

Euro crisis set to resume

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Last week the head of the European Central Bank, Mario Draghi told a German newspaper that while there were still risks, the worst of the euro zone crisis was over and the situation had stabilised. This rosy scenario is far from reality as concerns grow that a new round of the crisis may be set off by the worsening situation in Spain and Portugal.

In the short term, financial markets have reason to celebrate. The Greek bailout has meant that most of the debt contracted by the banks and other financial institutions has been transferred to the state, to be paid for by ever-deepening austerity measures imposed on the Greek people. In addition, the €1 trillion injected into the European financial system by the European Central Bank (ECB) has averted an immediate financial meltdown by providing banks with a lucrative source of ultra-cheap money.

However, no serious observer believes this policy has resolved any of the fundamental problems and may, in fact, be making them worse. Critics maintain that the bailout is leading to the creation of many “zombie” banks, which are completely dependent on the ECB for finance and are reluctant to provide credit either to each other or to businesses.

Portugal has carried out all the demands of the European Union in implementing an austerity program. Yet Portuguese 10-year bonds are still trading at interest rates of more than 12 percent, at least double the level considered sustainable.

Spain presents an even bigger danger. As the *Financial Times* noted, up until last week it might have been thought that the dangers of a Spanish debt default were receding. “That confidence,” it continued, “is already starting to evaporate. A growing chorus of

economists and analysts is warning that the Spanish economy—the euro zone’s biggest after Germany, France and Italy—is in much worse shape than markets might suggest.”

According to Citigroup chief economist Willem Buiter, Spain is “at a greater risk than before” of being forced to accept a debt restructuring. Such a move would pose a far higher threat to the European banks and financial markets than the Greek crisis.

Euro zone finance ministers are set to meet in Copenhagen at the end of the week to put in place a permanent rescue fund, but there are differences over the size of the so-called firewall. Reuters reported that a European Commission document had proposed increasing the available fund to €940 billion compared to the present €500 billion, with the aim of guaranteeing the stability of Italy and Spain. But Germany has reportedly ruled out the higher amount and a compromise of around €700 billion is expected to emerge.

Speaking at a conference in Frankfurt last week, German Finance Ministry official Ludger Schuknecht played down the idea of a “mega firewall” around the European financial system. Italy and Spain were “too big to be saved” by the rescue fund at present being contemplated, he said.

Today, *Financial Times* columnist Wolfgang Münchau warned that the planned European bailout fund is looking “more like a toy pistol than a ‘big bazooka’.” The planned European Stability Mechanism, which will make available around €500 billion, would be large enough to cope with small countries, but not Spain.

Fears about the stability of Spain's financial system saw interest rates on 10-year government bonds go above 5.5 percent last week—their highest level for more than two months.

The rate increase brought an immediate response from the EU commissioner for economic and monetary affairs, Olli Rehn. He said there was a perception in the markets that the Spanish government might not be fully committed to meeting deficit reduction targets previously set.

The EU has demanded that the Spanish government cut its budget deficit to 3 percent of gross domestic product by next year as compared to an 8.5 percent deficit last year. According to Rehn, there was a “perception” in financial markets that Spain was “relaxing” its fiscal targets for this year. “This shows how fragile the situation still is. To return to sustainable growth, it is a necessary condition to ensure sustainability of public finances,” he said.

Rehn's rapid response to the movement in Spanish bonds underscores the relationship between the banks and financial institutions and the EU. Concerns in the markets that austerity programs are not being imposed with sufficient intensity lead to a fall in sovereign bonds and a corresponding rise in interest rates. EU officials then spring into action to enforce the latest dictates from the financial oligarchy for deeper cuts.

The claim that austerity measures will bring sustainable economic growth is palpably false. Spain is in the midst of a severe recession, with more than one in five workers unemployed. The spending cuts demanded by the EU will lead to a downward debt spiral in which the contraction of the economy produces a fall in government tax revenue, thereby worsening the debt situation.

This economic fact of life is underscored by the experience in Greece. In 2009, the Greek economy contracted by 2 percent. But in 2010, with austerity measures going into effect, it declined by 4.8 percent and by almost 7 percent in 2011. A further contraction of 4.4 percent is expected this year.

Overall, the austerity measures being dictated by finance capital are having a devastating impact across Europe. A recent report by the US-based Levy Economics Institute said an assessment of all the European economies pointed to a “bleak future.”

Portugal, it noted, had done everything demanded by the EU and the IMF but its debt ratio was increasing as the economy shrank. It contracted by 2.7 percent in the fourth quarter of last year on an annual basis, with the government forecasting a further reduction of 3 percent in 2012.

While the so-called peripheral countries have attracted most attention, the recessionary tendencies are reaching into the heart of the European economy. German industrial production fell by 2.9 percent last December while exports dropped 4.3 percent. Industrial production in France dropped by 1.4 percent in December, as unemployment levels approached 10 percent.

“Contracting fiscal policies,” the Levy report concluded, “are turning Europe ... into an economic wasteland, as evidenced by widespread unemployment and grinding poverty throughout the region.”



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