

Is the Eurozone in a Dead End?

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It's remarkable that the Euro and the Eurozone currency grouping hasn't fallen apart until now. Greece could have done it in 2010 but it was avoided by extraordinary acts of the Euro governments and European Central Bank. Now those actions are coming back to haunt especially Germany who stands poised to become the "sugar daddy" of the debt-bloated southern Euro states such as Italy or Spain. This is one major reason that the anti-Brussels parties that triumphed in recent Italian elections—5-Star and Lega, suddenly dropped talk about leaving the Euro. They are betting that Macron and Merkel and their proposed new EU architecture will pull their debt chestnuts out of the fire at expense of German taxpayers. It's a timebomb ticking ever louder.

Ten years into the greatest financial meltdown in the history of finance, triggered by the USA sub-prime real estate bubble collapse in 2007, the Euro and its 19 member central banks are at a dangerous crossroad. It's clear from her recent address to the German Parliament that **Chancellor Merkel** intends to lure Germany into what she and Macron intend to become a "transfer union." In plain English that would mean the strong surplus economies of Germany and northern Europe including Holland, would have to "transfer" hundreds of billions of Euros to subsidize the deficit countries of Italy, Spain and southern Europe. The ultimate winner would be the shaky French and Southern Eurozone banks. It's not surprising that Merkel, a close ally of former banker Marcon of France, is not being open with her people on what is at stake.

Target 2 Trap

In 2011, in the wake of the manipulated Greek bond crisis that triggered a Eurozone contagion panic in markets, the European Central Bank initiated a highly controversial and poorly understood disguised bailout known as Target 2. Without getting into the complex details of how Target 2 central bank balances function, they in effect allow the central banks of the Eurozone crisis countries, led by Italy and Spain, to issue state bonds which are in effect taken by the strong central banks of the Euro, notably Germany's Bundesbank. Since 2011 and the Greek crisis, Target 2 balances have been growing phenomenally to where today the total is estimated for the Bundesbank alone at € 914 billion. This is about one third of German GDP.

In 2011 the highly-respected German economist and then-head of Munich's IFO Institute, **Hans-Werner Sinn**, called the ECB use of Target 2 "The ECB's stealth bail out." He was the first to warn that the ECB Target 2 system for "Target balances constitute public credit relations in the same way as credit that is given via official rescue packages."

In 2011 the sums involved were still a fraction of the present total. Today the sheer size of these little-publicized Target 2 central bank balances in the Eurozone, especially the Bundesbank, put enormous pressure on the more prudent northern EU countries, especially

Germany, to finally drop resistance to adoption of George Soros' plan to have the Euro countries issue common Eurobonds. With such Eurobonds, the public debt of euro-zone countries would be pooled and converted into Eurozone "Eurobonds" with collective responsibility. De facto that would mean German or other north EU taxpayers would support the debt of stressed countries like Italy or Portugal or Greece. For strong reasons former Finance Minister Wolfgang Schäuble fiercely resisted any supranational issuing of bonds as a disguised forced German bailout of the countries such as Italy or Spain.

As Sinn points out about the covert bailout Draghi's ECB has created via the little-understood Target 2 central bank credits, "And yet the Bundesbank's Target claims (on Italy, Spain, etc) are essentially worthless, because they can never be called due, and are issued at an interest rate determined by the debtors, which hold the majority on the ECB Governing Council. For the time being, they have set the interest rate to zero." This is €914 today, alone for the German Bundesbank.

Merkel, SPD and Eurobonds

Now it becomes clear why Merkel elegantly pushed Schäuble aside by naming him CDU Parliamentary leader. His replacement, Social Democrat Olaf Scholz, is rumored to be privately favorable to French President Macron's proposal for a European banking union and a transfer union. In her first speech in March as Chancellor in the new Grand Coalition, Merkel suggested favoring plans to turn the €500 billion European Stability Mechanism, the eurozone's crisis rescue fund since the crisis in 2013, into a permanent European Monetary Fund, an EU version of Washington's International Monetary Fund.

In a transfer union, the healthier countries of the Euro will support the weaker. This is behind Macron's call for a common Eurozone Finance Minister who would develop a common tax budget for the ECB member countries. Under the Macron Plan, which Merkel and the SPD have endorsed, each euro transferred from a Northern to a Southern European country would reduce the Target claims and liabilities by one euro.

The deeper underlying problem in all these schemes is the fact that the countries of the ECB and Euro have done nothing fundamental to clean up their banking insolvency mess. Instead the ECB under Draghi has been used to create what is today a de facto insoluble problem for the German and other strong central banks of the Euro using Target 2 balances as a stealth bailout. Now the Merkel-Macron axis in the EU is ready to spring the next step—Eurobonds, a common Eurozone Finance Minister and fiscal policy and a transfer union.

This is the real reason Italy's "Euroskeptic" parties suddenly dropped election demands for a referendum on leaving the Euro or the EU. They realized Italy could be a huge benefactor by staying in and backing an EU Transfer Union. Bond market speculators like Soros will have a field day. German and Dutch and other more prudent countries will de facto pay the bill. For Germany where the demographic reduction in working age population is already apparent and will accelerate in coming years, a growing pension obligation makes German debt obligation in the long run unsustainable. To now add a fiscal transfer from Germany to the indebted Southern EU countries spells political and economic Tsunami.

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