ECB’s Weber Sees Threat of ‘Grave’ Greek Contagion (Update2)

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(Adds economist’s quote in 12th paragraph. For more on the Greek crisis {EXT3 <GO>})

By Gabi Thesing

May 5 (Bloomberg) -- European Central Bank council member Axel Weber said Greece’s fiscal crisis is threatening “grave contagion effects” in the euro area as stocks fell around the world and riots in Athens left three people dead.

“There is a threat of grave contagion effects for other member states in the monetary union and increasing negative feedback loop effects on capital markets,” Weber said in a statement today as German lawmakers in Berlin debate the proposed rescue of Greece. “All in all, Germany’s contribution to the aid package for Greece is justifiable.”

The euro is tumbling as the Greek fiscal crisis spreads to other indebted nations such as Spain and Portugal. Moody’s Investors Service today placed its Aa2 rating on Portugal’s debt on review for a possible downgrade. In Germany, Chancellor Angela Merkel appealed to parliament to approve the country’s 22.4 billion-euro portion of the joint European Union- International Monetary Fund bailout amid public opposition.

“Weber is worried,” said Juergen Michels, chief European economist at Citigroup Inc. in London. “He knows that if Germany doesn’t ratify the Greek aid plan rapidly we’re facing more turbulence in the weeks ahead.”

The comments came as protests in Athens against austerity measures tied to the country’s bailout turned deadly. Three people were killed after demonstrators set fire to a building housing a branch of Marfin Egnatia Bank SA, fire officials said.
At least three more buildings were set ablaze.

Contagion

Contagion from the Greek crisis swept through European markets today, triggering a surge in the cost of insuring European banks against default to a one-year high and driving Spanish and Portuguese debt swaps wider. The euro fell below $1.29 to its lowest level in more than a year. It has dropped almost 15 percent against the dollar since late November.

Europe’s Stoxx 600 Index declined to the lowest since March and Spain’s IBEX 35 Index extended a 14 percent slide over the past two weeks.

Weber told the parliamentarians, who will vote on the aid package on May 7, that Greece defaulting on its debts “would in the current very fragile situation pose a significant risk to the stability of the monetary union and the financial system.”

Still, he said in a speech in Stuttgart later that there are limits to what policy makers should do, as some economists suggest the ECB could be forced to go as far as buying government bonds to staunch the crisis.

Emergency Measures

"The legitimate aim of preventing contagion effects in Europe's financial system doesn't justify using every means," Weber said. "Measures that damage the fundamental principles of the currency union and the trust of the people would be mistaken and more expensive for the economy in the longer term."

Weber will join ECB President Jean-Claude Trichet and the rest of the Governing Council in Lisbon for the central bank's monthly rate decision tomorrow.

"The ECB for its part should prepare contingent measures to deploy if contagion accelerates further," said Marco Annunziata, chief economist at UniCredit Group in London.

Measures could include reintroducing some unlimited liquidity offerings and abolishing collateral rules, he said.

Greek bond yields yesterday rose above their level before euro-area leaders agreed on the bailout on May 2, as escalating violence in Athens cast doubt on the country's ability to drive through cuts worth 30 billion euros.

Violence Escalates

"The demonstrations in Athens are another factor that must be scaring off, turning the mood of credit markets even more against Athens," Nobel prize-winning economist Edmund Phelps said in an interview on Bloomberg Television. The yield on Greece's 10-year government bond rose 74 basis point to 10.581 percent today.

Protesters trying to gain access to the parliament building today clashed with helmeted and padded riot police. Tear gas was fired at another crowd that threw rocks and set trashcans on fire at the central bank building.

"These measures are unjust and should be paid for by those politicians over the past 30 years who have led us here," said Barbara Tzerbou, 37, a lawyer who traveled to central Athens with her brother to participate in her first-ever protest.

Papandreou "had choices; we didn't need to get as far as the IMF."

Spanish and Portuguese bonds renewed last week's slide as investors questioned whether those countries can cut budget deficits that are among the highest in the region.

'Complete Madness'

Spanish Prime Minister Jose Luis Rodriguez Zapatero yesterday dismissed as "complete madness" speculation that his government would need a Greek-style bailout.

The risk premium on his country's 10-year bonds rose to 134 basis points today and the IBEX Index, the euro region's worst performer this year after Greece, slid as much as 3.4 percent.

Portugal's 10-year government bond spread over German bunds widened to 280 basis points after Moody's signaled a possible credit-rating downgrade.

"Today's rating action reflects the recent deterioration of Portugal's public finances as well as the economy's long-term growth challenges," Moody's said. The company "believes that increased risk discrimination in the financial markets may raise Portugal's financing costs for some time to come."

Countries like Portugal and Spain "don't require help in the way Greece does," said Weber, who heads Germany's Bundesbank. They will have “positive economic growth this year and next year and have the capacity to free themselves from these problems,” he said.

Spain’s budget deficit was the third-highest in the euro region last year at 11.2 percent of gross domestic product, while Portugal had the fourth-biggest at 9.4 percent of output.
Ireland’s topped the list at 14.3 percent and Greece’s was 13.6 percent.

Portugal’s Finance Minister Fernando Teixeira dos Santos told lawmakers today that government spending declined in the first quarter and is under control, while revenue is recovering.

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