Greek downgrade alarms markets

FRANKFURT

Fears rise that debt crisis will spread as agency cuts bonds to junk status

BY JACK EWING AND JACK HEALY

Greece's credit rating was lowered to junk status Tuesday by a leading credit agency, a decision that rocked financial markets and deepened fears that a debt crisis in Europe could spiral out of control.

The ratings agency, Standard & Poor's, downgraded Greece's long-term and short-term debt to non-investment status and cautioned that investors who bought Greek bonds faced dwindling odds of getting their money back if Greece defaulted or went through a debt restructuring. The move came shortly after S.&P. reduced Portugal's credit rating and warned that more downgrades were possible.

The downgrades, announced near the end of trading in Europe, came amid rising political tensions across the Continent that had already punished Greek bonds and sent stock prices down sharply from London to Paris to New York. Investors, worried about shock waves in the broader European economy, migrated away from the euro and pushed the dollar and Treasury bonds higher. The euro slid to $1.3316 in afternoon trading in New York from $1.3382 late Tuesday.

"This is a signal to the markets that the situation is deteriorating rapidly, and it's not clear who's in a position to stop the Greeks from going into a default situation," said Edward Yardeni, president of Yardeni Research. "That creates a spillover effect into Portugal and Spain and raises the whole sovereign debt issue."

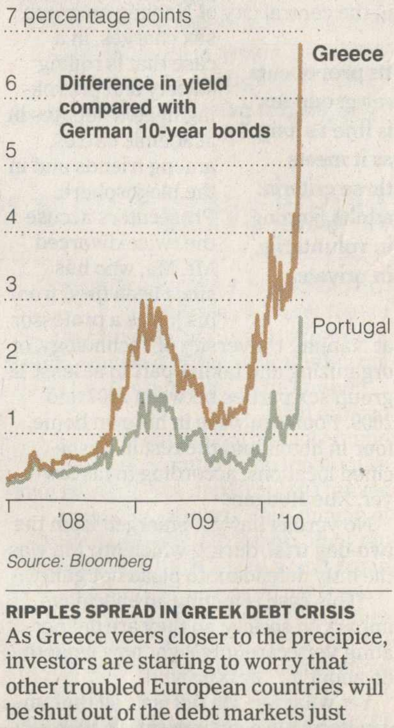
As transportation workers in Portugal and Greece went on strike against austerity measures Tuesday, the risk premium on Greece's bonds set records even before S.&P. announced the downgrades.

By early afternoon the major indexes on Wall Street had posted some of their sharpest declines in a month. The Dow

GREECE, PAGE 14

Paying the price

The premium on Greek and Portuguese bonds has jumped, while Standard & Poor's downgraded debt from both countries on Tuesday.



Source: Bloomberg

RIPPLES SPREAD IN GREEK DEBT CRISIS
As Greece veers closer to the precipice, investors are starting to worry that other troubled European countries will be shut out of the debt markets just when they need to raise cash. *PAGE 13*

Junk status for Greek bonds rattles markets

GREECE, FROM PAGE 1

Jones industrial average fell about 130 points, or 1.2 percent, and the broader S.&P. 500-stock index was 1.5 percent lower, with financial stocks and commodity shares down sharply.

Investors were unsettled by perceptions that European leaders have not yet shown they can contain the fallout from Greece's problems, as well as the political resistance in Germany to using taxpayer money for a rescue.

"This thing is getting more and more urgent and tense," said Robert Barrie, head of European economics at Credit Suisse in London. He said the markets could settle down once Greece manages to refinance €8.5 billion, or $11.2 billion, in bonds that mature in May. "But it's anything but calm at the moment," he added.

In an effort to show unity, European Union governments may hold a summit meeting May 10 to discuss releasing aid to Greece, according to an E.U. official who was knowledgeable about the ongoing talks on the matter, but who declined to be identified because the date was not yet confirmed.

The meeting could also provide a forum for Germany, where a large majority of voters oppose aid to Greece, to deliver a stern warning to other over-indebted countries that such aid is exceptional and should be avoided in the future.

