Crisis of the European Monetary System: The Euro Zone is on the Edge of Collapse

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Global Research, December 11, 2010
International Forecaster 11 December 2010

Region: Europe
Theme: Global Economy

Believe it or not the euro zone and European Union crisis is still in the formative stages.

The bailout packages arranged for Greece and Ireland are not to bail out those two countries, but to bail out the European banks that lent to them and bought their bonds when it was imprudent to do so. They knew, because they control the governments that the public of the solvent governments would bail them out. Thus, the governments of Ireland and Greece with Portugal and Spain to follow will be showered with an Anglo-American style bailout. As you know $1 trillion won't be enough to make the banks happy, so $3 trillion will be needed. Germany says no we are not going to do that. Well, we'll see just who the real masters of Germany are. Such policy flies in the face of German culture. It shows you though how close to the edge Europe and its euro zone really is. Germany understands, but the rest of Europe, particularly the PIIGS are in denial. The IMF has its nose under the blanket. It will lend and participate, so that it can serve its masters by keeping these wayward states completely in austerity and bondage for the next 50 years and in that process relieve them of their sovereignty. As all of Europe belatedly understands, one interest rate can never fit all.

We can assure you that the euro zone is on the edge of collapse. It's just a question of when. Nothing has been contained nor can it be contained. Like in the US the taxpayers of the solvent countries must bail out the banks and other financial institutions of Europe. The monetary policy created by the European Central Bank and the bankers has failed. Whether this was deliberate or not, we do not as yet know, but the truth will eventually surface. Currently the scapegoats are the citizens of these beleaguered countries, when in fact the real malefactors reside at the ECB and the European Parliament. These same players still do not have solutions other than destroying the Greek and Irish societies in the name of repaying the bankers. Whether you realize it or not, it has been a year since this odyssey began in Greece. We now have Ireland and they will be followed by Portugal and Spain and perhaps even Italy.

The main battlefield that will decide the outcome will be Spain due to its size and its persistent claim that Spanish banks are very solvent, which is symptomatic of denial. Mr. Zapatero tells us the Spanish debt crisis has passed. Our question, is he dumb, naive or a liar? How could he be so out of touch with reality? He blames Greece and Ireland for the euro zone's problems as if Spain was a victim of theirs and blameless. Mr. Zapatero's leadership is simply idiotic. This incompetent is shepherding his people toward financial disaster and servitude. Their real problem is the euro, the euro zone, the ECB, the EU and those who have allowed Europe to be led into a financial and economic trap. Germany, the euro zone powerhouse, doesn't want the euro or the EU and has never wanted them. They have been it shoved down their throats, because they lost WWII. This is also why Germany was forced to merge Eastern Germany into Western Germany under such horrible terms. Germany is sick of being used as a punching bag and they want out of both. In addition, the cost of staying in the euro is already unacceptable. Any further higher costs could lead to insolvency of currently stable countries such as Germany. Then there are the social issues. Germans expect other countries to work as hard as they do. That has not been the case and will never be the case, so they no longer want to continue to support them. Some say, the withdrawal from the euro will be too traumatic to contemplate. We say concerns regarding bankruptcy would be far more painful. A reflection of that are Germany's recent failed auctions. Buyers are only taking 20% of the offering. We interpret that as fear that Germany will financially injure itself if it has to continue bailing out failed euro zone members.

European bond markets are beset with the same problems and solutions that the UK and US are. The ECB and the Fed have to remain active in the bond markets, otherwise they fall. They have to buy persistently and in size. This week we saw the biggest drop in bonds and rise in yields in some time, as the selling grew overwhelmingly. The yield on the 10-year T-bill rose to 3.30% from 2.50% only a month ago. The 30-year fixed rate mortgage as a result rose from 4.30% to 4.66%. The bond markets cannot function without manipulation from the ECB, the Fed and the Bank of England. Needless to say, these interventions are not solutions – they only prolong the inevitable. The bonds need higher yields to compensate for risk or buyers must be convinced solutions are in hand, otherwise in the end the ECB, the Fed and the Bank of England will end up with all the government bond issues, which will lead to collapse. The sovereign crisis in all of these countries has not been solved, nor will it be solved with current policies. Once Ireland and Greece leave the euro, Portugal and Spain and perhaps Italy would be forced to follow. That would mean the demise of the euro. Like it or not that would cause currency controls in each of these currencies. Bank withdrawals would be limited as would travel outside each country. Each country making their goods and services inexpensive and competitive with those of other nations would set currency values low. There would be no debt overhang because debt would have been decimated. Bourses would function in a primary fashion. In many ways Europe would look as it did in the late 1940s and 1950s, without the physical destruction. We were there we experienced it. Recovery would take five to ten years, perhaps longer. There will be no Marshall Plan because the US and England will not be any better off. Nations will put new currencies in place and the rebuilding of economies and markets would commence accompanied by tariffs. The cycle would begin again.

