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Europe's widening sovereign debt crisis: Greece is but the Tip of the Iceberg

By Pete Grant
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As the price tag for the EU/IMF bailout for Greece has steadily grown over the past several months and contagion within the euro-zone has commenced, US investors are beginning to realize that the widening European sovereign debt crisis may indeed have some significant implication on our side of the pond.

While Europe scrambles to quarantine Greece with a proposed $150 bln bailout, the market remains extremely skeptical of the odds of success.

Greece is indeed just the tip of the iceberg, and whether the end-game is triggered by a sovereign default or a bailout — the die is cast at that point — there will either be a series of defaults or a series of bailouts within the Eurozone.

The outcome for either scenario could be equally dire. In fact, whether it's default or bailout, the potential is for an economic crisis far larger in scope than the 2008 US banking crisis.

The so-called PIIGS nations (Portugal, Ireland, Italy, Greece and Spain) have about $600 bln in funding needs this year alone according to Bank of America. Total financing needs for the PIIGS over the course of the next three years is nearly $2 trillion. The total debt of these countries is a staggering $3.9 trillion, according to a recent New York Times article.

Europe bares the brunt of this risk, due to the complex web of financial interconnectedness that has emerged in the region over the past decade, but the risks certainly don't end there. The pain may be initially contained, but if the large French, Swiss and British banks start feeling the pinch, it's just a matter of time before that pain gets exported to America.

Click here for an excellent graphic depiction of the aforementioned web of interconnectedness.

A Barclays Capital report back in February indicated that US banks had about $176 bln in exposure to Greece, Portugal, Spain and Ireland. Most of that risk being concentrated at the top-ten largest US banks; those likely still considered "too-big-to-fail."

More recently, Wells Fargo reported that JPMorgan — the second largest US bank — has exposure to the PIIGS totaling 28% of its Tier-1 capital. For Morgan Stanley, that risk is a whopping 69% of Tier-1 capital.

Tier-1 capital is a bank's core capital, including equity capital and disclosed reserves. It's not hard to imagine, that if a large chunk of core capital suddenly became illiquid and perhaps even worthless, US banks would be sprinting back to the government till, looking for yet another bailout of their own.

As perhaps a holdover from the World Wars, Americans still seem to view the Atlantic Ocean as an effective buffer against the woes on the Continent. Given how effective we were at exporting our sub-prime mortgage crisis across the Atlantic to Europe, it's naïve to think that a European sovereign debt crisis won't work its way to our shores.

A truly unquantifiable aspect of this developing crisis is the 'fear factor' — be it rational or irrational. Fears are unquestionably mounting in Europe and when markets react to fearwell, anything can happen.

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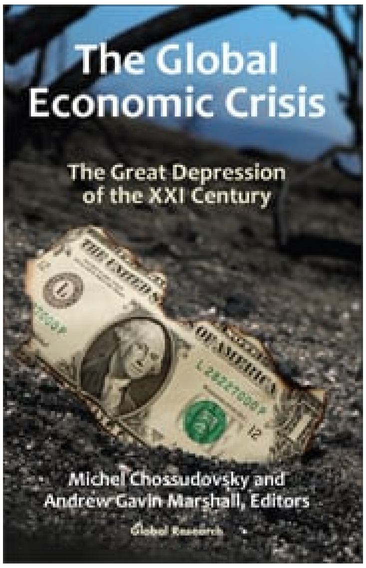

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