On the edge of the abyss

Europe's leaders must act fast to stop Greece's market contagion spreading.

IF A sense of panic has started to grip Europe over the potential for Greece to default on its debts, and the contagion to spread rapidly to the continent's other struggling economies, it has not yet struck Herman Van Rompuy, the president of the European Council. He insisted on Wednesday April 28th that there was "no question" of Greece's debts being restructured. He also said leaders of the euro-zone countries would meet next month to consider how to activate their proposed joint lending programme with the IMF to support Greece. Jean-Claude Trichet, president of the European Central Bank, delivered an almost identical message, saying that a Greek default was "out of the question".

The calm demeanour of Mr Trichet and Mr Van Rompuy is not shared by the markets. On Wednesday Greece said that it would ban the short-selling of shares for two months to prevent speculators doing further damage to the country's banks. The previous day, shares in Greek banks had plunged by nearly 10% and the Athens stockmarket as a whole fell by 6% on fears that the country would soon suffer another downgrade of its debts. Those fears proved entirely justified. After the markets closed Standard & Poor's heaped indignity on Greece by cutting the rating of its sovereign bonds to "junk" status. It also cut Greece's banks to "junk" because of their hefty exposure to government debt.

Although the move to ban short-selling steadied Greece's stockmarket somewhat on Wednesday, the chances of the country defaulting on its debts were still perceived by the bond markets as high. Spreads on Greek government bonds (the risk premium compared with German bonds) reached a 13-year high as investors worried that the proposed rescue plan for Greece could stall. Talks between Greece, the European Union and the IMF got under way last week.

Greece was initially seeking up to €45 billion ($60 billion) in emergency loans from euro-zone governments and the IMF this year, the first chunk of which will be needed by May 19th, when the Greek government must refinance a €8.5 billion bond. But as the crisis has worsened it has become clear that Greece could need much more. On Wednesday it was reported that the EU and IMF were preparing a package worth up to €120 billion over three years—if so, the biggest sovereign rescue yet attempted. Nevertheless, even aid on this scale might only postpone an eventual default, if Greece's economy fails to grow faster than its debt pile.

Investors do not seem convinced that euro-zone governments will be able to muster the political will to hammer out an agreement. Germany, as the largest euro member, is vital to any effort to save Greece, but it is wavering. German public opinion is firmly set against

dipping into the public purse to help the profligate Greeks. Angela Merkel, Germany's chancellor, is in a tight spot. If she agrees to extend aid quickly to Greece a voters' backlash back home may send her party crashing to defeat in regional elections set for May 9th. But if she sits back and watches Greece slide towards default, the contagion is sure to spread rapidly to other, bigger EU countries with debt problems—Mrs Merkel could then end up being blamed for triggering a far worse conflagration across Europe, including a fresh banking crisis.

Fears that Greece's fiscal crunch would spread to other euro-area countries have sent the region's single currency reeling to a one-year low against the dollar. S&P's decision on Tuesday also to downgrade the debt of Portugal by a couple of notches pushed European and world stockmarkets lower. Portugal, despite a smaller budget deficit and lower public debt than Greece, is widely touted as the next European country that may suffer a sovereign-debt crisis. Portugal's slow-growing economy, drastic loss of competitiveness and high public and private indebtedness are all weaknesses that markets might put to greater test.

If Portugal comes under intense pressure, contagion might then spread to Ireland, Italy or Spain, the other euro-area countries with some mixture of big budget deficits, poor growth prospects and high debts. Only swift and decisive action by the leaders of Europe's big economies is likely to head off the current crisis. Default by a smaller member such as Greece would be a body blow to the euro's standing but it need not spell the end of the currency. However, that might not be the case if the problems spread further afield.

Fonte: The Economist, Apr. 28th 2010. Disponível em: <www.economist.com>. Acesso em: 29 abr. 2010.