

THE SPAILOUT: Stock Markets Tumble. Failure of the Spanish Bailout

By [Washington's Blog](#)

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The market rallied for a couple of *hours* on news of the \$100 billion dollar Spanish bailout (which everyone is calling the [Spailout](#)) ... and then crashed.

Bloomberg [notes](#):

U.S. stocks fell, following the biggest weekly rally in the Standard & Poor's 500 Index this year, as optimism over Spain's bailout plan gave way to skepticism it will succeed in halting the debt crisis.

"The Spanish deal is another Band-Aid," said Matt McCormick, who helps oversee \$6.2 billion at Bahl & Gaynor Inc. in Cincinnati. He spoke in a telephone interview. "Many investors are viewing this with skepticism. The problem is not going to be fixed by this amount. It's not a solution, and people know the difference. Expect more volatility not less."

CNBC [writes](#):

Stocks accelerated their selloff in the final minutes of trading to close down more than 1 percent across the board Monday, as initial euphoria over Spain's bank bailout fizzled and amid ongoing fears over a global economic slowdown.

"A lot of people were concerned over the size of the bailout—we were expecting something closer to 150-200 billion [euros] and we only got 100 billion," said Phillip Streible, senior commodities broker at RJO Futures. "So once traders started to digest [the news], they started to take profit or sell into that rally because they think that in another 3 to 6 months, Spain's going to have to come back and ask for additional money."

Zero Hedge [says](#):

As evidenced by today's reaction to the bailout, which had a half life of 2 hours, and was a complete failure in 6, the market is learning much, much faster than expected.

This "Spanic" over the Spanish crisis is occurring even [before the ink has dried](#).

Nobel economist Joe Stiglitz [pointed out](#) the Ponzi scheme nature of the whole bailout discussion:

Europe's plan to lend money to Spain to heal some of its banks may not work because the government and the country's lenders will in effect be propping each other up, Nobel Prize-winning economist Joseph Stiglitz said.

"The system ... is the Spanish government bails out Spanish banks, and Spanish banks bail out the Spanish government," Stiglitz said in an interview.

"It's voodoo economics," Stiglitz said in an interview on Friday, before the weekend deal to help Spain and its banks was sealed. "It is not going to work and it's not working."

Credit Suisse's William Porter [writes](#):

"It's all about Spain", so now we are cutting to the chase. Recapitalization of the banks versus funding the sovereign is of course a semantic issue given the nature of the interplay. But it enables the attempted finesse we describe below.

"Portugal cannot rescue Greece, Spain cannot rescue Portugal, Italy cannot rescue Spain (as is surely about to become all too abundantly clear), France cannot rescue Italy, but Germany can rescue France." Or, the credit of the EFSF/ESM, if called upon to provide funds in large size, either calls upon the credit of Germany, or fails; i.e, it seems to us that it probably cannot fund to the extent needed to save the credit of one (and probably imminently two) countries that had hitherto been considered "too big to save" without joint and several guarantees.

Porter says that either France or the EFSF/ESM will fail in 2 months.

Press Association [notes](#) today:

Spain became the fourth country after Greece, Ireland and Portugal to turn to the eurozone rescue fund for financial help.

Of course (to no one's surprise) [Italy is next](#) in the [cross-hairs of debt crisis](#).

Many of us have been forecasting how this was going to play out since 2008.

For example, we [noted](#) in 2010:

It is now common knowledge that there is a potential domino effect of European sovereign debt contagion in roughly the following order:

Greece → Ireland → Portugal → Spain → Italy → UK

It is also now common knowledge that while Greece and Ireland have relatively

small economies, there will be real trouble if the Spanish domino falls.

As Nouriel Roubini [wrote](#) in February:

But the real nightmare domino is Spain. Roubini refers to the Spanish debt problems as “the elephant in the room”.

“You can try to ring fence Spain. And you can essentially try to provide financing officially to Ireland, Portugal, and Greece for three years. Leave them out of the market. Maybe restructure their debt down the line.”

“But if Spain falls off the cliff, there is not enough official money in this envelope of European resources to bail out Spain. Spain is too big to fail on one side—and also too big to be bailed out.”

With Spain, the first problem is the size of its public debt: €1 trillion. (Greece, by contrast, has €300 of public debt.) S

pain also has €1 trillion in private foreign liabilities.

And for problems of that magnitude, there simply are not enough resources—governmental or super-sovereign—to go around.

And as I’ve previously [pointed out](#), Germany and France – the world’s 4th and 5th largest economies – have the greatest exposure to Portuguese and Spanish debt. For more on the interconnections between Euro economies adding to the risk of contagion, see [this](#) and [this](#).

