European Central Bank points to return of sovereign debt crisis

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The European Central Bank (ECB) has issued a warning that the euro zone could again be engulfed in a sovereign debt crisis, as took place in 2012, because of low growth and financial vulnerabilities.

The crisis of 2012 was averted when the then ECB president Mario Draghi said he would do "whatever it takes" to save the European financial system and the single currency. But under conditions where the contradictions of the European and global capitalist economy have intensified since then, guarantees by the central bank will no longer be sufficient.

The warning of a new crisis was set out in the ECB's annual *Financial Stability Review* published on Wednesday. It pointed to the potential return of "market concerns over sovereign debt sustainability" under conditions of a worsening international environment marked by geopolitical uncertainty.

"Cyclical headwinds for euro area growth are compounding structural issues of low productivity and weak potential for growth across the euro area economy," it said.

On Monday, clearly basing herself on the review released two days later, ECB president Christine Lagarde delivered a speech in Paris that made clear the response of the European ruling classes to the worsening economic situation would be a deepening assault on the working class.

She said that unless there was an increase in productivity, the euro bloc risked facing "a future of lower tax revenues and higher debt ratios," which would mean "fewer resources for social spending."

In fact, the offensive is already under way as major manufacturing companies, particularly in the auto industry, now embroiled in a global war for markets and profits, initiate plant closures and massive job destruction.

The European political establishment has been shaken by the return of Trump to the US presidency and what his threats of tariffs hikes and trade war will mean for the economy.

Lagarde did not directly address the issue of US tariffs but emphasised that the "geopolitical landscape" was "fragmenting into rival blocs, where attitudes towards free trade are being called into question."

Europe was particularly exposed to the effects of trade war because it was "more open than others," with trade accounting for more than half of the continent's economic output.

The problems were compounded by the lag in technological development with Europe specialising in technologies developed in the last century and falling behind in the technologies of the future. Lagarde noted that "only four of the world's top 50 tech companies are European."

Europe, she continued, needed to "adapt quickly to a changing geopolitical environment and regain lost ground in competitiveness and innovation."

Under the capitalist mode of production, where economic "health" is not determined by the well-being of the population but by the bottom line, regaining "lost ground" invariably means intensified exploitation of the working class, using technology, and other means, to boost profits combined with an attack on its social conditions.

The ECB review devoted considerable space to underlining the mounting financial vulnerabilities which have grown markedly since the crisis of more than a decade ago and how what might seem to be relatively small events can have large consequences.

It cited as an example the global turbulence in July when a lower-than-expected increase in US job numbers and a tightening of Japanese monetary policy indicated “greater sensitivity to macroeconomic data surprises, raising the potential for heightened volatility going forward.”

The review pointed to a number of sources for risks to financial stability, citing what it called “stretched valuations in equity and corporate bond markets,” that is elevated market pricing of financial assets boosted by speculation. These risks could be “amplified by non-bank liquidity and leverage vulnerability.”

In other words, confronted with turbulence in the markets, when there is a “dash for cash,” financial firms engaged in speculative trading could suddenly discover their financial assets are not worth what they thought they were, they do not have enough money on hand and that their credit lines were not as secure as they had believed.

And the problems extend beyond financial firms to governments.

The review warned that “heightened policy and geopolitical uncertainty, weak fiscal fundamentals and sluggish trend growth raise concerns about the sustainability of sovereign debt in some euro area countries.”

Another problem area was “credit risk concerns” in some areas of the corporate and household sectors which “may lead to asset quality concerns for banks and non-banks.”

Elaborating on the dangers confronting governments, it referred to the breakdown of all the political mechanisms of the post-war period which has seen the growth in support for right-wing populist and even outright fascist forces.

Using the anodyne language of such reports, it said political fragmentation over the past three decades had “made it more challenging to form stable government conditions” leading to delays in “reaching agreement on key fiscal and structural reforms” [code words for attacks on social services spending].

Furthermore, geopolitical uncertainty could be “particularly challenging for countries where public debt levels are high, given their limited fiscal space to support the economy in the event of adverse shocks.”

Interest rates had started to come down, but this did not imply an easing of debt problems because, as the review noted, “sovereign debt service costs are expected to rise in the future as maturing debt is rolled over at higher interest rates than on outstanding debt.”

While the ECB did not directly state that social spending must be cut, it called for “greater discipline” on current spending to make space for increased expenditure on defence and the “structural challenges” of climate change.

The ECB warned that high funding costs and weak economic growth would continue to affect corporate balance sheets, especially of commercial real estate and small and medium enterprises (SMEs).

“The debt servicing capacity of SMEs appears to be particularly vulnerable to a slowdown in economic activity and higher borrowing costs,” it said.

The ECB does not hand out direct policy prescriptions to governments, but it is one of the chief voices of finance capital and its report delivered a clear message. It consisted of two parts. The first is that the conditions which led to the crisis of the entire financial system in 2012 have not gone away, but in many ways have worsened.

And second, that this developing crisis necessitates a frontal assault on the working class. This is becoming an imperative under what it called “geopolitical and geoeconomic fragmentation”—the preconditions for war—in order that ever greater resources can be devoted to militarism.