A wave of selling rolled through financial markets on both sides of the Atlantic Tuesday, shattering a calm that has pervaded global markets for the past few months, as concerns flared anew about Europe's troubled economies.

Investors are growing increasingly skeptical about the ability of Spain and other heavily indebted nations to successfully implement mandated austerity measures. The worry: Deep spending cuts and increased taxes could send those economies into a downward spiral, making it even tougher to handle their debt loads.

"Now people are beginning to look at fundamentals and wondering, 'Can they achieve it?' " said David Tan, head of global rates at J.P. Morgan Asset management in London. "People are looking at the math and saying, 'No, it doesn't add up.' "

Investors dumped Italian and Spanish bonds, sending prices down and yields to their highest levels this year. Italian stocks fell almost 5%, to their lowest since November, and Spanish stocks tumbled to their lowest close since March 2009.

Investors flocked to safe havens such as U.S. and German government bonds, pushing prices up and yields sharply lower. The benchmark 10-year Treasury note fell back below the closely watched 2% level, to 1.988%.
European stocks dropped early Tuesday, as investors fretted on recent downbeat economic data out of China and the U.S. and rising borrowing costs in Spain and Italy kept Europe's fragile economies in focus. Dana Cimilluca and Martin Essex discuss. Photo: AP

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Backslide
Percentage change in some benchmark stock indexes Tuesday

<table>
<thead>
<tr>
<th>Country</th>
<th>Index</th>
<th>Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>U.S. DJIA</td>
<td>-1.65%</td>
<td></td>
</tr>
<tr>
<td>U.K. FTSE 100</td>
<td>-2.24%</td>
<td></td>
</tr>
<tr>
<td>Germany DAX</td>
<td>-2.49%</td>
<td></td>
</tr>
<tr>
<td>Italy FTSE MIB</td>
<td>-4.98%</td>
<td></td>
</tr>
</tbody>
</table>

Source: WSJ Market Data Group

opened lower on Wednesday, with Tokyo down 1.4%.

The declines come at a time when many investors were already beginning to doubt the durability of recent stock-market gains. Coming into this week, the Dow was up roughly 23% from lows hit in early October and up 7% in 2012.

Dan Greenhaus, chief global strategist at brokerage firm BTIG LLC, is among analysts who have been calling for U.S. stocks to pull back roughly 5% to 7%. They point to the disappointing U.S. economy, European worries and the possibility corporate earnings this quarter may be lackluster.

"Declines like that are totally normal" after such a major rally, Mr. Greenhaus said. And positive catalysts could always emerge to prop up the markets. In the U.S., the first-quarter corporate earnings season got off to a strong start Tuesday with reports from Alcoa Inc. and positive comments from glass-container maker Owens-Illinois Inc.

Some technical analysts point to signs they say point to further declines, at least in the U.S. The Standard & Poor's 500-stock index fell below its so-called 50-day moving average, an indicator of market momentum, suggesting the index is losing steam.

Much of the rally in Europe has been attributed to European Central Bank stimulus that began in December. But that has largely worn off, and ECB President Mario Draghi indicated last week he isn't inclined to step back in.

The U.S. economy is showing signs of struggling. At the same time, some investors worry Federal Reserve Chairman Ben Bernanke is likely to wait for further signs of weakness before he would launch a third round of the stimulatory bond buying known as quantitative easing.

Tuesday's tumult raises the possibility the European debt crisis is beginning a difficult new chapter, one in which policy makers and the population are forced to face the scope of economic transformation necessary to cut governments' massive debt loads.

The drop in Europe came after a long Easter weekend. Tuesday was many investors' first chance to react to disappointing U.S. jobs data. As well, on Monday, Spain's government announced €10 billion of spending cuts in health and education.

In normal times, such a gesture of fiscal restraint might reassure bond markets. But increasingly, investors have grown concerned that measures like this in countries such as Greece, Portugal, Italy and Spain may hurt their economies too much as they struggle with their debts.

Spanish 10-year government-bond yields climbed 0.21
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percentage point to 5.95% as prices declined. Though that yield is still well away from the 7% level economists consider unsustainable, many traders predict the bond selloff could accelerate if yields pass the 6% level, as has happened in the past.

In a new sign the nervousness is spreading, Italian 10-year yields rose to 5.67%.

After the completion of a second bailout for Greece—where dockworkers began a two-day strike Tuesday to protest social-security changes and plans to deregulate shipping—the focus of the euro zone's three-year debt crisis has shifted to Spain and Italy.

The recent rise in borrowing costs is undoing the sharp drop since December, when the ECB began offering unlimited three-year loans to euro-zone banks.

The central bank has lent more than €1 trillion to banks under the program. Some European banks, in turn, used part of the money to buy European government bonds, helping bolster their prices and hold down governments' interest costs. For a time, it seemed there was a chance such a virtuous cycle would be able to slow the debt crisis.

But there is also the chance it could lead to a so-called negative feedback loop. Demand for the bonds appears to be waning; a Spanish debt auction last week was poorly received.

That in turn has hurt European banks. With massive amounts of their capital invested in government bonds, banks have become tethered to that market. Swings in prices for European sovereign debt now spark greater concerns about the solvency of the financial institutions.

Some European bank chiefs on Tuesday called on the ECB to revive its stimulus efforts. Alfredo Sáenz, chief executive of Spain's Banco Santander SA, the largest bank in the euro zone by market value, called for ECB purchases of government debt, something the central bank has been loath to do except in small quantities.

"The ECB has helped monetary expansion with its recent measures, but in my opinion, it should be more aggressive in the purchase of government and bank debt—that is, stronger European quantitative easing," Mr. Sáenz said at a banking conference.

Such a move would reopen a rift on the ECB's governing board. Two of Germany's top officials at the central bank resigned over the issue last year, and German Bundesbank head Jens Weidmann has been a leading critic of ECB bond-buying. It would also be a quick policy U-turn after Mr. Draghi's comments last week.

Spanish policy makers attempted to shore up confidence in Spain at a series of public appearances. "The agenda of reforms goes on, because we are convinced that with an economy based on austerity, reforms and equality Spain can emerge from its crisis," Finance Minister Luis de Guindos said at a conference.

—David Román, Geoffrey T. Smith and Matina Stevis contributed to this article.
Write to Matt Phillips at matt.phillips@wsj.com, Jonathan House at jonathan.house@dowjones.com and Christopher Bjork at christopher.bjork@dowjones.com

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