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White House said to be watching Greece situation

By Zachary A. Goldfarb, Published: May 10

The Obama administration is closely monitoring the statements and actions of Greek political leaders after voters in Sunday's elections dealt a setback to the country's efforts to overhaul its finances.

A senior Obama administration official said the muddled results were a new complication in the efforts to resolve Greece's debt crisis. The U.S. government, the official said, is studying whether Greek leaders are able to form a functioning government that can negotiate a path forward with the European Central Bank, European Union and the International Monetary Fund.

But the official added that the election results had not changed the fact that Greece has committed to undertaking a series of financial reforms. The official spoke on the condition of anonymity to talk freely about sensitive economic issues.

The problems in Greece and Europe, economists say, pose one of the most serious threats to the fledging U.S. economic recovery.

President Obama echoed this point at a fundraiser in Seattle on Thursday when discussing the U.S. economy. "We've still got headwinds," he said. "Europe is still . . . in a difficult state, partly because they didn't take some of the decisive steps that we took early on in this recession."

Eswar Prasad, a professor of trade policy at Cornell, said that with Congress unlikely to take additional action to stimulate the economy, the burden would fall on the Federal Reserve to help soften the blow of Europe's troubles.

"If there is a possibility of very severe financial stress around the world, I think the Fed would almost always step in," he said.

Ed Truman, a former U.S. Treasury official, said Wall Street has already taken account of much of the economic damage caused by Greece's — and Europe's — problems, and so the impact on the financial markets might not be so pronounced.

"We've already paid a big price," he said.

On Sunday, Greek voters defeated the establishment parties on the left and the right — putting into danger the changes that the nation has already agreed to in exchange for a financial rescue package offered by Germany and the ECB. No party now holds enough seats to be likely to form a coalition government, suggesting that new elections will have to be held soon.

Analysts are warning that with the election result, odds are increasing that Greece will be forced to exit the euro zone.

Prasad said the amount of damage caused by Greece's exit from the euro zone would depend on whether it is sudden or part of a long-term arrangement.

"If it happens in the very short term — next two or three months — which has now become a distinct possibility, that's going to create a great deal of turmoil in European financial markets — and financial markets more broadly," Prasad said.

But he said if Greece were to exit later in the year, when such an event would be anticipated by markets, the damage could be less.

"If by the end of the year Eur-ope has built stronger firewalls around the other peripheral economies or banks, then the financial turmoil will be there, but will be attenuated," he said.

Nigel Gault, chief U.S. economist at IHS Global Insight, said that if Greece decides to continue with its austerity plan, it will likely mean greater stability but a long period of economic stagnation**.**

On the other hand, he said, if Greece were to abandon the euro, it would cause an immediate cataclysm but would open the opportunity for longer-term stability as Greece's own currency would devalue and potentially boost the nation's competitiveness.

"Either alternative is bad," Gault said. "One is much worse in the short run but has the possibility of things getting better in the long term."

Domenico Lombardi, a senior fellow at the Brookings Institution, said the new round of problems buffeting Greece could once again spread to other struggling European countries like Spain and Italy. "This would clearly escalate the pressure on those economies and increase the risk of systemic instability," he said.