Amid the turmoil, a European Central Bank official warned all euro-zone countries to cut their soaring budget deficits and suggested that Greece may need to impose even harsher austerity measures to bring its debt under control.

The central bank vice president, Lucas D. Papademos, who was governor of the Bank of Greece from 1994 to 2002, told members of the European Parliament in Brussels that the Maastricht Treaty, which sets out borrowing limits for euro-zone countries, "is facing its biggest challenge since its adoption in 1997."

The economic program that European officials and the International Monetary Fund are negotiating with Athens in return for €45 billion in loans at interest rates well below what the

LOUISA GOULIAMAKI/AGENCE FRANCE-PRESSE

Public transport workers shouted slogans Tuesday outside the headquarters of the Greek Finance Ministry in another protest against government austerity measures.

"This is a signal to the markets that the situation is deteriorating rapidly."

market is demanding must "address the root causes of Greece's fiscal imbalances and structural weaknesses, so as to ensure the sustainability of its public finances and improve the country's international competitiveness," he said.

On the streets of Greece and Portugal, labor unions stepped up resistance to the austerity measures that will be crucial to any turnaround.

Portuguese public transportation workers went on strike against a government austerity plan intended to cut the budget deficit to 2.8 percent of gross domestic product in 2013 from 9.4 percent last year, Reuters reported. Public employees would face a salary freeze.

"It cannot only be the workers who pay," said Manuel Leal, spokesman for the Fedtrans transport union, according to Reuters.

Greek transportation workers also walked off the job Tuesday to protest austerity measures, while the country's labor unions called a national strike for next week.

Among investors there was growing pessimism that Greece would be able to repay its debt, equal to 115 percent of G.D.P., without a restructuring plan that would spread out the payments. Such a plan would effectively cut the value of Greek bond holdings.

S.&P. reinforced fear of a restructuring Tuesday. If there is a default, S.&P. estimated that investors might recover only 30 percent to 50 percent of their money.

German politicians, like Frank-Walter Steinmeier, leader of the opposition Social Democrats in Parliament, have fed speculation about a restructuring plan by calling for banks to share the costs of a Greek rescue. Greek and European Union leaders say restructuring is not on the table.

S.&P. forecast that Greece's debt problems would only get worse, rising to 131 percent of GDP in 2011, the agency said. At the same time, growth would be nearly flat until 2016, meaning that the government could not count on expansion to lift tax receipts.

The agency also noted that the debt crisis was putting increasing pressure on Greek companies and banks. Greek businesses typically must pay interest rates tied to the rate on government bonds, and Greek banks are vulnerable because of their extensive holdings of their government's debt.

Stock markets in Europe tumbled after the announcements.

In London, the FTSE 100 closed down 2.7 percent, the CAC-40 in Paris shed 3.8 percent and the IBEX 35 in Spain lost 4.2 percent. The PSI 20 index in Lisbon was off 5.4 percent and the Athens stock exchange general index slid by 6 percent, taking its year-to-date losses to 22.8 percent.

Banks were hit hard. The financial subsector of the Euro Stoxx 600 index lost 3.9 percent. UBS, the Swiss bank, lost 4 percent and Société Générale of France fell by 6 percent. Shares in National Bank of Greece tumbled 10 percent and Agricultural Bank of Greece, majority owned by the state, closed down 13.8 percent.

The yield of the 10-year benchmark Greek government bond surged to 9.7 percent, yet another record since the inception of the euro. German and French yields fell, suggesting that investors were rushing out of riskier fixed-income assets into safer harbors.

The yield spread, or difference, between Greek and German 10-year bonds surged to 680 basis points, the highest since 1998. Yields on Portuguese and Irish bonds also surged, although those of Spanish bonds fell slightly.

Mr. Papademos's unusually stern comments to the European Parliament are the latest expression of concern by the E.C.B. about the risks still embedded in the region's economy even though most countries have emerged from recession.

Jack Healy reported from New York. James Kanter contributed reporting from Brussels.