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Europe's Debt Crisis. How Does it Affect America?

By Washington's Blog
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What's Happening In Europe … Does It Impact American Investors and Taxpayers?

All of Europe is now infected with the debt crisis, not just the periphery.

As CNBC notes, the multinational bailout of European banks won't do much:

> After UBS announced it had lost $2 billion due to an alleged rogue trader, the world's major central banks stepped into the void created by the euro zone debt crisis.
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> The Federal Reserve and the European Central Bank, in co-ordination with the Bank of England, Swiss National Bank and Bank of Japan announced a plan to offer three-month dollar loans to commercial banks in order to avoid a liquidity crisis in the euro zone banking system.
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> The problem for Higgins is that while liquidity is not as big a problem as it was in late 2008 following the collapse of Lehman Brothers, solvency is.
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> "Even if banks in the euro-zone have less of a liquidity problem on their hands today than they did in late 2008, they have a greater solvency problem. This is reflected in the fact that the cost of insuring against a default by the banks is much higher," Higgins explained.
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> "Policymakers' response to the financial crisis was to recapitalize the banks and transfer risk to the public sector," he said.
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> This is now coming back to haunt the banks, according to Higgins, as they hold so much government debt and the governments themselves are in no position to offer renewed support.
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> "We expect a further near- to medium-term escalation of the euro zone crisis involving the default of a sovereign in, and the possible departure from monetary union of, at least one country," said Higgins.

Win Thin, a senior currency strategist at Brown Brothers Harriman, said today:

> "They're taking care of the symptoms, but the underlying illness is still out there. On the margin, it's positive. Until Greece defaults and we clear this whole thing up, they're still treading water"

Not Just Europe … U.S. Impacted Too

But it's not just Europe …

As MSNBC reports, US taxpayers could be on hook for Europe bailout.

The Economic Collapse Blog points out:

> Today we found out that once again the Fed is going to be taking huge piles of your money and loaning it to commercial banks in Europe. The Congress cannot overrule this decision. Neither can Barack Obama. Because it has so much power, many refer to the Federal Reserve as "the fourth branch of government", but unlike the other three branches of government, there are basically no significant "checks and balances" on the Federal Reserve. If you don't like the fact that the Federal Reserve is racing in to help big foreign banks survive the European debt crisis that is just too bad. The Federal Reserve pretty much gets to do whatever it wants to do, and the folks over at the Fed simply do not care whether you like that or not.
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> The Federal Reserve and other major central banks around the world decided that lending big European banks gigantic piles of dollars would be a good idea, so they are just doing it.
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> No debate, no votes and no democracy – they just tell us how things are going to be and that is that.
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> So how much money is going to be loaned out?
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> Well, according to an article in The Daily Mail, big European banks are going to be able to borrow an "unlimited" amount of money….
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>> The deal announced yesterday means banks will be able to borrow 'any amount' of money in three separate auctions in October, November and December. Banks will have to put up collateral, or security, to tap the emergency funds.

U.S. banks and money market funds are exposed to the meltdown in Europe as well. So the meltdown in Europe could cause real problems in the U.S.

Indeed, if Wall Street insured much of the European debt through derivatives contracts, the fallout could be amplified many times over. As the New York Times noted in June:

> If there were a single company standing behind many of these contracts, that company would be akin to the American International Group of the euro crisis. The American insurer needed a $182 billion federal bailout during the financial crisis because it had insured the performance of mortgage bonds through derivatives and could not pay on all of them.
>
> Even regulators seem unsure of whether a Greek default would reveal such concentrated risk in the hands of just a few companies. Spokeswomen for the central banks of both Europe and the United States would not say whether

their researchers had studied holdings of such contracts among nonbank entities like insurance companies and hedge funds.

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Derivatives traders and analysts are debating just how much money is involved in these contracts and what sort of threat they pose to markets in Europe and the United States.

