

New Phase of the Global Debt Crisis: Widespread discounting of Western Public Debt

30,000 billion US dollars in ghost assets will disappear by early 2013

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As we come to the end of the second half of 2011, it is evident that 15,000 billion in ghost assets have gone up in smoke since last July, just as was anticipated by LEAP/E2020 ([GEAB N°56](#)). And, according to our team, this process figures to continue at the same rate throughout the year to come. Indeed we estimate that, with the introduction of a 50% discount on Greek government debt, the global systemic crisis has entered a new phase: that of the generalized discount on Western public debt and its corollary, the fragmentation of the global financial markets. Our team believes that 2012 will bring an average discount of 30% of total Western public debt (1), plus an equivalent amount in loss of assets from the balance sheets of worldwide financial institutions. Specifically, LEAP/E2020 anticipates the loss of 30,000 billion ghost assets by early 2013 (2), with an acceleration in 2012 of the partitioning process of the global financial market (3) into three increasingly disconnected currency areas: Dollar, Euro, and Yuan. These two phenomena feed into each other. They will also be the cause of a sharp decline of 30% on the part of US currency in 2012 (4), as we announced last April ([GEAB N°54](#)), which will occur amidst a sharp reduction in demand for the US dollar and the worsening of the US governmental debt crisis. The end of 2011 will therefore see, as anticipated, the trigger of the European debt crisis detonating a US bomb.

In this GEAB N°59 we will analyze in detail this new phase of the crisis as well as the deepening US debt crisis. Moreover, we will begin to present, as indicated in previous GEABs, our forecasts about the future of the United States between 2012 and 2016 (5) starting with a fundamental aspect of Euro-US relations (and more generally the global system that has been in place since 1945), namely the strategic and military relations between the US and Europe. We have estimated that by 2017 the last US soldier will have left European continental soil. Finally, LEAP/E2020 will present its recommendations, dealing this month with currency, gold, capital-based pensions, the financial sector, and commodities.

In this public announcement we have chosen to present the various elements that will determine the next escalation of the US debt crisis, while taking stock of the October EU summit and the Cannes G20 summit.

As anticipated by LEAP/E2020 for several months, the G20 summit in Cannes turned out to be a resounding failure, resulting in no significant measures, and demonstrating an incapability of addressing the issues of change in the international financial system, global economic recovery, or reform of global governance. If the Greek question took center stage

during the summit, it is partly because the latter was lacking in content to begin with. [George Papandreou](#) enabled the G20 leaders to carry on “as if” Greek affairs had interrupted their work (6), when in fact the Greek crisis allowed them to disguise their inability to craft a common agenda.

Meanwhile, the decisions of the EU summit in the week before the Cannes summit have pointed to the official emergence of Euroland (with now two fixed summits each year) (7), the primacy of which will confer de facto decision-making authority within the EU (8). The pressure from this crisis has, in the last few days, helped to build the capacities of Euroland policies, putting it on the path to greater integration (9), a prerequisite to any positive developments towards a post-crisis world (10).



Comparison of national Italian (red), German (blue), and French (gray) budgets and debts, as percentage of GDP (2002-2011) - Source: Spiegel, 10/2011

With a government of national unity finally in place in Greece (11), a modern state must literally be built from the ground up, with a proper land registry and an effective administration enabling the Greeks to become “normal” members of Euroland, not subjects of a feudal system where prominent families and the church share the wealth and power. Thirty years after its unconditional integration into the European Community, Greece must go through a five or ten year transitional phase similar to that of the countries of Central and Eastern Europe before their EU accession: painful, but inevitable.

Italy, meanwhile, has managed to rid itself of a leader altogether typical of the world before the crisis, characterized by his “bling”, his racketeering, his unscrupulous acquisition of money, his unfounded self-satisfaction, his hold on the media, his constant Euro-criticism and junk nationalism (12), not to mention his overflowing libido. The scenes of joy in the streets of Italy show not all is wrong with this global systemic crisis! As we indicated in the previous GEAB, we believe that 2012 will for Euroland be a year of transition on the road to building the world after the crisis, instead of just suffering the woes of the collapsing system.