The option presently being pursued is unworkable. Perhaps $1 trillion can take care collectively of Greece, Ireland and Portugal, but an additional $2 trillion would be needed to bail out Spain ad Italy. In the end the debt load forced on the solvent countries would be unmanageable and that doesn't even include the political will, which could disappear at anytime. Remember, Germans, French, Dutch and Austrian patience are already close to an end. At the same time there would be a major bureaucratic tug of war between those who want their national sovereignty returned and those who would want even more amalgamation, the reason that Europe is in the state that it is today.

The assumption of fiscal decisions by the EU in Brussels regarding fiscal policy will be a fateful decision, because it will strip each state of its sovereignty. Otherwise Brussels' bureaucrats have made an expensive mess of everything else. Transferring such power under today's circumstances would be a shortsighted mistake.

There is no changing the culture and attitude of Portugal, Spain, Italy, Greece and Southern France. They are what they are and have been for centuries. They will never have the work ethic of northern Europe and, thus, they will never be competitive. This is why the Treaty of Versailles II option will be met with aggressive non-compliance. This is a forced devaluation internally within the EU in the form of lower wages. The goal is to make exports more competitive. This is just another wrinkle in the currency war that will bring about tariffs. This is not ingenious – it is transparent and stupid. The cheapening of capital is essentially a devaluation, that is if they can get away with it, which they cannot.

The cuts are too deep too fast. Shock treatment is traumatic and often does not bring the desired results. Overnight it is expected that Greece and Ireland will balance their budgets, have no reason to issue more debt, while the ECB buys toxic sovereign bonds. Who is going to absorb those losses? The public of all euro zone countries, of course. This is exactly what the UK and US are doing through their central banks. The ECB is just a little late to the party. Monetizing doesn't work and the debt purchased is still there to be written off. Deflation has gotten a small foothold in Europe and unless quickly reversed could end up irreversible. We do not think so though. The ECB has seen the error of its ways via Keynesianism and they will issue money and credit to meet the challenge and suffer the same inflation that others will. In the end monetization destroys all in the name of buying time.

If all of this is not going to work eventually then why do it? Why not do what Iceland has done and restructure debt, allowing bondholders to share losses. This, of course, is a form of partial default and in all probability it will work. This is also called a managed default similar to what happened in the early 1970s at the Smithsonian talks, at the Plaza Accord in 1985 and the Louvre Pact in 1987. Due to the contagion that would be caused by such unilateral policies, such attempts have to be done with all nations participating. This is the only fair way to solve the overall dilemma. There is no nation without quilt. They have all participated in cheapening their currencies, have created far more debt than they should have and have all engaged in excessive creation of money and credit. The notion that Germany, China and the US can produce capital to solve the problem is ludicrous. They all have their own problems. There can be no bailout, or the appearance of some savoir this time. Every nation has to bite the bullet simultaneously. This means that nations have to understand that quantitative easing will have to end and that a deflationary depression has to be accepted. The system has to be purged of its excesses in the creation of capital and its allocation. Banks and other financial institutions have to accept the blame for what they have done in their quest for excessive profits and power. This approach is the only way to avoid social chaos. After three years of recession and depression the world public is in no mood to play games. They have to be told the truth and what to expect. The blame game can be dealt with later. Either this happens or the world goes down in flames economically and financially.

We cannot afford more stress tests, which are nothing less than a game of fraud. Bank tests have to account for the risk of sovereign default. Most nations do not want their public or the rest of the world to know that they are financially on the edge of the abyss.

It is important to understand the concept of European government default and the potential inability to bailout banks. In the end there isn't enough money to bail them out, even if they print it. The flipside is inflation, hyperinflation and deflationary depressions. As a consequence very few people have much confidence in their bank, or its ability to survive. As a result, credit default swaps linked to 25 banks and insurers continue upward, which means confidence and perception are worsening. In addition, investors do not believe banks' assets are worth what they say they are.

The bottom line is the stress test does not work. How can it when they are allowed to keep two sets of books?
