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Racing to stabilize Europe's markets

In a flash, Greece's worry spanned a connected globe

NEW YORK

BY NELSON D. SCHWARTZ AND ERIC DASH

The fear that began in Athens, raced through Europe and finally shook the stock market in the United States is now affecting the broader global economy, from the ability of Asian corporations to raise money to the outlook for money-

NEWS ANALYSIS

market funds where American savers park their cash.

What was once a local worry about the debt burden of one of Europe's smallest economies has quickly gone global. Already, jittery investors have forced Brazil to scale back bond sales as interest rates soared and caused currencies in Asia, like the South Korean won, to weaken. Ten companies around the world that had planned to issue stock delayed their offerings last week, the most in a single week since October 2008.

The increased global anxiety threatens to slow the recovery in the United States, where job growth has finally picked up after the deepest recession since the Great Depression. It could also inhibit consumer spending as stock portfolios shrink and loans are harder to come by.

''It's not just a European problem, it's the U.S., Japan and the U.K. right now,'' said Ian Kelson, a bond fund manager in London with T. Rowe Price. ''It's across the board.''

European Union finance ministers on Sunday sought to forge a system that could radically expand the bloc's powers to raise funds to keep troubled member states from going bankrupt.

E.U. diplomats said that all member states were prepared to agree on expanding an existing lending program, but had not yet reached agreement on a more far-reaching mechanism.

In Spain on Saturday, Vice President Joseph R. Biden Jr. of the United States underscored the importance of the issue after a meeting with Prime Minister José Luis Rodríguez Zapatero.

Mr. Zapatero ''and I also spent time discussing the economic crisis that is focused on Greece and the efforts being made to address it,'' Mr. Biden said. ''We agreed on the importance of a resolute European action to strengthen the European economy and to build confidence in the markets. And I conveyed the support of the United States of America toward those efforts and was pleased to hear the efforts that were under way.''

Beyond Europe, the crisis has sent waves of fear through global stock exchanges.

A decade ago, it took more than a year for the chain reaction that began with the devaluation of the Thai currency, the baht, to spread beyond Asia to Russia, which defaulted on its debt, and eventually caused the near-collapse of a giant American hedge fund, Long-Term Capital Management.

This crisis, by contrast, seemed to ric-

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E.U. may expand loan program to €110 billion

BRUSSELS

BY JAMES KANTER

European Union finance ministers on Sunday sought to forge a system that could radically expand the bloc's powers to raise funds to keep troubled member states from going bankrupt, as the specter of more chaos in the financial markets on Monday morning loomed large.

The Swedish finance minister, Anders Borg, said immediate action was needed to tackle ''herd behaviors in the markets that are really pack behaviors, wolf pack behaviors.'' Echoing many European leaders who have attacked speculators over the past week, Mr. Borg warned that volatility in markets could ''tear the weaker countries apart.''

The emergency meeting, attended by officials from all 27 E.U. states, was called to reach agreement on a so-called European stabilization mechanism.

It was the Union's second attempt in a week to stabilize markets that have plummeted after the turmoil in Greece and signs of financial contagion in other struggling euro-zone economies, like Spain and Portugal.

The Spanish finance minister, Elena Salgado, said European Union officials would ''do whatever is necessary'' to defend the euro.

European Union diplomats said Sunday that all member states were prepared to agree to expand an existing lending program to €110 billion, or $140 billion, from the current level of €50 billion.

But ministers had not yet reached agreement on a much more far-reaching mechanism that could provide a way for member states, and possibly the European Central Bank, to guarantee hundreds of billions of euros that the commission would raise in the capital markets.

The commission could then use those funds to offer loans to states in need, like Greece, in what would amount to a kind of European monetary fund.

A key issue in the discussions was whether such loans would be guaranteed by individual member states or by the entire European Union — which could make liable those E.U. countries that do not use the euro, like Britain.

E.U. leaders including President Nicolas Sarkozy of France said early Saturday morning, at the end of an earlier summit meeting, that a mechanism should be ready by Monday morning. That effectively left the European Commission and finance ministers meeting in Brussels on Sunday to change the way the European Union operates in a single weekend.

