Hedge funds speculate on Greek default

By Ulrich Rippert
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Today is the deadline for private investors in Greek government bonds to decide to what extent they will voluntarily participate in a debt relief deal. The Association of International Finance (IIF), which negotiated the so-called "haircut" with the Greek government, has warned of catastrophic consequences should the debt swap agreement fail to be implemented.

IIF President Charles Dallara said Tuesday that an uncontrolled default of Greece would cost more than a trillion euros, as the resulting panic on the markets spread to Spain and Italy. Under the headline "Fear of a Trillion Bankruptcy", the German financial newspaper *Handelsblatt* reported Wednesday that some banks were "speculating on a decline of the euro".

The American hedge fund Greylock was the first to refuse to participate in a debt haircut for Greece and has since been followed by other large private investors. Uncertainty over a voluntary debt solution for private creditors led to severe losses on the stock markets on Tuesday. The German DAX at one point plunged by three percent.

A voluntary debt swap is part of the agreement reached by the finance ministers of the euro zone at the end of February. Their approval for a second financial package for Greece of more than €130 billion was subject to two conditions: first, the implementation of savage austerity measures, and second, a debt haircut for private bondholders amounting to 53.5 percent of the nominal value of their Greek bonds.

The social cuts were adopted by the government and parliament in Athens in the face of increasing popular resistance. But private creditors are stepping up their own offensive and demanding new conditions.

This is despite the fact that the banks and investment funds involved in the debt deal have already been compensated. The new €130 billion "bailout" package for Greece involves transferring €93 billion to the banks in return for their write-off of €107 billion of the face value of their Greek bonds. This is under conditions where the banks involved have long since written off the bulk of these bonds.

The terms of the relief packages for Greece were dictated by the banks and have led to an increase in the financial and political power of the international financial aristocracy. As a result, the reactionary profit motives of a handful of the most rapacious private investment groups are now able to determine the fate of Greece and other euro countries.

Under the headline "Hedge Funds Threaten Debt Deal," the *Süddeutsche Zeitung* writes: "Hedge funds with racy names like Marathon, Saba or Vega hold up to a quarter of the Greek bonds held in private hands." The newspaper points out that if a number of other hedge funds follow the lead of Greylock, the acceptance rate of the deal rapidly falls below the necessary 90 percent.

Should that occur, the Greek government would be forced to use coercive measures to force private creditors to take losses. "This entails a danger", the *Süddeutsche Zeitung* writes. The credit rating agencies would respond to such a contingency by declaring that Greece had "missed a payment", downgrading the country once more and further undermining the bonds of other nations such as Spain and Italy.

This would trigger the payment of credit default swaps (CDS) held as a hedge by bondholders. There are strong indications that hedge funds are refusing to participate in a deal because they have big CDS holdings on which they would like to cash in. It is estimated that these total €2.4 billion.

That, however, could trigger a far bigger chain reaction, in the first instance driving up interest rates on Spanish and Italian government bonds.

Credit default swaps are unregulated, "over-the-counter" investments that do not show up on bank balance sheets. The CDS market is virtually

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impenetrable because banks do not voluntarily yield information about their dealings in the risky financial instruments. It is estimated that the volume of the international CDS market is currently $32 trillion.

Hedge funds and banks buy and sell CDS contracts not only to insure their own bond holdings, they also enter into CDS deals purely to speculate on bond prices, whether or not they hold the particular securities. This gives the entire vast edifice of CDS trading the character of a colossal gambling casino.

Some banks and hedge funds have invested in the CDS market on Greek government bonds in order to bet that Greece will default, triggering a "credit event" and obliging the sellers of Greek CDS contracts to make good on their commitment to guarantee the bonds. Of course, the bigger the speculation against Greek debt, the more likely that a default will occur, creating an incentive for "short" investors to push Greece over the cliff.

The German Hypo Real Estate bank was saved from bankruptcy by the German government after it was dragged into the abyss by CDS transactions, threatening to bring down other banks in its wake. A similar situation led to the US government bailout of the insurance giant American International Group (AIG).

The largest issuers of CDS are major US banks. Should Greece be driven into a disorderly default, the financial consequences for US banks could exceed those that followed the 2008 Lehman Brothers bankruptcy.

This is why US-dominated financial organizations, such as the International Swaps and Derivatives Association (ISDA) in New York, are attempting to calm the markets and avert a panic. The projected debt relief deal for Greece is not a "credit event," said an ISDA spokesman earlier this week, insisting that credit default swaps on Greek bonds were not liable for payment.

Instead of calming the situation, this announcement only heightened nervousness on the international markets.

Whether the Greek debt swap deal has been completed will not be known until late Thursday evening. What is already clear, however, is that three-and-a half years after the Wall Street crash the most aggressive sectors of speculative finance capital have been able to significantly expand their activities and influence. Furthermore, the global financial system, far from having been stabilized by massive injections of public funds, is inexorably heading toward an even deeper crisis.

The entire framework of capitalist finance, based on private ownership and the drive for profit, is rotten, irrational and socially destructive. It cannot be reformed. It must be abolished as part of the socialist transformation of the world economy.

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