Perfect Financial Storm Shaping Up for Europe, U.S.

We are back to Greece, the little economy whose collapse set the European crisis in motion. As we warned at the time, the original Greek bailout and accompanying sigh of collective relief from the world financial markets would do little besides postpone the evil day. Now, little more than a year later, with Greece staring at obligations next month of $13.4 billion which it cannot afford to pay (and which, judging from the understandably truculent mood of the Greek people, who are in no mood for austerities imposed by foreign bankers, it is unwilling to pay) without another bailout, Europe is on the brink of a financial abyss. It is unlikely that the rest of Europe will be willing to continue paying to keep the Greek economy on life support, and equally unlikely that Greece will submit to further austerities, as her financial overlords are pressing her to do. The unavoidable result, in the very near-term future, will be a default of some kind — doubtless dressed up as some kind of debt restructuring, but a default nonetheless. As economist Andrew Lilico, writing for the *Telegraph* on May 25, put it:

> It is *when*, not *if*. Financial markets merely aren't sure whether it'll be tomorrow, a month's time, a year's time, or two years' time (it won't be longer than that). Given that the ECB has played the "final card" it employed to force a bailout upon the Irish — threatening to bankrupt the country's banking sector — presumably we will now see either another Greek bailout or default within days.

The results will be nothing short of catastrophic, at least in the short term, certainly for Europe and quite possibly for the rest of the world as well. According to Lilico, a Greek default will be followed by the immediate insolvency of every bank in Greece (as they all hold large amounts of Greek government debt, which will become worthless the moment Greece defaults). The nationalization of Greek banks and a prohibition on withdrawals — a Greek "bank holiday," as it were — will be next, and then emergency laws to keep a restive populace from burning down the country. Greece will devalue its currency and change its name — to the "New Drachma," or some such — for cosmetic effect. Ireland, already mightily resentful of the strings attached to their own bailout, will promptly follow Greece's example, and most likely Portugal as well. With the loss of huge sums in sovereign debt, many major European banks, as well as the European Central Bank, will become insolvent, leaving the ECB with the option of printing its way out of crisis, thereby devaluing the euro. Spain, one of the world's largest economies, is next on the chopping block, and when Spain fails, so too will the rest of Europe. In a word, the eurozone party is over.

While it may seem that the shell game indulged in by central bankers and sovereign treasuries of borrowing vast sums of money and then expanding the money supply to paper over deficits can be played forever, such financial legerdemain is always, in the long run, subject to political limits. There is a limit to how much taxation citizens and subjects will endure to continue to bail out financial fatcats and the deadbeat politicians they subsidize. The peoples of Ireland and Greece are furious at the austerities — higher taxes chief among them — inflicted on them by their political masters. They rightly reject moral responsibility for the financial mess the bankers and politicians have created. They will express their displeasure at the ballot box — as Spain's voters have done recently — or in the streets, as has been happening in Greece. Governments are then left with the option of repudiating their debts outright, as Argentina did in 2002, or of trying to inflate their way out of the problem.

The financial markets are already making clear that they will not settle for anything that even looks like a default on the part of Greece. According to Reuters' Ingrid Melander and Paul Taylor:

> Ratings agency Standard & Poor's said this month it would define as a default anything that would have a negative impact on the net present value of a bond. Fitch Ratings has said: "An extension of the maturity of existing bonds would be considered by Fitch to be a default event, and Greece and its obligations would be rated accordingly."

Meanwhile, the IMF, whose disgraced former president, Dominique Strauss-Kahn, was instrumental in helping the eurozone finesse the bailouts of Greece, Ireland, and Portugal, is rudderless and likely to have considerably less clout. The G8 countries are meeting this week to try to cobble out yet another way to buy time for Europe, but they will be distracted by a burgeoning debt problem on the other side of the Atlantic: the spectacle of the United States sinking into insolvency as it runs out of money to borrow. Greece, after all, has been sunk by indebtedness of around 150 percent of the GDP; can the USA, whose debt has reached roughly 100 percent of its own GDP, be far behind?

In a word, events are shaping up for a major financial storm in the weeks and months ahead. Even if a Greek default is avoided in the immediate term, it will not be long in following. With a partial default of our own (in the form of some kind of restructuring or unilateral change in the terms of payment) a very real possibility for the United States by August, it's looking to be a long, hot summer, financially speaking, for both Europe and the USA.

Photo: AP Images