It’s Not Just the “Peripheral” European Countries … Financial Contagion Could Spread to “Core” Eurozone Countries and the U.S.

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It’s not just the “peripheral” European countries which are in trouble.

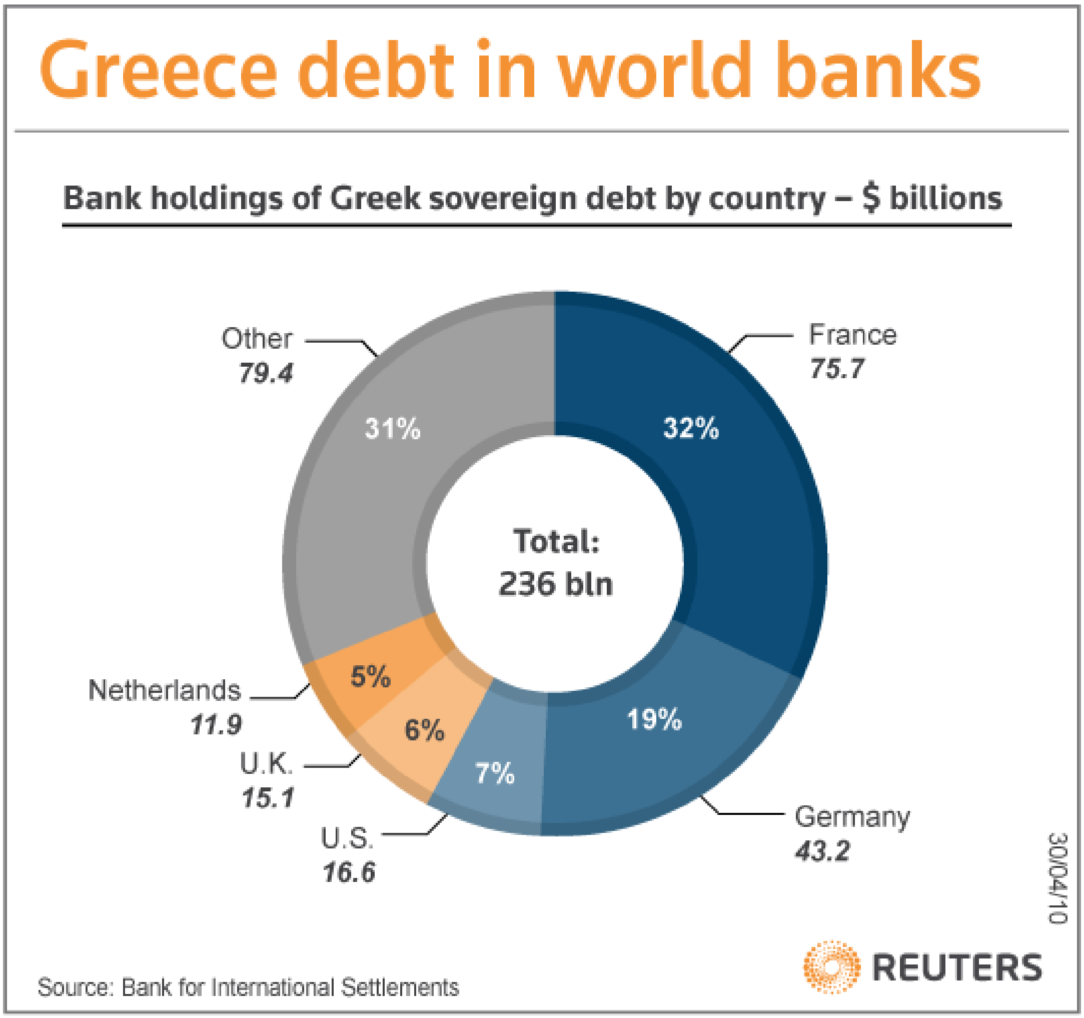
As Ambrose Evans-Pritchard reported yesterday:

> The escalating debt crisis on the eurozone periphery is starting to contaminate the creditworthiness of Germany and the core states of monetary union.
>
> Credit default swaps (CDS) measuring risk on German, French and Dutch bonds have surged over recent days, rising significantly above the levels of non-EMU states in Scandinavia.
>
> “Germany cannot keep paying for bail-outs without going bankrupt itself,” said Professor Wilhelm Hankel, of Frankfurt University. “This is frightening people. You cannot find a bank safe deposit box in Germany because every single one has already been taken and stuffed with gold and silver. It is like an underground Switzerland within our borders. People have terrible memories of 1948 and 1923 when they lost their savings.”
>
> The refrain was picked up this week by German finance minister Wolfgang Schäuble. “We’re not swimming in money, we’re drowning in debts,” he told the Bundestag.
>
> While Germany’s public and private debt is not extreme, it is very high for a country on the cusp of an acute ageing crisis. Adjusted for demographics, Germany is already one of the most indebted nations in the world.

(While future demographic trends for the U.S. are not good, for example, Germany’s population is even older.)

As I wrote in May:

> As the following Reuters chart shows (based on information provided by BIS), France and Germany are the largest holder of Greek debt:



Reuters graphic/Stephen Culp

As The Street notes, France and Germany are also greatly exposed to Portugal and Spain:

> France's banking sector has the second-largest exposure to Portugal and Spain debt loads, after Germany, according to the BIS.
>
> European banks have more at-risk assets in Portugal and Spain than in Greece. European lenders are holding Portugal debt issues of $240.5 billion — including $47.4 billion by German banks and $44.9 billion by French firms, according to BIS figures from the end of 2009 quoted in a Bloomberg report.

And as Tyler Durden points out, France Germany and the UK are getting hit with wider credit default swap spreads:

> **With a stunning $630 million, $558 million and $370 million in net notional derisking, France, UK and Germany are the top three most active recipients in negative bets in the prior week,** not just in sovereigns but in **all names…**
>
> Zero Hedge's outside bet to be the first core country to blow up, thanks to its massive PIIGS exposure, France, finally made the top spot in net derisking, with $629 million in net notional, or 189 contracts. The smart money is now massively betting that

> > Europe's core is done for; as the PIIGS have demonstrated, the blow out in spreads for the core trifecta can not be far behind.
>
> Given that central bankers have – for several years – focused on credit default swaps as the most important economic indicator (see this and this), widening spreads are a bad sign, indeed.

As the Washington Post points out today, the U.S. is not immune:

> U.S. banks hold about $133 billion in debt from Ireland, Spain, Portugal and Greece ….
>
> ***
>
> A full-blown debt crisis in Europe could … also send the euro plunging against the dollar, making the greenback stronger on world markets and undermining the efforts of the Obama administration to boost U.S. exports overseas.
>
> "For now, the U.S. is kind of insulated," said Simon White, a partner at the London-based research firm Variant Perception. But whether it stays that way, he said, "depends on how deep the crisis goes."

CNN notes:

> Americans will not be spared if there's a recession in Europe, even if U.S. bank exposure to European government debt is relatively limited.
>
> The European Union is the second largest market for U.S. exports, behind only Canada. The EU bought about $175 billion in U.S. goods in the first three quarters of this year. That's up about 8% from a year ago.
>
> So worsening problems in Europe will clearly be a drag on the U.S. as well.

Niall Ferguson, Marc Faber, and SocGen's Edwards and Grice predicted 9 months ago that the European debt crisis would eventually spread to America.

But the question of what country the "contagion" might spread to next is the really wrong question altogether.

The real question is whether the wealth of the people around the world will continue to be shoveled into the bottomless pit of debts held by the big banks, or whether the people will prevail and the giant banks and bondholders will be forced to take a haircut. See this, this and this.

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