Stronger economic integration strikes at the heart of issues of national sovereignty that have left the European Union politically fragmented a day after the 65th anniversary of the end of the Second World War in Europe. That cataclysm led to the creation of pan-European institutions that were meant to ensure peace and prosperity in the region,

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Uncertainty goes global as Europe struggles with Greek debt

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ochet from country to country in seconds, as traders simultaneously abandoned everything from Portuguese bonds to American blue-chip shares. On Wall Street on Thursday afternoon, televised images of rioting in Athens to protest austerity measures only amplified the anxiety as the Dow Jones industrial average briefly plunged nearly 1,000 points.

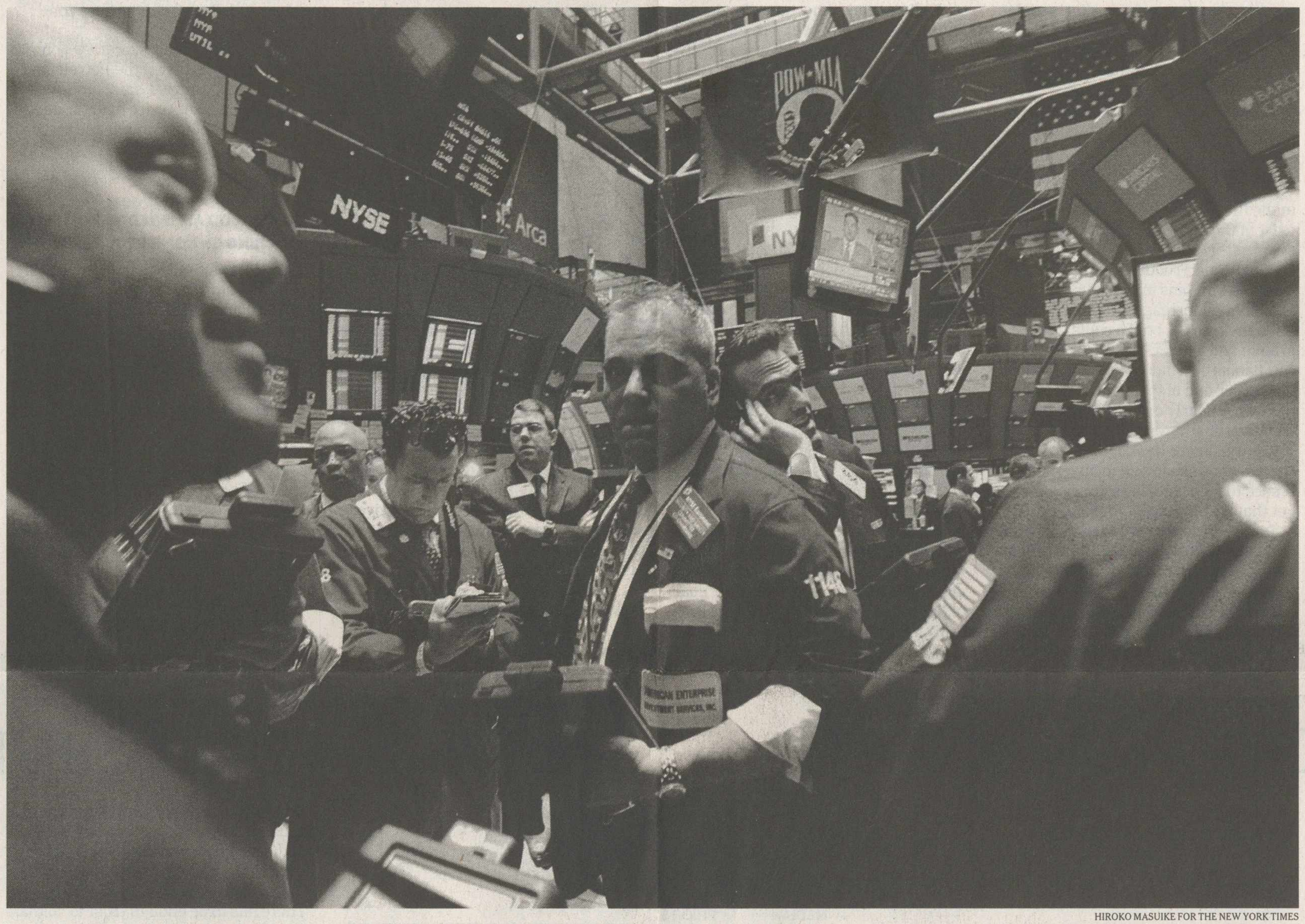
"Up until last week there was this confidence that nothing could upset the apple cart as long as the economy and jobs growth was positive," said William H. Gross, managing director of Pimco Group, the giant bond-management firm. "Now, fear is back in play."

