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Sharp market falls over euro and oil price slump

By Nick Beams

6 January 2015

European and US equity markets fell sharply yesterday as a result of another drop in oil prices, fears of financial instability in Europe over Greek debt and the signs that global deflationary pressures are increasing.

In the US, the Dow Jones index finished the day 331 points down, a fall of 1.86 percent, while the S&P 500 was down by 1.83 percent. The Vix, a measure of market volatility, jumped by 12 percent. Earlier in the day, European markets fell by around 3 percent.

Currency markets also exhibited instability. The US dollar hit a nine-year high against a basket of currencies, while the euro touched a nine-year low, amid concerns over whether the Greek election, to be held on January 25, would spark political instability if the opposition SYRIZA coalition were to win.

The first issue before the incoming Greek government will be to sign off on a new debt agreement. The country was given a two-month extension, to the end of February, on the present bailout plan.

The main factor in the fall in US markets appears to have been the further sharp decline in oil prices, continuing the downward trend that started in June, which was accelerated by the Saudi-led OPEC oil cartel's decision not to cut production levels.

West Texas intermediate crude yesterday fell below $50 a barrel, its lowest level for five years, while Brent crude, regarded as the global benchmark, dropped by more than 6 percent to under $53 per barrel. The price of oil is now heading down to the levels reached in 2008-2009, when the global financial crisis saw it plummet from $100 per barrel to around $40.

The falling oil price is indicative of the deflationary pressures in the world economy as a result of continuing stagnation in Europe and clear signs that the Chinese economy is slowing.

The drop in the euro was set off by a comment by European Central Bank (ECB) president Mario Draghi during an interview published last Friday. Draghi said the risk of deflation in Europe was higher than six months ago, indicating that the ECB is getting ready to extend its so-called quantitative easing when its governing council next meets on January 22.

The euro fell further on a report published over the weekend in the leading German news magazine *Der Spiegel* that German Chancellor Angela Merkel and Finance Minister Wolfgang Schäuble had reached the conclusion that it was no longer necessary to keep Greece within the euro zone at any price and that a Greek exit would not create a financial crisis, as it threatened to do in 2012.

"The danger of contagion is limited because Portugal and Ireland are considered rehabilitated," *Der Spiegel* quoted an unnamed government source as saying. Thus, Germany regarded a Greek exit as "bearable."

Following the article, the Merkel government said it was working on the assumption that no matter if SYRIZA won the election, the next Greek government would continue to abide by agreements reached with EU institutions.

Under the austerity program dictated by the "troika"—the ECB, the International Monetary Fund and the European Commission—the Greek economy has contracted by 25 percent over the past six years. Even assuming a growth rate of 2 percent per year, the Greek economy would not attain the levels it reached in 2007 until after 2027.

SYRIZA, the "Coalition of the Radical Left," has abandoned any commitment to repudiate international debts, or restore previous cuts. It now talks of debt "renegotiation," while insisting that Greece remain within the euro zone.

The financial markets have taken SYRIZA's measure and recognise that a SYRIZA government of itself is no danger. There is the underlying fear, however, that any election victory could spark a movement from below that could begin to break out of the political straitjacket that has so far contained the working class.

One of the factors that may have led German authorities to consider a Greek exit "bearable" is that Greece's debt has largely been transferred to public institutions. Consequently, German banks would not be as heavily impacted as they would have been three years ago.

It is estimated that more than 80 percent of Greece's debt is now held by official creditors, including the International Monetary Fund and the European Stability Mechanism, which functions as the euro zone's rescue fund.

While the prevailing view in financial circles, at least to this point, is that the euro zone would be able to "handle" a Greek exit, other powerful forces, in the form of deflation and the prospect of a third recession since the financial crisis, are stretching the monetary union.

Inflation figures will be published tomorrow and there are indications that they may record a negative result for the year, after an increase of just 0.3 percent for the year to November. Fears of a negative outcome were increased following yesterday's news that German inflation had fallen to a five-year low.

Draghi is insisting that the threat of deflation, which increases the level of real debt and interest payments for banks and financial institutions, must be countered by further quantitative easing, involving, in some form, ECB purchases of sovereign debt. However, German Bundesbank president Jens Weidman, who sits on the ECB's governing council, strenuously opposes the purchase of government debt.

According to former German foreign minister and Green Party leader Joschka Fischer, the policy differences threaten to turn "politically explosive" because they are "becoming a conflict between Germany and Italy."

Those conflicts are set to intensify. This time last year, the official view was that Europe was starting to recover. But after a brief upturn, growth began to fall, most significantly in the so-called core countries, France, Italy and Germany.

Economic stagnation brings rising debt levels. Despite the imposition of austerity measures, Italy's debt ratio has increased from 116 percent to 133 percent of gross domestic product (GDP) over the past three years because GDP is not rising fast enough to keep pace with interest costs.

As an article in yesterday's *Wall Street Journal* noted, 2014 was supposed to have been the year when the euro zone exited the debt crisis, as growth returned to the region. Instead, "the eurozone is arguably now in greater peril of breaking up than ever before."