European debt crisis intensifies as contagion fears rise. European financial markets continued to deteriorate on Tuesday as investors remained skeptical that Irish bailout will help draw a line under the European debt crisis. Spanish and Italian government bond yields rose sharply, sending the yield spreads over the benchmark German bunds to record highs since joining the euro—the spreads of 10-year Italian securities over similar-maturity German debt rose to more than 2% for the first time since 1997. Nevertheless, the borrowing cost of Spanish (stand at 5.63%) and Italian (4.77%) government debt remain much lower than that of Ireland (more than 9% for 10-year securities) and Greece (almost 12%).

Sovereign debt insurance for Italy, Spain, Portugal, and Ireland surged to fresh records today. Five-year sovereign credit-default swap on Italy rose 22 basis points (bps) to 268 bps, Spain climbed 20 bps to 372 bps, Portugal was up 29 bps at 569 bps and Ireland was 13 bps higher at 617 bps—swaps on Greece also rose 12 bps to 981 bps. Corporate debt insurance cost also escalated, with Markit’s iTraxx Europe Index of 125 companies with investment-grade ratings rising 6.5bps to 120 bps, which is the highest level since July. Meanwhile, the euro fell below the $1.30 for the first time in two months and slid against the yen to levels last seen in mid-September.

Home prices in 20 U.S cities in September were down by 0.7% compared to the previous month, however compared to the same month a year ago they were up 0.6%. Housing prices, which has been at the center of the financial crisis, have been declining consistently on a monthly basis since 2007. However, since March 2010, thanks to the government tax credit which helped boost demand, the decline appears to have been interrupted with moderate property price increases across U.S cities between March and July. The resumption of the downward trend in house prices since August may serve to increase the mounting foreclosure pressures as currently more than 20 percent of borrowers owe more than their home is worth and an additional 33 percent have equity cushions of 10 percent or less, putting them at risk should house prices decline much further.

The number of unemployed falls to 18yr low in Germany. For the 17th consecutive month, the number of unemployed in Germany, the Eurozone’s largest economy, fell. In November the number of people out of work declined by 9000 (seasonally adjusted), leaving a total of 3.14 million unemployed - the lowest level in 18 years [see Chart at http://gem or http://www.worldbank.org/gem]. Structural reforms carried in recent years allowing for greater flexibility in the labor market in particular have been helpful in allowing firms to quickly respond to the upturn in the global demand. Currently, the
unemployment rate remains unchanged at a seasonally adjusted 7.5% (and 7% non-seasonally adjusted). This contrasts with developments elsewhere in the Eurozone where unemployment levels inched up by 0.1% in October to 10.1%, showing the two track recovery path in the Eurozone.

The improvement in employment situation in Germany is already reflected in a firming up of consumer spending, which is all the more important as global trade growth slows down. Germany’s HDE retail industry association reported a strong first weekend of pre-Christmas shopping on Sunday. Stronger domestic demand in Germany should be helpful to support growth, elsewhere in the Eurozone.

Among emerging markets... In Central and Eastern Europe and the CIS, Latvia’s retail sales fell 1.7% (m/m) in October, signaling weaknesses in consumer spending.

In South Asia, the Indian economic recovery maintained its fast pace in the third quarter, with a better than expected increase of 8.9% (y/y) in real GDP at factor cost (sectoral), led by a firming-up in agricultural output. On an expenditure basis, GDP at market prices accelerated to 10.6% (y/y) in Q3 2010 from 10.3% (y/y) in Q2 2010. Private consumption accelerated from 7.8% (saar) in Q2-2010 to 9.3%, but investment growth cooled from 19% (saar) in the second quarter to 11.1% in Q3-2010. Inflation eased marginally, with the headline CPI index growing 9.7% (y/y) in October compared to 9.8% a month earlier, but inflationary pressures are still present with domestic spending remaining strong despite recent interest rate hikes by the central government.

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