At the same time the United Kingdom has basically been kicked out of the Euroland meetings (13). EU members outside the Eurozone have backed Euroland in refusing to support the British proposal concerning the right of the 27 to veto Euroland decisions. The United Kingdom’s drift has been boosted by the efforts of British Eurosceptics (generally the foot soldiers of the City) (14) to try to sever as quickly as possible the strongest ties with continental Europe (15). Far from being proof of their policy’s success, it is rather an admission of complete failure (16). After twenty years of continuous efforts, they failed to disrupt the European integration process, which has been revived by the pressures of the crisis. So they are now “dropping hawsers” out of a fear - well founded, by the way (17) - of seeing the UK absorbed into Euroland by the end of this decade (18).

All told, it is a desperate march forward which, as pointed out by Will Hutton in a remarkably lucid article in the [Guardian](#) on 30/10/2011, can only lead the UK towards a break with a Scotland seeking to recover not only its independence (19) but also its European anchorage, and towards the socio-economic condition of an off-shore financial market without social protection (20) or an industrial base (21): in sum, a Dis-United Kingdom adrift (22).

And with its US ally in dire straits itself, that drift may drag on for years, to the great misfortune of a British people growing increasingly discontented with the City. Even veterans are beginning to join the Occupy the City movement (23); obviously, on this point, there is a convergence between the views of the British people and those of Euroland!

For consolation, British financiers can say that they hold the largest proportion of Japanese state assets outside of Japan, but when the IMF warns Japan of the systemic risk of maintaining public debt above 200% of GDP (24), is that such a consolation?



Japanese asset allocation (United States, United Kingdom, Euroland, China, Asia), in (1) percentage of countries' GDP and (2) percentage of total foreign assets - Source: European Central Bank, 06/2011

Speaking of public debt, it is time to turn to the United States. The coming weeks figure to remind the world that it is this country, not Greece, that is at the epicenter of the global systemic crisis. In one week's time, on November 23, the Congressional "Supercommittee" in charge of reducing the US federal deficit will admit its failure to find 1,500 billion US dollars in savings over ten years. Each side is already crafting arguments that will blame the other side (25). As for Barack Obama, apart from his televised simpering with Nicolas Sarkozy, he now contemplates the situation passively, while noting that Congress has torn into pieces his grand jobs project introduced only 2 months ago (26). And it is not the utterly unrealistic announcement of a new Pacific Customs Union (excluding China) (27) on the eve of an APEC summit where Chinese and Americans are expected to confront one another harshly, which will enhance his stature as head of state, let alone his chances for reelection.

The predictable failure of the "Supercommittee", which reflects the overall paralysis of the US federal political system, will have an immediate and drastic consequence: a new series of credit ratings deteriorations. The Chinese agency Dagon has opened fire, confirming that it would once again lower the rating upon the failure of the "Supercommittee" (28). S&P will probably lower one more time the US rating, and Moody's and Fitch will have then no other choice but to get on board, having given the US a reprieve until the end of the year under condition of effective results in terms of public deficit reduction. Incidentally, in order to dilute the flow of negative information in this regard, it is likely that there will be an attempt to reinforce the public debt crisis in Europe (29) by lowering France's rating in order to weaken the European Financial Stability Fund (30).

All of this makes for an eventful season for the financial and monetary markets, casting severe blows on Western banking systems and, beyond that, on all US T-Bond holders. But beyond the failure of the "Supercommittee" to reduce the federal deficit, the entire US pyramid of debt will be thoroughly examined, in a context of global - and of course US - recession : falling tax revenues, unemployment increases, increases in the number of unemployed no longer receiving benefits (31), further drops in home values, etc.



US (in red) and Greek (in blue) private sector as a percentage of GDP (2000-2010) - Source: SuddenDebt, 03/2011

Let's keep in mind that the state of US private debt is far worse than in Greece! In this

context, we are not far from a panic-inducing situation about the United States's capacity to repay its debt other than with a devalued currency. The end of 2012, then, will see many US debt-holders seriously considering this ability and of the precise moment when it might suddenly be called into question by all financial players (32).

What could the United States offer after the failure of its "Supercommittee"? Not much, particularly in an election year! On the one hand it was created because other actions were not working, and on the other the issue is not so much one of amount but of the very ability to undertake a significant and sustained reduction. The failure of the "Supercommittee" will rightly be seen as evidence of this inability of the US in tackling the deficit problem.

