Portugal Requests EU-IMF Bailout

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In a new escalation of the euro crisis, Portugal became the third European country to ask the European Union and the International Monetary Fund for a loan under the terms of the European Financial Stability Fund (EFSF). This follows emergency loans by the EU-IMF to Greece (€110 billion in May 2010) and Ireland (€85 billion in November 2010).

On Wednesday evening the Portuguese caretaker administration led by Prime Minister José Sócrates announced that it would request financial assistance from the European Union. On Tuesday government sources had stressed that Portugal had no need for such a loan. Just 24 hours later, however, the government did an about-face, citing pressure from international banks and investors.

The interest rate Portugal pays on its 10-year bond rose to over 8.5 percent on Wednesday, a level that would make it impossible for the country to service its debts. Portugal's financial problems were also worsened following concerted action from leading credit ratings agencies, which recently downgraded Portuguese debt to just one notch above junk status.

The manner in which the major banks and rating agencies are preparing to bring another European economy to its knees was bluntly summed in an editorial in Wednesday's Financial Times entitled "Banks 1, Portugal 0". It declared, "Another Eurozone country has been humbled by its banks. Earlier this week, Portugal's banks were threatening a bond-buyers' go-slow unless the caretaker government sought financial help from other European Union countries. After being beaten up in Wednesday's debt auction, Lisbon has waved the white flag".

Both Sócrates, the head of the social-democratic Socialist Party (PS), and the main opposition party, the right-wing Social Democratic Party (PSD) immediately gave into the banks. Sócrates failed to name a specific sum for the requested loan, but analysts expect it to be between €60 and €80 billion. As in the case of the loans to Greece and Ireland, a new EU-IMF bailout for Portugal will allow the banks and other European governments to demand massive social cuts in Portugal.

The Portuguese government has already passed a series of austerity budgets with broad cuts to public sector wages and jobs. Official unemployment in the country now stands at a record high of 11.2 percent, with nearly double that figure for youth. In addition the country is expected to undergo a renewed recession in 2011. The social turmoil resulting from the austerity measures led to a prolonged series of demonstrations, protests, strikes and general strikes in the country during the past year.

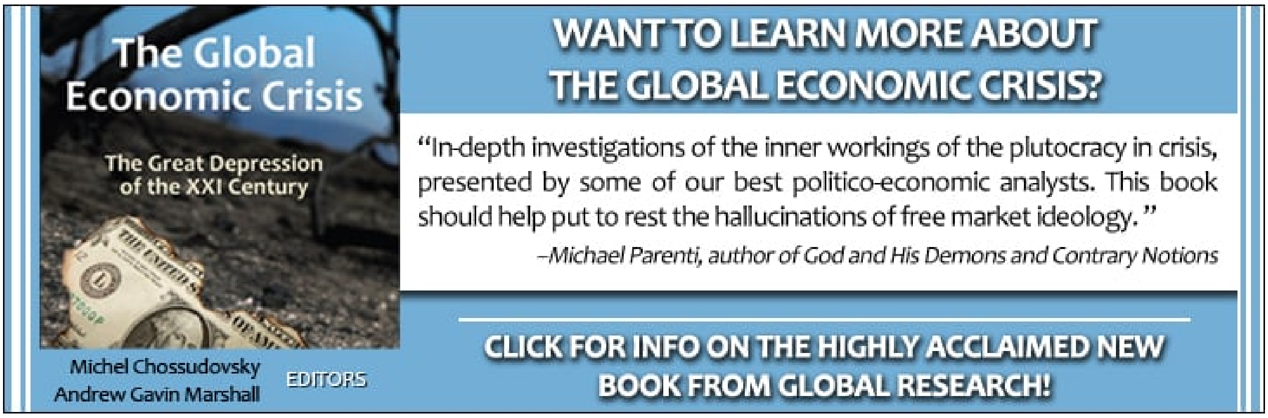
In the face of mass protests, including demonstrations by hundreds of thousands of young workers and families in 11 cities on March 12, the PSD decided that Sócrates was not up to the job of implementing the necessary austerity policies and pulled the plug on his minority government. Sócrates is currently heading a caretaker government until elections take place in two months.

The PSD also immediately rushed to support the EU-IMF bailout. Making clear that its differences with the government were merely tactical, the PSD declared it was committed to the same deficit reduction targets as the PS but differed merely on details. PSD leader Pedro Passos Coelho has proposed a government of national unity to implement the austerity plan to be worked out by the EU and IMF.

