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Is Europe Facing a Financial "Black September"?

If there's one thing Europe's seemingly interminable debt crisis has taught discerning observers, it's that, while we can always predict where the economic follies of politicians will lead, it's impossible to predict the timing or the severity of such consequences. Ron Paul, Peter Schiff, and other savants accurately forecast the implosion of the housing bubble, but no one could have predicted precisely when the debacle would unfold. In a similar vein, we have been predicting financial collapse in Europe and the end of the eurozone for two years, yet the Europeans continue to postpone the evil day — guaranteeing in the process that, when the moment of reckoning eventually arrives, the consequences will be all the more severe.

The latest prospect for a European financial "zero-hour" is this coming September, when a confluence of several events may finally tear the eurozone apart and drive the global economy into a dizzying new downturn. So dark do Europe's prospects now appear that one senior eurozone policymaker, speaking recently to Reuters' Jan Strupczewski, characterized September as "crunch time." And an unnamed EU diplomat added, "In nearly 20 years of dealing with EU issues, I've never known a state of affairs like we are in now. It really is a very, very difficult fix and it's far from certain that we'll be able to find the right way out of it."

So what has prompted this latest round of hand-wringing? Well, if Europe was staring into the abyss at this time last year, it's now hanging by its nails from the proverbial stubby pine tree jutting from the cliff face. Spain, the world's seventh-largest economy, is now reeling under interest rates on 10-year government debt well in excess of seven percent, the magic level that drove Ireland, Greece, and Portugal into receivership. Italy, on the eve of another debt auction needed to keep paying its government's bills, found itself on the receiving end of another downgrade, courtesy of Moody's. Italy managed to sell more debt, but 10-year bonds, after declining from last fall's spike, are back up around six percent. Greece, after dragging Europe through a desperate round of negotiations to get substantial parts of its gargantuan public debt forgiven, is now admitting that — no surprise — it's going to need yet another bailout, and a lot more time, to return to solvency. And the folks who are footing the bill for the mess are getting antsy. On September 12, the German Constitutional Court is scheduled to rule on the constitutionality of the treaty that set up the 500 billion euro bailout fund called the European Stability Mechanism (ESM). That same day, the Dutch, who are growing weary of paying for the follies of "Club Med," are holding parliamentary elections. If the Dutch elect enough anti-bailout politicians, talks to renegotiate Greece's debt yet again, scheduled for later in September, may come untracked.

What's a Eurocrat to do? Outside the eurozone, the outcome of the crisis is becoming painfully evident. The Greek debt picture alone is evidence enough that the European financial house of cards is about to collapse: After nearly bringing the world economy to its knees only a few months ago over negotiations for a second bailout, Greece's political leaders are demanding more time and more money — a lot more. The new demands will amount to up to 50 billion more euros being poured into the bottomless Greek money pit, and will entail forgiveness of massive amounts of Greek debt on the part of European governments. This last is significant because, so far, only large private creditors have had to take a haircut on Greek debt. What is now being contemplated, but has little prospect of implementation, is that creditor governments, like Germany and France, write down their holdings of Greek debt (which amount to about two-thirds of all Greek public debt) and pass the costs on to European taxpayers. This, in a continent that is already in recession and whose taxpayers have so far been shielded from bailing out the likes of deadbeat Athens. "If Greece is to be saved," said Peter Vanden Houte, chief economist at Holland's ING Bank, "we must see some debt forgiveness from euro zone governments in the coming years because otherwise Greece is never going to come out of the situation it is in now. We are talking about potentially a 50 percent haircut, which would still mean the Greek debt would be (proportionately) around the euro zone average." A eurozone official estimated to Reuters that "[Greece] will have to default on 30-40 percent of the loans." In exchange for such largesse, the EU is certain to demand, according to Vanden Houte, unspecified significant concessions of sovereignty on the part of Greece — above and beyond what the Greeks agreed to in joining the eurozone in the first place. But given the fact that Greece is far behind on fiscal reforms promised only a few months ago, it is unlikely the rest of Europe will provide any further lifelines.

And Greece is just the beginning of the story. If Greece is somehow permitted to default on 50 percent or so of her remaining debt (bringing an epochal debt load of 160 percent of GDP down to a barely manageable 80 percent), Ireland and Portugal are likely to demand similar treatment.

Spain, which has been coming unraveled for several months now, is Europe's biggest story. Spain's real estate bubble and subsequent collapse mirrored that of the United States — but Spain's unemployment is north of 20 percent, and her entire banking sector is in need of a bailout, a sector that includes global banking giants like Banco Santander. Not only that, but many of Spain's larger regional governments, from Catalonia to Valencia, are now in desperate need of government bailouts to avoid defaulting on their debts. It is estimated that the Spanish government still needs to raise more than 50 billion euros by year's end, a task that will become impossible if long-term borrowing rates persist above seven percent. By way of comparison, imagine the United States in deep recession, with more than one-fifth of its citizenry out of work, all of its money-center banks dependent on a bailout in the trillions of dollars, its creditors insisting on charging crippling interest rates, and all of its largest states no longer able to pay their bills without massive infusions of federal dollars. That, in effect, is where Spain now finds itself, and the future looks grim indeed.

Spain's huge economy is far beyond the capacity of Europe to bail out. It is well-nigh impossible to imagine circumstances where Europe could be persuaded to fork up the funds for Spain, although foreign entities like the United States Federal Reserve may yet decide to get into the act.

Beyond Spain, however, there is Italy, whose economy is many times larger than Madrid's. In this global economy, stifled by seemingly endless malaise, there do not exist funds in the entire world to bail out Italy.

But Europe's ruling elites are not finished. Although Germany continues to oppose it, many eurocrats want to give the European Central Bank (ECB) the power to buy unlimited amounts of debt from member states in order to keep borrowing rates down. Many are now arguing that, for the eurozone to survive, the nations of Europe must sacrifice a lot more sovereignty and start acting more like a single country. This in turn would allow the ECB to start acting more like the Federal Reserve and other central banks, with more discretionary power to inflate the money supply at will and print their way out of short-term crises.

But it appears unlikely that Germany, Holland, and other European nations on sounder economic footing will be willing to continue to underwrite the profligacy of deadbeat countries. It is equally unlikely that the Greeks, Irish, Spanish, Italians, and the rest will accept massive tax hikes simply to pay for the debt their politicians have run up. With each passing week, Europe's fate becomes clearer: a catastrophic currency meltdown, as Greece and other countries flee the euro, followed by a global financial earthquake as many of these states repudiate large portions of their respective debt. And, following the inevitable European meltdown, creditors will at last turn their attention to the massive debts of the United States and Japan. If the United States does not get serious about cutting the size and cost of government, she will soon follow Europe into the abyss.

"For two years we've been pumping up the life raft," one European diplomat told Reuters, "taking decisions that fill it with just enough air to keep it afloat even though it has a leak. But now the leak has got so big that we can't pump air into the raft quickly enough to keep it afloat."

Will America wake up in time?