Sounding the Horne

James Horne November 8, 2011

Analysis of Europe .... Europe is finished.

Analysis of Europe has focused on the super-leveraged banking system (26 to 1). At these levels, even a 4% drop in asset prices wipes out equity. That alone warrants concerns of systemic risk.

The situation is not much better at non-Financial European corporations. Indeed, the debt situation is so endemic to Europe as a whole that corporate Debt to Equity ratios for ALL of the PIIGS as well as the supposedly fiscally conservative countries of France and Germany are TERRIBLE.

Country	Corporate Debt to Equity Ratios
Portugal	145%
Italy	135%
Ireland	113%
Greece	218%
Spain	152%
UK	89%
France	76%
Germany	105%

Europe's debt problems extend well beyond Greece's debt. Indeed, the entire European banking and corporate system is over-burdened with debt.

The situation is no better for European Sovereign states themselves, which are facing their own debt roll over issues at a time when investors are rapidly losing their appetite for sovereign debt.

To wit, Spain, Portugal, and Italy have all relied heavily on the ECB to buy their debt at recent auctions. Germany actually just had a *failed* debt auction this morning. And in *this* environment , these nations need to meet the following debt roll over obligations:

Maturing Debt Plus Budget Deficit as a % of GDP

	2011	**2012**
Portugal	21.6%	21.0%
Italy	22.8%	23.1%
Ireland	19.5%	18.0%
Greece	24.0%	26.0%
Spain	19.3%	18.7%
UK	15.7%	13.6%
France	20.6%	19.7%
Germany	11.4%	10.5%

And this is just maturing debt that's due in the near future: it doesn't include unfunded liabilities.

Jagadeesh Gokhale of the Cato Institute puts the situation as the following, "*The average EU country would need to have more than four times (434 percent) its current annual gross domestic product (GDP) in the bank today, earning interest at the government's borrowing rate, in order to fund current policies indefinitely."*

Europe is finished. The region's entire banking system is insolvent (with few exceptions). European non-financial corporations are running massive debt to equity ratios. And even EU sovereign states require intervention from the ECB *just* to meet current debt issuance, to say nothing of the huge amount of sovereign debt roll over that is due over the next 14 months.

Again… Europe. Is. Finished.

The Great debt Implosion will hit Europe within the next 14 months and likely much much sooner. When it does, we will see numerous debt defaults and restructuring on both the corporate and sovereign levels. We're also very likely going to see significant portions of the European banking system collapse "Lehman-style" along with subsequent HUGE losses of capital.

The impact of this will be global in nature. The EU, taken as a whole, is:

1) The single largest economy in the world ($16.28 trillion)

2) Is China's largest trade partner

3) Accounts for 21% of US exports

4) Accounts for $121 billion worth of exports for South America

Deutsche Bank on Europe: 'It's Not

Inconceivable That We Could Be In Full Crisis

Mode By The End Of This Week'

Such is the severity of the situation in Italy.

Here's Deutsche Bank's Colin:

Its not inconceivable that we could be in full crisis mode by the end of this week. The situation with Italy feels increasingly like one that has little chance of materially improving until some extreme pressure is put on someone to act. It may not come to a head this week but the signs are not good that we can avoid an extreme situation emerging soon.

The big problem: Berlusconi doesn't seem like he's in an urgent mood to make reforms, the ECB isn't doing much, and China and Brazil have dropped out of the picture.

Hence we could get a big bustup:

For us there is no obvious near-term solution other than a stress event which prompts action.
Maybe the EU authorities will use the experience learnt from the Greece situation last week
that a hard-line response is the only way to force countries to act in the way they want. It is a
big risk but at the moment the weaker countries seem to still want

the Euro enough that the ECB and Germans could play hard ball and get what they want if they are prepared to take the risk. Indeed ECB Governing Council member Yves Mersch fired a warning over the weekend saying that the ECB often discusses the possibility of ending the purchase of Italian government bonds and could if it concludes Italy is not adopting promised reforms. Such talk will not encourage private capital into Italy meaning that the ECB may need to intervene more to have the required impact.

The German Economy Is Falling Off The Cliff

Germany can no longer maintain the illusion that it's an island of stability, immune to the problems its neighbors are facing.

The bad news is that its economy is tanking.

German industrial production just fell 2.7% in October; much worse than September's 1% decline; and far worse than the expected fall of 0.5%.