

## The European Bailout: Not a Very Promising Start

By [Washington's Blog](#)

Global Research, May 11, 2010

[Washington's Blog](#) 10 May 2010

Region: [Europe](#)

Theme: [Global Economy](#)

Many people have written insightful criticisms of the European bailout. For example, [Tyler Durden](#), [Joe Weisenthal](#) and [Gregory White](#) point out that the French banks are the real winners of the bailout (but don't forget [JP Morgan](#)).

Ron Paul [points out](#) that the Fed opening its [swap lines](#) to Europe violated its promise to Congress not to do so. Paul also says the bailout will help lead to the destruction of all fiat paper currencies, ensuring that "gold will rule the roost".

And see Mish's [roundup](#) for more general criticisms of the bailout.

Many have predicted that it is only a short-term measure to kick the can down the road. But the numbers themselves show that the bailout might not even be having a sufficient short-term effect.

For example, as the following Euro to Dollar chart shows (courtesy of Finviz), the Euro rallied, and then sunk back almost all the way to its pre-bailout level today:



(The Euro's rally against the Japanese Yen [didn't last very long](#), either. And Morgan Stanley's Stephen Hull [thinks](#) any rally in the Euro will be short-lived, anyway.)

As Bloomberg [notes](#), bank swap and libor rates show that the bailout might not be enough to stem the sovereign default crisis:

Money markets and the cost of protecting bank bonds from losses show investors are concerned the almost \$1 trillion rescue plan announced by European leaders may not be enough to contain the region's sovereign debt crisis.

A credit-default swaps index linked to European banks that usually trades

tighter than an investment-grade benchmark is 30 basis points higher, according to CMA DataVision. A measure of banks' reluctance to lend remained three times higher than it was in March.

\*\*\*

The difference between [libor] and the overnight indexed swap rate, the so-called Libor-OIS spread that rises as a signal banks are less willing to lend, climbed yesterday even after the rescue announcement. The rate advanced to 18.83 basis points, from 18.11 at the end of last week and 6 basis points March 15.

Morgan Stanley emerging market strategist Rashique Rahman [says](#) that - even after the bailout - Europe's troubles are growing:

Liquidity provision or not, sovereign credit risk has not gone away. Our work suggests ongoing deterioration of DM sovereign creditworthiness going forward, manifested by further downward credit rating pressure. Additionally, the transference of periphery Europe indebtedness to that of core Europe via the stabilization fund - and further, via ECB purchases - bears very close monitoring. Contamination to the core (of DM) lies at the heart of contagion for EM - which again is manifested through DM funding market stresses.

Nouriel Roubini [told](#) Bloomberg that the bailout is not a cure-all:

The implications of the plan require fiscal austerity and higher taxes, damping growth and possibly extending economic hardship, Roubini said.

"In the short term, raising taxes and cutting spending is going to imply further recession and further deflationary pressures in the euro zone," Roubini said.

Greece, Spain, Portugal, Italy, Ireland and other members of the euro zone may struggle to comply with the fiscal requirements and to restore competitiveness after years of an appreciating euro boosting growth, Roubini said. Euro zone countries' ability to act may be hindered by divided governments such as the U.K.'s hung parliament, German Chancellor Angela Merkel's weakened clout, and the continuing protests in Greece, he said.

In the longer-term, Simon Johnson [points out](#) that the bailout creates huge moral hazard risks:

This is a whole new level of global moral hazard - the result of an alliance of convenience between troubled governments in the south of Europe and the north European banks (and implicitly, north American banks) who enabled their debt habit. The Europeans promise to unveil a mechanism this week that will "prevent abuse" by borrowing countries, but it is hard to see how this would really work in Europe today.

\*\*\*

The European Central Bank intervention and this package raise enormous moral hazard issues. The ECB's management was forced into this kicking and screaming. It was only when they realized that the whole euro zone financial system was at risk of collapse that they threw the kitchen sink at the problem.

This can now go two ways: either they tighten fiscal policy across the eurozone, and introduce much more rigorous and enforced rules on deficits and profligate credit through banks, or, they let a system persist which is another “doomsday machine” that will live again to grow, and could one day topple them.

