CRASH ALERT: The Stock Market is Falling like a Stone

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As you might have noticed, the stock market is falling like a stone. As of 9 AM PST, the Dow Jones has dropped 172 points while all the other indices are down sharply. German 2-year debt (bund) has dipped below 0% this morning at auction, signalling an acceleration in the bank run taking place in southern Europe. Depositors in Spain, Greece, Italy, Portugal, etc would rather take a loss on their investment, then risk not their money back at all. The European Central Bank (ECB) does not guarantee deposits, so people are withdrawing their money en masse and getting out of Dodge pronto. What we're seeing is a real-time panic.

The ostensible trigger for the panic is known, but you won't read about it in the financial media where the news is dumbed down to the point of incoherence. What's really going on is that the German central bank (The Bundesbank) has indicated that it's ready to pull the plug on Greece which means that future bailouts will probably not be forthcoming. That's bad. It means that Greece will run out of money some time in June; their banking system will implode, and the "birthplace of democracy" will be reduced to 3rd world status overnight. Here's a blurb from the Bundesbank's communique:

"Current developments in Greece are extremely worrying. Greece is threatening not to implement the reform and consolidation measures that were agreed in return for the large-scale aid programmes.

This jeopardises the continued provision of assistance. Greece would have to bear the consequences of such a scenario. The challenges this would create for the euro area and Germany would be considerable, but manageable given prudent crisis management. By contrast, a significant dilution of existing agreements would damage confidence in all euro-area agreements and treaties and strongly weaken incentives for national reform and consolidation measures. In such circumstances the institutional status quo comprising liability, control and individual responsibility of member states would be fundamentally called into question.

When the Eurosystem provided Greece with large amounts of liquidity, it trusted that the programs would be implemented and thereby ultimately assumed considerable risks. In the light of the current situation, it should not significantly increase these risks. Instead, the parliaments and governments of the member states should decide on the manner in which any further financial assistance is provided and therefore whether the associated risks should be assumed."

Okay. So German central bankers don't want to wait until the June elections in Greece to decide whether to provide more money or not. They're throwing in the towel now. No more money. No more bailouts. No more Mr. Niceguy. End of story. But what does that mean? Does it mean that the whole global financial system is headed back into the shitter again like after Lehman Brothers?

No one knows for sure, but there's bound to be a few bumps in the road, don't you think? Take a look at this from Bloomberg today (Wed):

"Europe's banks, are sitting on $1.19 trillion of debt to Spain, Portugal, Italy and Ireland, are facing a wave of losses if Greece abandons the euro. While lenders have increased capital buffers, written down Greek bonds and used central-bank loans to help refinance units in southern Europe, they remain vulnerable to the contagion that might follow a withdrawal, investors say. Even with more than two years of preparation, banks still are at risk of deposit flight and rising defaults in other indebted euro nations." (Bloomberg)

Can you really slash a trillion bucks out of the rotting corpse of the EU banking system and still keep things running smoothly?

Don't bet on it. Here's more from Bloomberg:

> "The ECB's unprecedented provision of 1.02 trillion euros in three-year cash in December and February helped calm financial markets in the first quarter by removing concern that banks unwilling to lend to one another would run out of cash. Lenders in Spain and Italy also used the funds to buy sovereign debt, reducing government borrowing costs….
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> Lenders probably would need another 800 billion-euro liquidity lifeline from the ECB to help stem contagion from a Greek exit, Citigroup analysts estimated in a May 17 note…." (Bloomberg)

That's right, the EU banks were gifted over 1 trillion euros 3 months ago, and they're still too undercapitalized to weather the storm of a Greek default. Nice, eh? So, the whole system is just an empty gourd, right? They're broke, so the ECB will have to print up another 800 bil just to keep the house of cards from collapsing in a heap.

Getting worried yet?

US Treasuries are also rallying big today. In fact, the yield on the 10-year –which hit a record low last week–is on its way back down indicating that investors are freaking scared-out-of-their-minds. In real terms, investors are now socking money into 10-year Treasuries knowing that (inflation adjusted) they'll get LESS money back then they put in.

How do you like them apples? That's what I call a full-blown panic! And yet, you ain't hearing a blasted thing about it on the news, right? Why would that be?

Here's a little icing on the cake from Bloomberg:

"Greece may have only a 46-hour window of opportunity should it need to plot a route out of the euro.

That's how much time the country's leaders would probably have to enact any departure from the single currency while global markets are largely closed, from the end of trading in New York on a Friday to Monday's market opening ….

> "I am completely convinced they could not orchestrate an orderly exit," said Erik Nielsen, chief economist at UniCredit SpA in London. "This is a country that can't implement laws, so how in the world are they going to secretly agree to print money, control the banks, control capital flows and think this is going to be orderly? It's completely impossible." …
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> "There is no reason to think there won't be riots and violence," said Lefteris Farmakis, a strategist at Nomura International Plc in London. "It would be a pretty disastrous situation. People have no understanding of the consequences of a euro exit." ("War-Gaming Greek Euro Exit Shows Hazards in 46-Hour Weekend", Bloomberg)

Riots, street violence, skyrocketing unemployment, grinding poverty…the whole schmeer. And what's the most likely scenario for Greece after all that?

Well, probably another military coup backed by President Hopium and his band of CIA merry pranksters, right?

Okay, my bad. I don't want to polarize all the Obama fans, but, Geez Louise, things are looking mighty grim for the poor Greeks, don't you think?

Of course, it all could go smoothly "without a hitch"; no credit crunch, no bank runs, no flight to safety, no crashing stock markets, no decades of struggle and social unrest, no splitting up of the eurozone, no ethnic animosities, no uber-nationalism, no right wing fanaticism, no border skirmishes or armed hostilities, no revolutions, no depression, no rise of fascism…just a smooth transition to a new, slimmed-down version of the EZ. After all, that's what Germany is expecting. And they could be right.

But, probably not.