From Brussels to Bombay: The euro crisis could spread

By Elena Panaritis

How real is the global impact of Europe's debt crisis?

Here's the bad news: Europe's debt crisis could spread, sending shockwaves across the globe.

How real is this risk? It's real enough for the World Bank's new president, Dr Jim Yong Kim, to warn of a deep global recession if European policymakers do not take the necessary steps to restore stability.

According to Kim, no country is immune. He said decisions in Brussels also affect fisherman in Senegal and software programmers in India. Kim fears that Europe's crisis could even lead to a severe reduction (four percent or more) of GDP in developing nations – enough to trigger a global recession.

Are the warnings getting through to Germany, the European Union's paymaster?

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Not yet. German Chancellor Angela Merkel has refused to budge on proposals that could help solve Europe’s crisis. She has rejected the Eurobonds, dismissed European Central Bank intervention and turned her back on the creation of a speedy banking union. She continues to stand in the way of a sustainable solution.

A statement by Merkel this week also sent the euro currency falling. The chancellor questioned whether “everything will turn out well” and by doing so she sent the bloc’s single currency stumbling to its lowest level in more than three years against the British pound. The euro also suffered broad losses against the dollar and other currencies.

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And as the euro stumbled, bond prices soared over fears of slow economic growth. Cash-strapped Spain suffered the most. Its bond auction ended badly. Spanish ten-year bond yields rose above the seven percent mark making it extremely costly to borrow new money in order to pay for public services and to service its debts.

The fact that Spain, which applied for a Eurozone bailout late last month, had to pay more to sell its debt is not a reassuring sign. It’s actually a disturbing development for the Eurozone and evidence that the bloc’s two-year-old debt crisis is far from being over.

Merkel did, however, take a step towards safeguarding the stability of the Eurozone as a whole on July 19 this year. Her government won a vote on the recapitalisation (as much as 100 billion euros) of Spain’s debt-laden banks in the Bundestag, the lower house of parliament in Berlin.

According to German Finance Minister Wolfgang Schäuble, who kicked off the extraordinary debate in the Bundestag, the only way Spain can continue with its fundamental economic reforms is if problems in the country’s banking sector are solved. “It’s a matter of breaking a vicious circle,” he said.

As Europe's biggest economy, Germany will guarantee the biggest slice of the Spanish aid deal. But it remains to be seen whether the vicious circle Schäuble referred to will finally be broken and whether the European Union will finally embark on a path to sustainable growth, or will it all melt down and the euro will become part of a 12-year exercise that will mark recent history.

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