European markets, banks staggered as Greece slides toward default

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The crisis of the common European currency and the region's banking system intensified Monday as fears mounted that Greece could soon default, with potentially catastrophic consequences for the European and global economy.

European stock markets fell sharply, with the shares of French banks taking a particularly severe hit, following major losses on Asian markets. Share prices also fell broadly in the so-called emerging economies. US stock markets swung wildly, ending the day with modest gains after rising more than 2 percent from their midday lows.

The broad sell-off followed precipitous falls Friday on the news that Jürgen Stark, a German member of the European Central Bank (ECB) governing board and the body's chief economist, was resigning in protest over the bank's policy of purchasing government bonds of highly indebted euro zone countries. The resignation highlighted bitter divisions over policy approaches to a sovereign debt crisis that is rapidly engulfing major banks and undermining the stability of the euro.

The shock of Stark's resignation was followed over the weekend by reports that the German government was working out plans to bolster German banks in the event of a Greek default, and an article in Monday's *Die Welt* by German Economy Minister Philipp Roesler rejecting any "taboos" in the effort to stabilize the euro.

Roesler, who leads the junior party, the Free Democrats, in the coalition government of Chancellor Angela Merkel and also holds the post of deputy chancellor, went on to say, "This includes, if necessary, an orderly bankruptcy of Greece, if the necessary instruments are available."

Roesler and the Free Democrats are openly at odds with Merkel, who has reluctantly supported the measures taken thus far by the European Union, the ECB and the International Monetary Fund (IMF) to bail out Greece and other highly indebted euro zone countries such as Portugal and Ireland. He and his party are in virtual rebellion over the more recent decision by the ECB—under intense pressure from the financial markets and backed by Merkel—to buy the government bonds of larger euro zone states such as Italy and Spain.

Roesler's article marked the first open suggestion by a high-ranking European government official of support for allowing Greece to default and leave the euro zone. It followed a turbulent week in which officials of the "troika" that controls the bailout fund for Greece—the EU, ECB and IMF—walked out of talks with Greek officials and demanded they impose new austerity measures to close a 2 billion euro gap in their deficit-reduction commitment in return for the next 8 billion euro installment of bailout cash.

The mass layoffs and social cuts imposed by the social-democratic PASOK government under the whip of the EU, ECB, IMF and the international banks have thrown the country into a deep recession, undercutting the efforts to reduce its budget deficit and debt in line with the targets imposed in return for the bailout. Last week the government said the economy would shrink 5.3 percent this year, more than the 3.8 percent forecast by the European Commission, and recent data shows that Greece's budget gap widened 22 percent in the first eight months of the year. The unemployment rate in June was 16 percent, up from 11.6 percent a year earlier.

Over the weekend, Greek Prime Minister George Papandreou made a speech in Thessaloniki to announce a new 2 billion euro across-the-board property tax to satisfy the demands of the "troika." The regressive tax will impose further hardships on already devastated homeowners. It follows recent measures to further slash public sector wage costs by cutting 20,000 more jobs and reducing civil servants' allowances.

Papandreou was guarded by some 7,000 police who used billy clubs and tear gas against 25,000 protesting workers and youth. Working-class anger is once again on

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the rise after two years of brutal austerity, with striking taxi drivers joined by dentists, doctors and other professionals protesting layoffs and cuts in wages, pensions, health care and other benefits. There is growing fear in Greek ruling circles that the trade unions, which back the government, may not be able to continue containing and suppressing working class opposition.

The "troika" is set to return to Greece Wednesday to decide whether the new measures announced by Papandreou warrant the release of the next installment of the bailout fund, without which Greece will be unable within a matter of days to pay its bills. The *Wall Street Journal* was cited Monday as the source of a statement by unnamed IMF sources that the 8 billion euro payment was likely to be approved.

However, that did little to calm the markets. The Stoxx Europe 600 index fell 2.5 percent following its 2.6 percent decline on Friday. The French CAC 40 index plummeted 4 percent as French bank stocks were particularly hard hit. The country's three largest banks—BNP Paribas, Credit Agricole and Societe Generale—all fell sharply, with BNP Paribas down 12 percent and the other two falling by more than 10 percent.

It is widely expected that Moody's Investor Services will downgrade the French banks later this week because of their large exposure to Greek government and commercial debt.

Other European bank stocks also fell sharply. Deutsche Bank dropped 7.3 percent and Commerzbank lost 8.3 percent. Royal Bank of Scotland shares declined 3.4 percent, Italy's Unicredit was down 11 percent and Spain's Banco Santander fell 4.7 percent. The National Bank of Greece lost nearly 8 percent.

The yields on Greek government bonds already correspond to a country that is on the edge of default. The interest rate on one-year Greek bonds rose above the 100 percent level Monday, essentially pricing in a near-certain default. Greece's two-year note yields jumped more than 12 percentage points to a euro-era record 69.55 percent, after climbing 9.9 percentage points last week.

In an article posted Monday, Bloomberg reported that Greece's chance of defaulting over the next five years has risen to 98 percent, according to forecasts based on the cost of credit default swaps on Greek sovereign debt. "It now costs a record $5.8 million upfront and $100,000 annually to insure $10 million of Greek debt for five years using credit default swaps, up from $5.5 million in advance September 9, according to CMA," Bloomberg wrote.

But the collapse of confidence in Greek debt is spreading more broadly across the European banking system and wreaking havoc on the euro. The common currency on Monday slipped to its lowest level against the yen since 2001 and fell to a seven-month low against the dollar.

Bloomberg wrote: "The risk of contagion beyond Greece pushed sovereign credit default swap prices to record highs across the euro region." It cited Suki Mann, a strategist at Societe Generale SA in London, as saying, "The contagion impact of a default will be severe, because next in the firing line will be Italy, Spain and it will take in the whole of the European banking sector too. This trio are already under intense pressure, but it will get much worse."

In a column published Monday in the British *Telegraph*, Ambrose Evans-Pritchard wrote of the statements coming from Germany on a Greek default: "If it is a pressure tactic to force Greece to submit to EU-IMF demands of yet further austerity, it may instead bring mutual assured destruction… We have never been so close to EMU (European Monetary Union) rupture."

Citing a report issued last week by UBS bank, he continued: "If a debtor such as Greece left [the euro zone], the new drachma would crash by 60 percent. Its banks would collapse. Switching sovereign debt into drachma would be a default, shutting the country out of capital markets. Exit would cost 50 percent of GDP in the first year."

On the implications of a fracturing of the European Monetary Union, he added, "Monetary unions do not break up lightly. The denouement usually entails civil disorder, even war."

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