Funds flee Greece as Germany warns of "fatal" eurozone crisis

Germany has triggered a near-panic flight from southern European debt markets by warning that there will be no EU bail-outs, even though it fears the region's economic crisis has turned dangerous and could prove "fatal" for the entire eurozone.

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The yield on 10-year Greek bonds blasted upwards by over 40 basis points to 7.15pc in a day of wild trading. Spreads over German Bunds reached almost four percentage points, by far the highest since Greece joined the euro, and close to levels that risk a self-feeding spiral. Contagion hit Portuguese, Spanish, Irish, and Italian bonds.

George Papandreou, the Greek premier, said in Davos that his country had been singled out as the weak link in a "attack on the eurozone" by speculators and political foes. "We are being targeted, particularly by those with an ulterior motive."

Marc Ostwald, from Monument Securities, said the botched syndication of €8bn (£6.9bn) of Greek debt earlier this week has made matters worse. Many of the investors were "hot money" funds that bought on rumours that China was emerging as a buyer, offering them a chance for quick profit. When the China story was denied by Beijing and Athens, these funds rushed for the exit.

However, a key trigger yesterday was testimony in Germany's parliament by economy minister Rainer Brüderle, who said there would be "no bail-outs" for struggling debtors and no move to a "European economic government".

"A few European nations are exhibiting dangerous weaknesses. That could have fatal consequences for all countries in the eurozone," he said. Despite the warning, he said each country must solve its own problems.

"Germany is not in a mood to be the deep pocket for what they consider profligate, southern neighbours," said hedge fund doyen George Soros.

Mr Brüderle's hard line contradicts a report in *Le Monde* that Franco-German officials are discussing a rescue for Greece in order to keep the International Monetary Fund at bay.

The paper cited a source saying that EMU partners were ready to "help" Greece. "It is a question of credibility for the eurozone. The IMF might want to impose monetary conditions."

Le Monde's story was shot down by Berlin and Paris, but there is little doubt that certain officials have been trying to build momentum for a rescue. It is clear that the EU family is split on the issue. Jean-Claude Juncker, head of the Eurogroup of finance ministers, backs "assistance", with support of EU integrationists hoping to nudge the EU towards full fiscal union.

This is fiercely opposed by Berlin, and the German-led bloc at the European Central Bank. There are reports that Berlin is deliberately bringing the crisis to a head, hoping to lance the boil early and force the Club Med states to reform before it is too late. If so, this is a risky strategy. German banks have huge exposure to Greek, Spanish, and Portuguese debt.

Hans Redeker, currency chief at BNP Paribas, said Greece will face "great trouble" if it has to pay 7pc rates for long. Athens must raise €53bn this year, mostly in the first half. It has a been relying on cheap short-term debt to fund the budget deficit of 13pc of GDP, but this raises "roll-over risk".

Tim Congdon, from International Monetary Research, said the danger is that wealthy Greeks may shift money to bank accounts abroad if they lose confidence (akin to Mexico's Tequila Crisis in 1994-1995). This would set off a banking crisis and become self-fulfilling.

Greece has been financing current account deficits – 15pc of GDP in 2008 – through its banks, which have built up €110bn foreign liabilities. "If foreign creditors want their money back, defaults and/or a macroeconomic catastrophe appear inevitable," Mr Congdon said.

Adding to worries, Moody's has issued an alert on Portugal's "adverse debt dynamics", saying Lisbon needs a "credible plan" to reduce a structural deficit stuck at 7pc of GDP rather than "one-off measures".

The deeper concern is Spain, where youth unemployment has reached 44pc and the housing bust has a long way to run. Nouriel Roubini – the economist known as 'Dr Doom' – said Spain is too big to contain. "If Greece goes under that's a problem for the eurozone. If Spain goes under it's a disaster," he said.

Jose Luis Zapatero, Spain's premier, replied wearily: "Spanish public debt (52pc of GDP) is 20pc lower than Europe's average; our treasury spends 5pc of revenues on debt costs, less than France and Germany. Nobody is going to leave the euro," he said.

http://www.telegraph.co.uk/finance/comment/ambroseevans_pritchard/7095818/Funds-flee-Greece-as-Germany-warns-of-fatal-eurozone-crisis.html