And Johnson notes that the bailout might for even more painful decisions in the long-run:

As Willem Buiter (formerly Bank of England, now at Citigroup) remarked last week, you have the greatest incentive to default when you are running a balanced primary budget (i.e., after substantial budget cuts) and still have a large government debt outstanding. His point is that the incentive structure of these programs means they will postpone a decision to default which would otherwise be rational now.

\*\*\*

The underlying fiscal problems in Europe could fester – and the “rules” designed to limit moral hazard may turn out to be a complete paper tiger. In that case, the Europeans again have to make a fateful decision: Do they try to inflate out of the debt burdens of their weakest member countries; or do they instead try to manage selective default, keeping in mind that most Greek debt at that stage will be held by other eurozone governments.

As Yves Smith [notes](#):

The real problem is that there appears to be no impetus towards a longer term solution. How do solve imbalances within the eurozone? Without a plan to develop a plan on that front, this simply rearranging the deck chairs on the Titanic.

Of course, the myriad fraudulent schemes (using derivatives and other means) to hide the problems of Greece, Italy and other countries are still continuing to some extent. And the size of the too big to fails means they can take down companies or nations using high-frequency trading, short-selling, credit default swaps and other means. Indeed, Jim Rickards [argues](#) that the bailout won’t really help because “Goldman can create shorts faster than Europe can print money”.

Therefore, without fundamental reform of the financial system, there can be no true and lasting European recovery.

## **New Release from Global Research**

**LAUNCH DATE: MAY 25TH 2010**

The Global Economic Crisis  
The Great Depression of the XXI Century

Michel Chossudovsky and Andrew Gavin Marshall (Editors)

Montreal, Global Research Publishers. Centre for Research on Globalization (CRG), 2010.

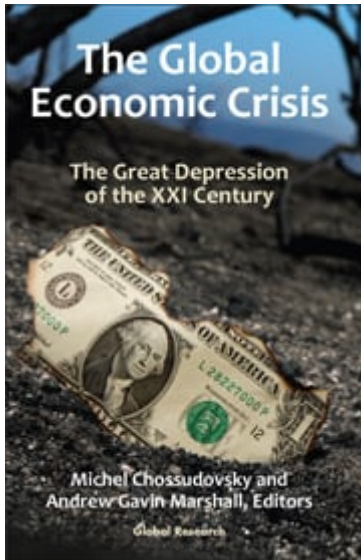
ISBN 978-0-9737147-3-9 (416 pages)

[For further information as well as ordering information, click here](#)

**Special Pre-Publication Offer:** \$15.00 plus S&H (includes taxes where applicable) (List Price US\$25.95 plus taxes)

The book will be shipped following the launch date of May 25, 2010. This also applies to other purchases combined with the pre-publication offer

(if you wish to purchase 3 or more copies, scroll down for discounted price)



[For further information as well as ordering information, click here](#)

The original source of this article is [Washington's Blog](#)

Copyright © [Washington's Blog](#), [Washington's Blog](#), 2010

---

[Comment on Global Research Articles on our Facebook page](#)

[Become a Member of Global Research](#)

Articles by: [Washington's Blog](#)

**Disclaimer:** The contents of this article are of sole responsibility of the author(s). The Centre for Research on Globalization will not be responsible for any inaccurate or incorrect statement in this article. The Centre of Research on Globalization grants permission to cross-post Global Research articles on community internet sites as long the source and copyright are acknowledged together with a hyperlink to the original Global Research article. For publication of Global Research articles in print or other forms including commercial internet sites, contact: [publications@globalresearch.ca](mailto:publications@globalresearch.ca)

[www.globalresearch.ca](http://www.globalresearch.ca) contains copyrighted material the use of which has not always been specifically authorized by the copyright owner. We are making such material available to our readers under the provisions of "fair use" in an effort to advance a better understanding of political, economic and social issues. The material on this site is distributed without profit to those who have expressed a prior interest in receiving it for research and educational purposes. If you wish to use copyrighted material for purposes other than "fair use" you must request permission from the copyright owner.

For media inquiries: [publications@globalresearch.ca](mailto:publications@globalresearch.ca)