In terms of the amounts at stake, a quick calculation by a USreader of GEAB gives some sense of how much the "efforts" undertaken to reduce the budget deficit are ridiculous in relation to the needs : Treating the US federal budget as that of a household, things become abundantly clear. Simply remove 8 zeros for budget that comes to mean something for the average citizen:

Annual household income (income tax): + 21,700
Family expenses (federal budget): + 38,200
New credit card debt (new debt): + 16,500
Past credit card debt (federal debt): + 142,710
Budget cuts already made: - 385
Budget reduction targets of the Supercommittee (for one year): - 1,500

As can easily be seen, the Supercommitte (like Congress last August) cannot even agree to a 10% reduction ... of the annual increase in federal debt. This is how it is: unlike in Europe, which, over the months, has introduced new mechanisms and takes steps to reduce expenditures and debts (33), the US continues to run full speed into increasing debt. As a matter of fact, ni the next semester, Washington plans to issue 846 billion US dollars worth of Treasury bonds, 35% more than this time last year (34).



September 2011: Beginning of the loss of confidence by foreign central banks with respect to US Treasury - Trends in foreign central bank transactions concerning US Treasury and agency holdings (2000-2011) (in brown: monthly increases / green line: above, central banks are buying; below, they are selling Treasury bonds) - Source: CaseyResearch, 10/2011

With the failure of the MF Global investment fund, we have seen that Wall Street titans can crumble at once due to errors made regarding public debt trends in Europe. [Jon Corzine](#) is no [Bernard Madoff](#). In moral terms, he is perhaps close, but as for the rest, there is no comparison. Madoff was a Wall Street maverick, but Corzine was a member of the aristocracy: former CEO of Goldman Sachs, former governor of New Jersey, main donor to the Obama 2012 presidential campaign, sensed to replace Timothy Geithner as Treasury Secretary last August (35), and one of the "creators" of Obama back in 2004 (36). This affair goes to the heart of the incestuous relationship between Wall Street Washington, one which is now being denounced by a majority of Americans (37).

In August, it appeared as if he was untouchable, on top of Wall Street; nevertheless he was completely mistaken about the course of events. He believed that the world had not

changed, and that private creditors would continue to be paid “cash on the barrelhead”. The result: huge losses, bankruptcy, innumerable customers bilked, and 1,600 employers out on the street (38).

We announced in the previous GEAB that we have entered a phase involving the decimation of Western banks. This phase is truly in swing, and customers of all financial operators (banks, insurance companies, investment funds, pension funds) (39) are now questioning the soundness of these institutions. As is evident from the Corzine affair, they should not assume that these institutions are a priori stronger than others just because they or their leaders are famous or enjoying a strong reputation (40). It is not knowledge of the rules of the financial game of yesterday, which formed those reputations, that now counts; but rather it is the understanding that the rules have changed that has become crucial.

Notes:

(1) Amounting to 45,000 billion USD in the US, the UK, Japan, and the Euroland alone.

(2) As the crisis worsens, the greater the amount of phantom assets increases. This process will continue until we can find a ratio of financial assets to real assets consistent with sustainable socio-economic functioning, somewhere around the ratios from the years 1950-1970.

(3) Engagement with the Greek debt crisis means a quick release of the financial system in Euroland from of the Dollar. The fact that this process was initiated originally by Wall Street and the City in order to “break” the Eurozone only illustrates on the one hand the irony of history, and on the other that at the end of the day all of the actions of world players are coming back to haunt them.

(4) Even the Financial Times recognizes that the Dollar has become more fragile than the Euro. Source: [FT](#), 04/11/2011.

(5) Our predictions regarding the EU and Euroland will be featured in an upcoming edition of GEAB.

(6) The only thing that has been seriously disrupted by the Greek situation is French President Nicolas Sarkozy’s plan to use the European and G20 summits as a double springboard to try to regain credibility with the French. This proved, however, a double failure. Far from having been resolved, as he had announced on television, the Greek crisis exploded again on the eve of the G20, handing the summit’s organizer a note reading: zero! LEAP/E2020 takes this opportunity to reiterate its prediction of 15 November 2010 ([GEAB N°49](#), maintaining that the candidate of the UMP (Sarkozy or otherwise) will not participate in the second round of 2012 French presidential election, which will be decided between the candidate of the Socialist Party, François Hollande, and the candidate of the National Front, Marine Le Pen.