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The less conservative figure, the gross exposure, is $78.7 billion for Greece, according to Markit. And there are many other types of contracts, like about $44 billion in other guarantees tied to Greece, according to the Bank of International Settlements. The gross exposure of the five most financially pressed European Union countries — Portugal, Italy, Ireland, Greece and Spain — is about $616 billion. And the broader figure on all derivatives from those countries is unknown.

The pervasiveness of these opaque contracts has complicated negotiations for European officials, and it underscores calls for more transparency in the derivatives market.

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“There’s not any clarity here because people don’t know,” said Christopher Whalen, editor of The Institutional Risk Analyst. “This is why the Europeans came up with this ridiculous deal, because they don’t know what’s out there. They are afraid of a default. The industry is still refusing to provide the disclosure needed to understand this. They’re holding us hostage. The Street doesn’t want you to see what they’ve written.”

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Darrell Duffie, a professor who has studied derivatives at the Graduate School of Business at Stanford University, said that he was concerned that regulators may not have adequately studied what contagion might occur among swaps holders, in the case of a Greek default.

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At the European Central Bank, Eszter Miltenyi, a spokeswoman, said: “This is much too sensitive I think for us to have a conversation on this.”

On Wall Street, traders are debating whether the industry’s process for unwinding credit-default swaps would run smoothly if Greece defaulted. The process is tightly controlled by a small group of bankers who meet in an industry group called the International Swaps and Derivatives Association.

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The uncertainty around how a sovereign default would course through the derivatives market had greatly increased the price premiums banks were charging to put on new derivatives trades related to European countries. As of last week, the price to insure against default on $10 million of Greek debt was $1.9 million per year, up from $775,000 a year ago, according to Markit.

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“There is lack of transparency and visibility in these products, and that

> increases the risk," said Marc Chandler, global head of currency strategy at Brown Brothers Harriman, a boutique banking firm in New York.

(Economics professor Michael Hudson alleges that the European debt crisis is really financial warfare by the bank, and that the the U.S. is strong-arming European countries into austerity because U.S. banks have issued credit default swap "insurance" against their debt, and American banks don't want to have to pay out on such "policies".)

What Caused the European Crisis?

Matt Taibbi notes that it wasn't a rogue trader, but a rogue bank … or more accurately, all big banks have gone rogue.

As I've noted for 3 years, there wouldn't be a crisis among European nations if banks' toxic gambling debts hadn't been assumed by the world's central banks.

Fraud caused the Great Depression, and the current crisis as well. But – instead of solving the problem – fraud has been covered up in Europe, just like in the U.S. Indeed, one of the world's top experts on fraud says that we've had the greatest financial crime in the history of the world, and that none of the main players have been prosecuted.

As such, the European crisis continues to worsen, just as the U.S. economy is worsening because no amount of band-aids will cure a cancer that is not removed.

Ultimately, the Failure to Follow the Rule of Law Caused the European – Like the American – Crisis

As I wrote last year:

> The government is deploying all of its equipment to rescue the economy.
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> But rather than fixing the economy, the equipment is just getting swallowed up.
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> Why?
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> Ben Bernanke's answer to all of the water running out of the bathtub (high unemployment, falling home prices, slow growth, etc.) is to pour more and more water (easy money) into the tub (quantitative easing, zero percent interest rates, etc.)
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> Similarly, Geithner and Obama and Congress can throw all of the money at the giant banks through direct and hidden bailouts that they like, but – until the hole is plugged – nothing they do will work.
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> The water will just keep running away.
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> What's the hole that is swallowing up the economy? The failure to follow the rule of law.
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> The rule of law is what provides trust in our economy, which is essential for a stable economy.
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> The rule of law is the basis for our social contract. Indeed, it is the basis for our submission to the power of the state.

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Lawlessness – the failure to enforce the rule of law – is dragging the world economy down into the abyss.

No investor – or taxpayer – in Europe or America (or any other part of the world) will be safe until the rule of law is restored.

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