Markets stabilise but “smell of fear” is in the air

Nick Beams
24 May 2010

Global markets stabilised at the end of last week but there are deepening concerns that the turmoil resulting from the eurozone financial crisis is only just beginning.

The *Financial Times* cited one market analyst who wrote to his clients that “the smell of fear is in the air”. He had not felt this way since the collapse of the US investment bank Lehman Brothers in September 2008.

Summarising the outlook after the sell-off, the FT report noted: “The question now is whether a buying opportunity beckons or, more ominously, whether the debt crisis will spiral further out of control, dragging the euro lower and ultimately leading to the break-up of the eurozone. There are also those who fear that the crisis will spread to other heavily indebted countries such as Japan, the UK and even the US, raising the spectre of mass deleveraging and deflation.”

Last week’s global sell-off was the biggest fall in financial markets since March 2009 when the massive injection of money into the financial system by governments and central banks following the Lehman crisis produced a rebound. Since mid-April this year, the FTSE All World Index has dropped by 14 percent. While “emerging markets” have showed the biggest decline, Wall Street’s S&P 500 index is down 10 percent from its most recent high.

Significantly the Vix, which measures market volatility, increased from 15 a month ago to close at 50 last Friday, its highest level since March 2009. The speed of the rise of the index last week was even greater than that recorded in the crisis of September-October 2008.

Markets received a lift last Friday from the decision of the German Bundestag (parliament) to ratify Chancellor Angela Merkel’s commitment of €148 billion to the €750 billion eurozone bailout package.

The vote was 319 in favour with 73 against and 195 abstentions, mainly coming from the Social Democrats (SPD). But the opposition might have been larger had Merkel not been able to quieten, at least temporarily, opposition in the ranks of her own Christian Democrats (CDU). Ten CDU members voted against authorising the payment. More defections might have resulted had Merkel not announced a ban on “naked short selling” in bond markets—a move which, according to one observer, was “practically cheered to the ceiling” by CDU members.

In a move to restore the confidence of the financial markets in the eurozone, European Union finance ministers met in Brussels on Friday to discuss plans for sanctions against member countries that break EU budget rules. At a press conference following the talks, EU president Herman van Rompuy said there was “broad consensus on the business of having financial sanctions and non-financial sanctions”. The EU finance ministers or their representatives are scheduled to meet twice in the next month and prepare a progress report for a summit of EU leaders later this year.

But despite the show of unity after Friday’s discussions, differences have already emerged. Under pressure from France, the ministers moved away from discussing measures that would require changes to EU treaties. Germany, on the other hand, wants harsher measures, including the vetting of each government’s stability program by an independent body and a commitment by member states to incorporate the rules of the EU stability and growth pacts into their national laws.

© World Socialist Web Site

Germany also pushed for sanctions if eurozone countries failed to meet deficit reduction targets, including the withdrawal of access to certain EU funding and the loss of some voting rights. It has also been suggested that national budgets should be reviewed at the EU level before being adopted.

This brought immediate opposition from the incoming British Chancellor George Osborne who insisted that "national parliaments are sovereign and have to be told first about budget plans". At the same time, British Prime Minister David Cameron, on a visit to Berlin, repeated three times that he opposed new rules that would "transfer further powers from Westminster to Brussels". This was interpreted as meaning that while he would oppose measures directly impacting on the UK, he might support measures affecting members of the eurozone, of which Britain is not part.

Attention in the media has focused on the issue of budget deficits and lack of fiscal restraint—reflecting the drive by all European governments to carry out the dictates of financial markets and utilise the crisis to attack the social position of the working class. Other analysis, however, points to the worsening situation of the European banks as the underlying cause of the crisis.

According to this analysis, weakness in the European banking system was the reason the bailout package was initiated in preference to a "restructuring" of Greek debt—a move that would have led to some banks incurring losses.

In an interview with the magazine *Der Spiegel* last week, former Bundesbank (German central bank) head Karl Otto Pöhl denounced the bailout decision for changing the foundations of the euro and turning the eurozone into a "transfer union".

The package, he said, was "about protecting German banks, but especially French banks, from debt write off. On the day that the rescue package was agreed on, shares of French banks rose by up to 24 percent. Looking at that, you can see that this was really about—namely, rescuing the banks and the rich Greeks."

A note prepared last week by Nicolas Véron, a senior analyst at Bruegel, a Brussels-based think tank, pointed to "Europe's banking fragility" as lying at "the core of the dramatic policy developments since the beginning of May".

"The European banking system has been in a state of severe fragility since at least the post-Lehman shock; the ensuing public liquidity assistance had the perverse additional effect of encouraging the weaker banks to overinvest in high-yield debt such as Greece's."

While some European banks had strong balance sheets, the system was "only as strong as its weakest links, and we don't even know exactly where they are".

Véron noted that the EU had not conducted a review of European banks nor subjected them to "stress tests," reflecting the fact that "political leaders, including those in France and Germany, are deeply captured by national banking establishments". National officials were afraid to reveal the "sorry state" of some banking "champions" as this could make them takeover targets. He warned that failure to undertake EU bank restructuring could have "devastating consequences".

One of the less publicised components of the eurozone bailout package was the decision to reverse a previously firmly-held policy of the European Central Bank (ECB) to allow it to purchase government bonds. The ECB is reported to have carried out a €16.5 billion purchase in three of the most distressed eurozone markets—Portugal, Ireland and Greece—after they had all but frozen. The *Economist* magazine reported that in the case of secondary markets for Greek and Portuguese debt, "the only real buyer seems to be the ECB".

Whatever the movement on financial markets this week, it is clear that the bailout package has, at best, only papered over the financial crisis in the short-term, while worsening it in the longer run.

To contact the WSWS and the Socialist Equality Party visit:

wsws.org/contact

© World Socialist Web Site