While it is tempting to assume that the Eurozone bailouts mean that creditor nations which have managed their economies well and saved huge amounts of excess reserves which they lend out, Sean Corrigan [points out](#) that the European bailouts are a Ponzi scheme:

Under the rules of this multi-trillion shell game, the sovereigns guarantee the ECB which funds the banks which buy the government debt which provides for everyone else’s guarantees.

(America is no different: Bill Gross, Nouriel Roubini, Laurence Kotlikoff, Steve Keen, Michel Chossudovsky and the Wall Street Journal all [say](#) that America is running a giant Ponzi scheme as well....

It didn’t have to be like this. The European nations did not have to sacrifice themselves for the sake of their big banks.

As Roubini [wrote](#) in February:

“We have decided to socialize the private losses of the banking system.

Roubini believes that further attempts at intervention have only increased the magnitude of the problems with sovereign debt. He

says, “Now you have a bunch of super sovereigns— the IMF, the EU, the eurozone—bailing out these sovereigns.”

Essentially, the super-sovereigns underwrite sovereign debt—increasing the scale and concentrating the problems.

Roubini characterizes super-sovereign intervention as merely kicking the can down the road.

He says wryly: “There’s not going to be anyone coming from Mars or the moon to bail out the IMF or the Eurozone.” [[Others](#) have made the [same point](#)]

But, despite the paper shuffling of debt at the national level—and at the level of supranational entities—reality ultimately intervenes: “So at some point you need restructuring. At some point you need the creditors of the banks to take a hit—otherwise you put all this debt on the balance sheet of government. And then you break the back of government—and then government is insolvent.”

Indeed, the world’s foremost banking authority [warned in 2008](#) that this would happen:

As I [pointed out](#) in December 2008:

The Bank for International Settlements (BIS) is often called the “central banks’ central bank”, as it coordinates transactions between central banks.

BIS points out in a new [report](#) that the bank rescue packages have transferred significant risks onto government balance sheets, which is reflected in the corresponding widening of sovereign credit default swaps:

The scope and magnitude of the bank rescue packages also meant that significant risks had been transferred onto government balance sheets. This was particularly apparent in the market for CDS referencing sovereigns involved either in large individual bank rescues or in broad-based support packages for the financial sector, including the United States. While such CDS were thinly traded prior to the announced rescue packages, spreads widened suddenly on increased demand for credit protection, while corresponding financial sector spreads tightened.

In other words, by assuming huge portions of the risk from banks trading in toxic derivatives, and by spending trillions that they don’t have, central banks have put their countries at risk from default.

But They Had No Choice ... Did They?

But nations had no choice but to bail out their banks, did they?

Well, actually, they did.

The leading monetary economist [told](#) the Wall Street Journal that this was not a liquidity crisis, but an insolvency crisis. She said that Bernanke is fighting the last war, and is taking the wrong approach (as are other central bankers).

BIS [slammed](#) the easy credit policy of the Fed and other central banks, the failure to regulate the shadow banking system, “the use of gimmicks and palliatives”, and said that anything other than (1) letting asset prices fall to their true market value, (2) increasing savings rates, and (3) forcing companies to write off bad debts “will only make things worse”.

Remember, America wasn’t the only country with a housing bubble. The world’s central bankers let a global housing bubble development. As I [noted](#) in December 2008:

The bubble was not confined to the U.S. There was a worldwide bubble in real estate .Indeed, the Economist magazine [wrote](#) in 2005 that the worldwide boom in residential real estate prices in this decade was “the biggest bubble in history”. The Economist noted that – at that time – [the total value of residential property in developed countries rose by more than \\$30 trillion, to \\$70 trillion, over the past five years – an increase equal to the combined GDPs of those nations.](#)

Housing bubbles are now bursting in [China](#), [France](#), [Spain](#), [Ireland](#), the [United Kingdom](#), [Eastern Europe](#), and [many other regions](#).

And the bubble in commercial real estate is also bursting world-wide. See [this](#).

BIS also [cautioned](#) that bailouts could harm the economy (as did the [former head of the Fed’s open market operations](#)). Indeed, the bailouts create a climate of moral hazard which encourages more risky behavior. Nobel prize winning economist George Akerlof [predicted](#) in 1993 that credit default swaps would lead to a major crash, and that future crashes were guaranteed unless the government stopped letting big financial players loot by placing bets they could never pay off when things started to go wrong, and by continuing to bail out the gamblers.

These truths are as applicable in Europe as in America. The central bankers have done the wrong things. They haven’t fixed anything, but simply transferred the cancerous toxic derivatives and other financial bombs from the giant banks to the nations themselves.

And Europe – like the U.S. – has made the cardinal sin of [covering up fraud](#), so that the wound can never be cleaned, but will just infect the patient. Indeed, the sepsis is [killing the patient](#).

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