European debt crisis sparks global sell-off on financial markets

Joseph Kishore
10 November 2011

The debt crisis in Europe, now centered in Italy as well as Greece, sent world markets tumbling Wednesday amidst fears of financial contagion and a sharp downturn in world economic growth.

Market pressure was focused on Italy, with investors insistent that Prime Minister Silvio Berlusconi step down to make way for a government better able to implement crippling austerity measures. Concerns that this was not happening quickly enough sent interest rates on Italian bonds soaring on Wednesday, surpassing 7.5 percent, a new euro-era high. (See, "Italian Prime Minister Berlusconi announces his resignation")

Moves by the major European powers to restructure the Greek government for a similar purpose appeared to falter on Wednesday as well, with the major parties in Greece failing for another day to reach agreement on a new prime minister. From the standpoint of the European banks, the central task of the new government, which will replace that headed by outgoing Prime Minister George Papandreou, is to force through an austerity program overwhelmingly opposed by the Greek population.

Stock markets in Europe were off about 2 percent on the day and interest rates for Spanish and French bonds soared on concerns that the debt crisis would spread beyond Italy.

In the United States, the Dow Jones Industrial Average dropped nearly 390 points, or 3.2 percent, with all 30 component stocks of the index suffering declines. The broader Standard & Poor's 500 index fell 3.7 percent.

Markets elsewhere in the Americas were also down between 2 and 4 percent.

Bank stocks were particularly hard hit on fears of exposure to European debt in the wake of the collapse of MF Global, a major US brokerage firm, due to bad bets on European bonds. The S&P financial index fell 4.4 percent. The cost of credit default swaps to hedge against the default of the debt of major US banks moved sharply upward.

There are already clear signs of economic slowdown in the United States, which remains plagued by the worst jobs crisis since the Great Depression. Last week, the Federal Reserve reduced its projection for economic growth in 2012 to between 2.5 percent and 2.9 percent, a percentage point lower than earlier estimates.

Europe is plunging into recession. The latest reports on manufacturing in the euro zone showed a pronounced deceleration and the new president of the European Central Bank, Mario Draghi, last week said Europe would fall into a "slight" recession this quarter.

Soaring Italian interest rates raised the concern Wednesday that Italy, the euro zone's third largest economy, would have to seek a bailout and that the existing bailout mechanisms would not be sufficient to the task.

Speaking in Beijing on Wednesday, International Monetary Fund Managing Director Christine Lagarde warned of the cascading impact of the euro crisis, in part to solicit Chinese contributions to the European Financial Stability Facility.

"If we do not act together," she warned, "the economy around the world runs the risk of a downward spiral of uncertainty, financial instability." She added, "Asia is not immune… Whether it is the trade channel or whether it is the financial sector which can operate as a crisis accelerator, Asia needs to be prepared."

Lagarde referred to "dark clouds gathering in the global economy" and warned of a "lost decade."

One concern cited by the *Financial Times* in a front-

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page article on Wednesday was that the financial crisis in Europe would create "a global wave of instability by sucking liquidity out of financial markets worldwide." A drying up of credit and seizing up of the financial system was last seen in the wake of the collapse of US investment bank Lehman Brothers in September 2008.

The *Financial Times* quoted Mark Carney, the governor of the Bank of Canada and chairman of the Financial Stability Board, the international association of regulators, who told an audience in London Tuesday, "As global liquidity recedes, volatility is increasing and activity falling. The effect on the real economy will soon be felt."

Pointing to the potential for a new financial breakdown three years after the crash of 2008, Scott MacDonald, an analyst at Alladin Capital Management, told Bloomberg: "There is a risk of contagion that sits there in the financial sector. If we have a big tumble here with Italy, it's going to cause a very steep recession in Europe and it will have ripples through interbank markets."

A withdrawal of credit would have international implications, including in Asia and Latin America. The *Financial Times* quoted Guido Mantega, the Brazilian finance minister: "We have to be worried about this because if it hits emerging nations then the international situation will get worse."

Over the past several years, Brazil and other so-called emerging markets have faced a sharp inflow of capital from investors seeking higher rates of return, prompted by the near-zero interest rate and cheap dollar policy of the US. This has led to surging currency valuations, which has hit exports. Now, the flow of cash threatens to reverse itself, sparking a banking crisis.

A withdrawal of credit from Asia could lead to a sharp economic slowdown. Recent data points a slowdown of manufacture in China, whose economy has been a major factor in sustaining world economic growth over the past three years.

The crisis in Europe is calling into question the future of the European Union and the euro currency. Reuters reported Wednesday that France and Germany are engaged in intense discussions over a "radical overhaul" of the EU, which would involve pushing countries like Greece out.

An unnamed senior EU official was quoted by the news agency as saying, "We have to move very cautiously, but the truth is that we need to establish exactly the list of those who don't want to be part of the club and those who simply cannot be."

In a column in Wednesday's *Financial Times* ("Thinking Through the Unthinkable") economic commentator Martin Wolf wrote: "Only the fear of the consequences of a break-up is now keeping [the euro zone] together. The question is whether that will be enough. I suspect the answer is no." The exit of Greece from the euro, however, created the risk of "blowing up the world," he said.

The capitalist powers, in fact, have no way out of the crisis. Attempts to cobble together a coordinated response, including the recent G20 meeting, have ended in failure, with deep divisions between different nation states over the allocation of the spoils and the costs of whatever action is taken.

The ruling classes of Europe and the United States are united on only one thing: that the working class must pay through the destruction of social programs and a drastic lowering of wages and living standards. Far from resolving the crisis, however, this only creates the conditions for a deeper economic downturn, while intensifying explosive class tensions are building up on a world scale.

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