While the immediate cause of the worries is the ballooning budget deficit in Greece and the risk of default there and in countries like Spain and Portugal, the turmoil also exposed deeper fears that government borrowing in bigger economies like Britain, Germany, Japan and even the United States is unsustainable.

"Greece may just be an early warning signal," said Byron Wien, a prominent Wall Street strategist who is vice chairman of Blackstone Advisory Partners. "The U.S. is a long way from being where Greece is, but the developed world has been living beyond its means and is now being called to account."

If the anxiety spreads, American banks could return to the posture they adopted after the collapse of Lehman Brothers in the fall of 2008, when they cut back sharply on mortgages, auto financing, credit card lending and small-business loans. That could stymie job growth and halt the broader economic recovery that is beginning to gain traction.

Some American companies are facing higher costs for financing their debt, while big U.S. exporters are seeing their edge over European competitors shrink as the dollar strengthens. Riskier assets, like stocks, are suddenly out of favor, while cash has streamed into one of the safest investments, gold.



HIROKO MASUIKE FOR THE NEW YORK TIMES

Traders working on the floor of New York Stock Exchange on the day after the Dow Jones industrial average briefly plunged nearly 1,000 points amid growing global anxiety.

Just as Greece is being forced to pay more to borrow, more risky American companies are being forced to pay up, too. Some issuers of new junk bonds in the consumer sector are likely to have to pay roughly 9 percent on new bonds, up from about 8.5 percent before last week's volatility, said Kevin Cassidy, senior credit officer with Moody's.

Not all of the consequences are negative, however. Though the situation is perilous for Europe, the U.S. economy does still enjoy some favorable tailwinds. With the flight to quality prompted by the volatility, interest rates have dropped, benefiting homebuyers seeking mortgages and other borrowers.

Further, crude oil prices fell last week on fears of a slowdown, which should bring lower prices at the pump within weeks. Meanwhile, the U.S. dollar gained ground against the euro, reaching its highest level in 14 months.

While that makes European vacations more affordable for American tourists and could improve the fortunes of European companies, it may hurt profits at their American rivals. A stronger dollar makes American goods less affordable for buyers overseas, a one-two punch for American exporters if Europe falls into recession as a result of the crisis. Excluding oil, the 16 countries that make up the euro zone buy about 14 percent of U.S. exports.

For the largest U.S. companies, which have benefited from the weak dollar in recent years, the pain could be more acute. More than a quarter of the profits of companies in the Standard & Poor's 500 stock index come from abroad, with Europe forming the largest component, according to Tobias Levkovich, Citigroup's chief U.S. equity strategist.

If Europe does end up in a double-dip recession, that could reduce economic growth in the United States by 0.3 to 0.4 percentage point, said Bernard Baumohl, an economist for the Economic Outlook Group in New Jersey.

The direct exposure of American banks to Greece is small, but below the surface there are signs of other fissures. Even the strongest banks in Germany and France have heavy exposure to more troubled economies on the periphery of the Continent, and these big banks in turn are closely intertwined with their U.S. counterparts.

Over all, American banks have $3.6 trillion in exposure to European banks, according to the Bank for International Settlements. That includes more than €1 trillion in loans to France and Germany, and nearly $200 billion to Spain.

What is more, American money-market investors are already feeling nervous about hundreds of billions of dollars in short-term loans to big European banks and other financial institutions.

"Apparently systemic risk is still alive and well," Alex Roever, a J.P. Morgan credit analyst, said in a research note on Friday. With so much uncertainty about Europe and the euro, managers of these ultrasafe investment vehicles are demanding that European borrowers pay higher rates.

These funds provide the lifeblood of the international banking system. If worries about the safety of European banks intensify, it could push up their borrowing costs and push down the value of more than $500 billion in short-term debt held by U.S. money-market funds. Uncertainty about the stability of assets in money market funds signaled a tipping point that accelerated the downward spiral of the credit crisis in 2008, and ultimately prompted banks to briefly halt lending to one other.

"It seems like only yesterday that European policy makers were gleefully watching the U.S. get its economic comeuppance, not appreciating the massive tidal wave coming at them across the Atlantic," said Kenneth Rogoff, a Harvard University finance professor and former chief economist at the International Monetary Fund. "We should not make the same mistake."

James Kanter contributed from Brussels.