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June 16, 2011

Worries Grow About Breadth of Debt Crisis

By **GRAHAM BOWLEY**

The tumult in the European monetary zone is spreading concern among investors of a broader crisis in financial markets from Ireland to Spain.

The worry is that the worst case, a Greek debt default, would lead to damaging losses for European banks and spur a global panic, replaying the events of September 2008. Then, investors fled all but the safest government debt, unloading everything from corporate bonds to American and emerging country stocks. Global markets froze.

As European officials headed into a long weekend of critical talks, the European Union and the International Monetary Fund said that they were confident of a deal to secure a vital 12 billion euros (\$17 billion) in outside aid needed to stave off an imminent Greek default.

The comments, reflecting belated advances in negotiations that have been going on for weeks, were aimed at calming anxious financial markets. But so far, the deepening concerns are stopping short of transferring forcefully to the United States. For the time being at least, investors seem to believe enough shock absorbers have been built in to comfortably withstand any default by Greece or other highly debt-ridden nation.

The interest rate on United States 10-year Treasury bonds remains below 3 percent. In contrast,

Spanish bond yields rose to an 11-year high of 5.74 percent as anxious investors fretted that it could be next in the firing line after Greece.

“U.S. financial institutions are very cash-rich, so that means a liquidity crisis would have to be extraordinary before it affects them,” said Guy LeBas, the chief fixed-income strategist for Janney Montgomery Scott.

After a 179-point sell-off on Wednesday, American markets stabilized, with all the main United States indexes closing higher.

But the cost to investors of insuring their holdings of Greek government debt, to make sure they recoup their money in the event of a default, registered its single biggest one-day move.

An investor now has to pay about \$2 million annually to insure \$10 million of Greek debt over five years, compared with about \$50,000 on the same amount of United States government debt, according to Markit.

Insurance rates on the debt of Irish and Portuguese governments, as measured by rates in the market for credit-default swaps, also climbed to record highs. In addition, Spain struggled to kindle investor interest on its auction of bonds, selling 2.8 billion euros (\$4 billion), missing its top target and with average yields creeping up again. The fear is that a Greek default could threaten the integrity of the euro zone, require European countries to bail out banks that lent heavily to Greece and other deeply indebted countries, and spread panic across global markets.

The European Union’s top economic official, Olli Rehn, said he had reached a deal with the International Monetary Fund to avoid a Greek default through at least the fall.

But he warned politicians they must agree to new austerity measures or the program would be worthless.

The mood in the markets was made more nervous when Michael Noonan, finance minister of Ireland,

said on Wednesday that the Irish government was ready to impose losses on senior unsecured bondholders of Anglo Irish Bank and the Irish Nationwide Building Society if the European Central Bank agreed. That added to fears that countries beyond Greece might be involved in a broader restructuring.

Also, some well-regarded economists say that a Greek default is almost inevitable. The chances of Greece defaulting are “so high that you almost have to say there’s no way out,” Alan Greenspan, the former chairman of the Federal Reserve, said on a “Charlie Rose” broadcast, shown on Bloomberg TV on Thursday night. He added that as a result, some American banks may be “up against the wall.”

The financial markets are watching nervously as the Greek government tries to push through austerity measures required to secure more international aid.

Greece “needs to better inform the markets as well as the Greek people that what’s being done is actually achieving results, which will help restore confidence,” said Claude Giorno, the senior economist for Greece at the Organization for Economic Cooperation and Development, based in Paris.

But the United States, for the time being, appeared insulated from the problems, and American assets remain a destination for anxious global investors, with the dollar and Treasuries rising.

The Standard & Poor’s 500-stock index rose 2.22 points, or 0.18 percent, to 1,267.64. The Dow Jones industrial average closed up 64.25 points, or 0.54 percent, to 11,961.52. The Nasdaq composite index fell 7.76 points, or 0.29 percent, to 2,623.70.

Still, two Deutsche Bank strategists, Jim Reid and Colin Tan, warned in a report on Thursday that this Greek crisis had echoes of the collapse of the Lehman Brothers investment bank in September 2008, an event that plunged the financial system into chaos and required the commitment of trillions of dollars in government support to stave off another Great Depression.

“Everyone in every corner of global financial markets should be keeping a very close eye on upcoming Greek events,” they wrote. “The period is resembling the buildup to the Lehman collapse where,

although markets were increasingly nervous, virtually everyone expected a last-minute buyer.”

One ugly scene that some analysts are imagining involves a default by Greece leading to losses inflicted on banks in other European countries that own large amounts of Greek debt. The European Central Bank, too, is a big holder of debt, and analysts said in the event of a default it might need to be recapitalized, another blow to confidence.

Those losses could then cascade to the United States because the American and European banking systems are so interlocked, lending billions of dollars to each other every day.

American banks and insurance companies may also be liable for the biggest share of default insurance payments to European institutions if Greece or other countries fail. And the trillion-dollar money market fund industry could also suffer.

About 44.3 percent of money-market fund assets are European bank debt, according to Fitch Ratings, although they may be a little insulated because they have sold much of their Spanish, Portuguese and Irish debt. The funds have never held Greek bank debt, which rarely met the funds' credit rating standards. The markets are keenly watching for signs that contagion is spreading through the global financial system.

The renewed volatility in the markets has again trained a spotlight on the Chicago Board Options Exchange Volatility Index. The VIX, as it is known, measures the implied volatility of options on the Standard & Poor's 500-stock index. It rose to settle above 21 on Thursday for the first time since March.

Another pressure gauge under scrutiny is the overnight interbank lending rate. As of Monday, investors' expectations for three months from now of the overnight interbank lending rate showed an increase of about 10 basis points to nearly twice its current levels.

Still, increases in those two measures so far pale in comparison to the spikes in both during last year's

flare-up in Europe.

Contributing reporting were Eric Dash, Stephen Castle, Matthew Saltmarsh and Liz Alderman.



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