms in the euro area".

There are fears that the demands of the German government of Chancellor Angela Merkel to impose severe penalties on eurozone members that do not maintain tight fiscal constraints could deepen the already significant divisions in the monetary union.

Those divisions became apparent in the behind-the-scenes wrangling that preceded the announcement of the EU rescue package on May 10 and came into public view with Germany's unilateral decision this week to ban "naked short selling"—the practice in which banks and hedge funds sell bonds they either do not own or have not borrowed, hoping to create a fall in the market from which they can then profit by buying the bonds they previously sold.

Defending the move in an interview with the *Financial Times*, German finance minister Wolfgang Schäuble said that while debt had to be brought under control, there also had to be tougher regulation of financial markets. "I'm convinced the markets are really out of control. That is why we need effective regulation, in the sense of creating a properly functioning market mechanism," he said.

Later, when asked about the opposition in financial markets to the move, Schäuble told reporters: "If you want to drain a swamp, you don't ask the frogs for an objective assessment of the situation."

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These measures, which in themselves will do little or nothing because they can be easily circumvented, have only increased market turbulence because they have also underscored the divisions among the European powers.

One British official was reported to have described the ban as “crackers”. Earlier, French finance minister Christine Lagarde said the move was “debatable, because there was no prior discussion”. She insisted that the euro was not in danger despite Merkel’s warnings that the euro remained under threat and the bailout package could only bring a temporary respite.

Merkel’s comments on the dangers to the euro brought a bitter response from other European leaders. Luxembourg prime minister Jean-Claude Juncker, who chairs meetings of the eurozone finance ministers, said: “In my opinion, certain people would do better to think before they speak … sometimes they would do better to keep their mouths shut.” He later insisted his comments were not directed at Merkel.

Yves Leterme, the Belgian prime minister, was more direct: “We finalised an agreement to defend the euro. We cannot, like Madame Merkel, call into question its feasibility.”

Besides its impact on the US, the euro crisis is stoking fears in China and the rest of Asia of a significant economic downturn. Qi Zhongyi, the director of the information department of the China chamber of commerce for the import and export of machinery and electronic products, told the *Financial Times* that many Chinese companies had suffered “huge losses” because of the 14.5 percent decline of the euro against the renminbi so far this year. He said while a full investigation had not been carried out, the losses were not confined to machinery and electronics exports.

The EU is China’s biggest export market, accounting for 19.7 percent, or $236 billion of its exports last year. The sharp decline of the euro completely disrupts the US plan to try to secure a revaluation of the Chinese currency to improve its own trade position.

There are also fears that by cutting growth, the European crisis will severely affect the profits of resource companies selling to China. Tom Albanese, the chief executive of the mining giant Rio Tinto, has said he fears a rerun of the crisis of 2008 when the seizing up of credit markets had a major impact on Chinese growth in the fourth quarter.

These concerns are reflected in the “sell Australia” wave that has ripped through financial markets, leading to a plunge in the Australian dollar. The Australian currency has fallen to US82.5 cents, compared with US90 cents last week and US93 cents at the end of last month. Because its fortunes are so closely tied to the Chinese economy and its demand for industrial raw materials, the Australian dollar is often considered a bellwether for risk. Its precipitous decline in the past 10 days is a sure sign that global financial and economic risks are rapidly rising.

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