Written by Bruce Walker on September 10, 2011

Private Banks Urged to Support Greek Bonds

The feedback that the Greek government is getting over its sovereign debt crisis is more than just from the private sector. German Chancellor Angela Merkel, whose own job hangs by a thread and who has just been limited by Germany’s Constitutional Court in using German assets to solve the Greek sovereign debt crisis, is now acknowledging that it was a mistake to admit Greece to the European Union. Merkel remains committed, however, to keeping Greece in the union, provided that no more help is needed from nations with stable and sound fiscal policies. She also warned the rest of the "PIIGS" nations (Portugal, Italy, Ireland, and Spain) to expect no more bailouts. European Central Bank President Jean-Claude Trichet echoed Merkel’s sentiments, and warned that the purpose of the ECB was to maintain the stability of the euro and not to protect nations which incurred debt far beyond their ability to repay.

Meanwhile, the Managing Director of the International Monetary Fund, Christine Lagarde, called again on European countries to recapitalize their own banks to prevent those banks from floundering or even falling under the weight of the bad sovereign debt of nations such as Portugal, Ireland, Italy, Greece, and Spain. "In view of the heightened risks and uncertainties — and the need to convince markets — some banks need additional capital. We must not underestimate the risks of a further spread of economic weakness, or even a debilitating liquidity crisis. That is why action is needed so urgently so that banks can return to the business of financing economic activity." Lagarde seems to be making the same sort of mistake that Merkel and Trichet have promised not to make: using the power of government or super-governmental organizations such as the IMF to force private businesses to act in ways that they would not otherwise.

That is a polite way of saying that the looming likelihood of a default on Greek government bonds could pull down major banks in Europe, and that those who have money — and are not themselves governments or part of super-governmental organizations — ought to make otherwise imprudent investments in order to prevent Greece, Italy and other nations from defaulting. In the case of Greece, it is hard to see how things could get much worse. The short-term bond rate, which is needed to turn over existing debt, has risen like a shot — over 45 percent interest. In late August, Greek officials revised their estimate of the country’s national deficit, and the revision, predictably, was bad news: The deficit will be even larger than anticipated. Still, some Greek bankers are trying to sound optimistic. An Athenian banker, pondering what percentage of this debt will be bought by private banks and investors, said: "Even with a participation rate of 70 percent or better, which is my current view, (it) will proceed."

The markets are reacting. Both the euro and Greek bank stock prices dropped and the cost of insurance against a Greek debt default soared.

Perhaps more pointedly, political leaders in Germany, Holland, and Finland are suggesting that Greece may have to leave the European Union. The Dutch Economic Affairs Minister Maxime Verhagen, however, explained that his government's proposal for a European fiscal discipline "czar" was not aimed at pushing Greece out of the European Union. Perhaps more candidly, True Finns Party leader Timo Soini declared that a Greek default was certain and that bailouts would only make matters worse. Pulling few punches, he added,

> With Greece it is clear that they cheated — some of their politicians. Of course the ordinary people are in trouble and they are innocent in this one, but if the political system doesn't fix itself then the consequences are really hard. We think also that those countries that cannot follow the rules, they must exit the system. Or the other option is that countries like Finland, Holland, maybe Germany, leave because they cannot pay any more.

But just as President Obama and his allies have found it comfortable to attack struggling businesses for not hiring more people when they have the money (as if maintaining the President's popularity was a solemn patriotic duty), expect the Greek government and several of the other PIIGS to try blaming investors who have no confidence in the security of their sovereign debt on the selfishness of private banks. Recall that these governments quickly jumped on the attack when investment rating services, whose economic information has value only if it is honest and impartial, reduced the creditworthiness of those government bonds.

The market works and the information it provides — lowered rating services, high interest to attract buyers of sovereign debt instruments, and companies finding other use for liquid assets rather than hiring unnecessary workers to inflate employment figures — is much more valid that the promises of politicians.

Photo: Parthenon