(7) And we can only note that it is decision-makers from the European level ([Mario Monti](#), the Italian former European Commissioner, and [Lucas Papademos](#), Greece’s former Vice-President of the ECB) who, in Greece and Italy, are taking the reins power, this providing another signal of the Eurozone’s accelerating integration – including at the political level. This will also reinforce the urgent need of institutional reforms for democratic governance in Euroland, since people will not accept for more than a year that these developments take

place as they stand as mere spectators. Note that the majority of Germans, French, Italian, Spanish, etc. have not found aberrant the Greek proposals for a referendum on anti-crisis measures, unlike their leaders. Without realizing it, George Papandreou has probably greatly increased the demand for a future referendum on the trans-Euroland governance of the Eurozone by 2014/2015. For more, see Franck Biancheri's article published in the [Forum Anticipolis](#), 06/10/2011

(8) The UK pays an immediate price (as we discuss in this GEAB), with its marginalization confirmed and reinforced, losing all its ability to influence Euroland. As a sign of the times, Nicolas Sarkozy has severely rebuked David Cameron, saying that the leaders of the Eurozone were tired of hearing Cameron's advice for the proper management of the Euro while being fundamentally against the European currency. Nicolas Sarkozy being only strong with the weak, this is an indicia of the extent to which Cameron has fallen. Source: [Aljazeera](#), 24/10/2011

(9) Source: [Business Week](#), 14/11/2011

(10) This does not mean that LEAP/E2020 believes that the situation is fine in Euroland as a whole, with the EU already in recession (like the United States for that matter), with the challenge of public debt still open even if the tools to address the problem are multiplying (including new public debt discounts), and with popular anger, as elsewhere in the world, being amplified, in particular in countries where no political alternative seems possible. Sources: [Le Monde](#), 17/10/2011; [Libération](#), 18/10/2011; [La Tribune](#), 07/11/2011; [ANSA](#), 08/11/2011; [Spiegel](#), 11/11/2011; [Les Affaires](#), 10/11/2011

(11) A historic premiere. Source: [Spiegel](#), 07/11/2011

(12) Both trends generally go together with political leaders. Their Euroscepticism is mostly the ideological dressing of a much more down-to-earth reality: their desire to continue to wield power as they wish in their country. From Vaclav Klaus in the Czech Republic to the conservative Eurosceptics in the UK, and from Berlusconi's Euro-criticism to that of the Swedish Eurosceptics elite, one thing is in common: let us do as we wish in our country, and do not come and disrupt our citizenry with external ideas. To influence public opinion, just change the majestic "we" to a collective one, and make the people believe that it is their own power that European integration will challenge! This, in general, works rather well, given the current number of citizens who rightly resent the lack of democratic debate on the financial mechanisms in place in Euroland to manage the crisis, and who raise hue and cry along with the Eurosceptic leaders of their countries ... when in fact they often have no idea how these same mechanisms work in their own country. Take the example of France, where those who have denounced the interplay between private banks and state debt under the Treaty of Maastricht are unaware that that was already the case in France since 1973!

(13) Source: [Spiegel](#), 31/10/2011

(14) A "City" that David Cameron described as "under siege" by Euroland. Incidentally, this declaration by the British prime minister confirms that there is indeed a war between the City and the Euro, contrary to what the Anglo-Saxon media has to say. Source: [Telegraph](#), 28/10/2011

(15) Source: [Telegraph](#), 28/10/2011

(16) Source: [Guardian](#), 23/10/2011

(17) According to LEAP/E2020, the inevitable failure of the British “[Sonderweg](#)” by 2020 will lead England to end up doing like Scotland and Wales, who will refuse to follow “road to nowhere”... not even to America. Moreover, even in the Eurosceptic Daily Telegraph, where the quality of analysis is often able to overcome its ideology, mention is made that a crisis in Euroland will deepen that of the UK. Source: [Telegraph](#), 09/11/2011

(18) This hysterical British attitude towards Euroland integration (called, over the Channel, the “Euro-crisis”) is marked by delusional fantasies published in the mainstream press, combining nostalgia for the victory of 1945 with a vulnerable sentiment without precedent in Great Britain, due to which the Franco-German axis becomes a war machine aimed at Britain. In this genre, the article published 31/10/2011 in the [Daily Mail](#) is a must-read. In the same manner, the [Telegraph](#) could not resist writing in a 22/10/2011 article about the “new European empire.”