With three countries now under, or in the process of entering under the umbrella of the EFSF, the financial markets and rating agencies are increasingly turning their attention on Spain. Spanish banks are estimated to possess one third of the total exposure of foreign banks in the Portuguese financial system, and a deepening of the crisis in Portugal will have immediate consequences for the Spanish economy.

Commenting on the implications of a bailout of Portugal, an article in Pravda(April 4) raises the question, “Is Spain next?” It continues, “The cost of saving Spain, a €1.1 trillion ($1.56 trillion) economy, would dwarf previous bailouts and could test the financial strength of Europe as a whole. The truth is that the rest of Europe simply does not have the kind of financial muscle necessary to continue putting together huge bailouts indefinitely. If Spain does go down, it is going to put a massive amount of strain on the rest of the continent”.

Spain, however, is not the only economy to be threatened by Portugal’s financial woes and a further escalation of the euro crisis. A report this week in the Financial Times revealed that German banks are among the biggest holders of Eurozone sovereign debt—with a total bond holding of €46.5 billion from the governments of Greece, Ireland, Portugal and Spain combined. German banks have an additional €91 billion of exposure to the banking sectors of these countries.



The application for a bailout by Portugal coincides with fresh reports of deepening crisis in a number of other ailing European economies. Having already implemented a series of austerity measures at the behest of the EU and IMF, the Greek economy is, like Portugal, also in recession. As a result of government cuts, the country’s tax revenues are declining and its debt burden increasing. Last year, Greece’s total state debt stood at 148 percent of gross national product. The debt is expected to rise to 160 percent of GDP this year.

In response to its growing fiscal crisis, the Greek government has announced yet another round of austerity measures, aiming to raise some €25 billion over the next four years. The

Greek government plans to raise basic taxes, including a near-doubling in VAT (from 13 to 23 percent) for selected items, and further cuts in the pay of civil servants. These latest measures are supplementary to a new round of privatisations of state assets aimed at raising an additional €50 billion.

The failure of the Greek government to reduce its debt burden despite draconian austerity measures has given rise to renewed speculation that the country will either apply for a further EFSF loan or a restructuring of its debts. This would in turn place the European banking system under enormous strain.

Meanwhile, "stress tests" have revealed that the financial problems of Irish banks are even worse than previously thought. So far, the government has sunk €46 billion into the black hole of the Irish banking system. Now analysts are claiming that a further €24 billion is needed to protect four leading Irish banks from imminent bankruptcy. This will bring the total sum so far transferred to the Irish banking system to €70 billion, around 45 percent of the country's annual gross domestic product. Cash for the new bailout is to be taken from reserves set aside for workers' pensions in the National Pension Reserve Fund.

It is against this background of a crisis spiralling out of control that the European Central Bank announced on Thursday that it was raising its basic rate of interest from one percent to 1.25 percent.

The rise in the bank rate is small but significant. In common with all major central banks, the ECB has run a near-zero interest rate since 2009, following the intensification of the 2008 financial crisis. The record low levels of interest on the part of central banks around the world allowed investors and financial institutions to restock their funds and undertake a new round of speculative trading.

The ECB played a leading role in the crisis by supplying the banks with virtually interest-free loans in the Eurozone, while at the same time buying up billions of euros worth of state bonds from the continent's most beleaguered economies. Having printed and pumped huge sums of money into the banks for two years, the ECB has now reacted to an inevitable increase in inflation by pushing up its interest rates—a measure that puts pressure on governments to prevent workers' demands for higher wages to compensate for higher prices.

The main victims of the ECB rate rise, however, will be the ailing peripheral countries already incapable of paying off their debts. According to financial analysts, the strategy of the ECB is to raise its interest rate in stages by a total of one percent by the end of this year.

Marchel Alexandrovich of Jeffries International stated that a one percent increase in ECB rates would mean that home loan interest payments of Eurozone households would rise by around 7 percent on average. However, this would mean a 30 percent jump in debt service payments for households in Portugal and Finland, a 15 percent increase in Ireland, and a 10 percent rise in Spain and Italy—i.e., a massive new burden for households in struggling economies.

In a debate in the European parliament last week, European Commission President José Manuel Barroso declared that he wanted "to avoid a Europe divided on north-south or centre-periphery lines". Such divisions, however, are the inevitable result of policies pursued at the behest of the banks by the EU, IMF, the ECB and the European Commission that will bankrupt economies across the continent. Such measures will deepen tensions between European states and impoverish millions of workers and their families.

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