(19) The former British army chief is even considering opening the debate on future Scottish armed forces in light of the proposed referendum on independence coming in three to four years. Source: [GoogleNews](#), 18/10/2011

(20) With massive unemployment, and youth left to their own devices without education, work, or future prospects. Sources: [Guardian](#), 14/11/2011; [Telegraph](#), 14/11/2011

(21) Source: [Telegraph](#), 01/11/2011

(22) ... which will continue its descent in the classification of the most important economies on the planet, with Brazil poised to overtake the UK this year. With the financial crisis continuing, the decline of the City will considerably reduce the size of the UK economy, which depends so much on this world financial center. Source: [Telegraph](#), 31/10/2011

(23) Source: [Guardian](#), 12/11/2011

(24) Bear in mind that public debt in Italy is only equal to 120% of its GDP. Source: [Ahram](#), 12/11/2011

(25) Source: [New York Times](#), 08/11/2011.

(26) Source: [Newsdaily](#), 03/11/2011

(27) Aside from the absence of China in such a project, the announcement of this declaration of intention was without any detailed foundation, leaving concrete aspects for later. But these are “promises made”: there will be a customs union! Hollywood film scenarios are often unrealistic, but this is something of a fairy tale.

(28) Source: [Guardian](#), 12/11/2011

(29) Even the most moderate of voices, like Jean-Pierre Jouyet, president of the French Authority of Financial Markets, now recognizes that there is a war between the Dollar and the Euro. Source: [JDD](#), 12/11/2011

(30) This will result, in order of increasing importance, in the reduction of the electoral prospects for Nicolas Sarkozy, the acceleration of financial and fiscal integration in Euroland,

and the advancement of the idea of a large Euoland public borrowing to disengage, once and for all, from the Anglo-Saxon financial markets. This last option will, according to our team, be put into place by the first half of 2013. We will discuss its nature in another GEAB.

(31) Leaving the unemployment system gives an impression of improvement on this front – we will not return to the issue of the reliability of US unemployment statistics, which has been addressed previously in GEAB. Two facts can be acknowledged, however: last year at this time 75% of the unemployed were receiving benefits, as opposed to 48% today; and more than 26 million Americans are now considered under-employed, a historic record. Sources: [CNBC](#), 05/11/2011; [Business Insider](#), 20/10/2011

(32) These phenomena, being essentially psychological, can manifest suddenly.

(33) Except in France, where Nicolas Sarkozy, alongside his Prime Minister François Fillon, have continued to degrade public finances, multiplying miniature measures with little long-term efficiency in the hopes of contributing to reelection. The European Commission has been sounding alarms on this very subject.

(34) This alone is three times the total public debt of Greece before discount! Source: [ZeroHedge](#), 01/11/2011

(35) Source: [New American](#), 05/08/2011

(36) Another common ground between Barack Obama and Nicolas Sarkozy, two representatives of the world before the crisis: their intimacy with the financial sector. Sources: [Le Monde](#), 22/10/2011 ; [Minyanville](#), 04/11/2011

(37) And this failure shows that everything continues in Wall Street as before 2008, despite the so-called financial sector control measures adopted by US authorities. This scandal will have a profound impact on the 2012 US elections. Sources: [CNBC](#), 01/11/2011; [USAToday](#), 18/10/2011

(38) Source: [FINS](#), 11/11/2011

(39) For example, [ABP](#), the largest pension fund in the Netherlands, will have to reduce its payments to retirees because of losses in recent months. This is a very real consequence of the disappearance of ghost assets.

(40) One can notice a growing concern amongst investors and investing firms in New York and London. Source: [Huffington Post](#), 12/11/2011

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