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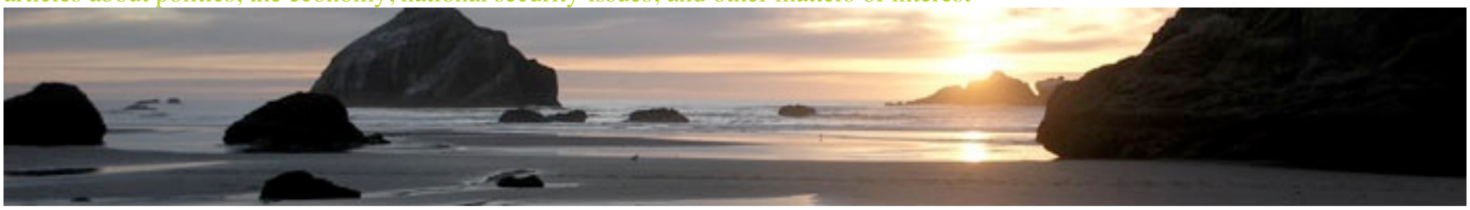

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The Economic Tsunami Continues Its Relentless And Unforgiving Advance Globally

27 09 2010


By Timothy D. Naegele[1]

The Wall Street Journal has an article about the EU entitled, "Currency Union Teetering, 'Mr. Euro' Was Forced to Act," which is worth reading and reflecting on seriously.[2] It represents an excellent discussion of what has happened in the past. However, its conclusions are sobering and ominous:

> [F]our months later, the root causes of the Greek crisis remain: There is no central authority to even coordinate national tax-and-spending policies.
>
> In the past month, financial markets have turned their sights on Ireland and Portugal. Doubts remain over the solvency of banks on Europe's stricken fringe. That leaves them dependent on [the European Central Bank president Jean-Claude Trichet]'s largesse, in the form of "temporary" lending facilities introduced by the ECB when the crisis first hit.
>
> Despite Mr. Trichet's assurances that the bond-buying program is a stop-gap, it not only continues but has also increased in recent weeks—with no end in sight.

Put succinctly, Europe is still on the brink. It is foolish to believe otherwise. The "green shoots" that have appeared recently are an "illusion" and merely a brief respite in the midst of a maelstrom, which economic historians will describe as the "Great Depression II" (or by some similar name) 20-40 years from now.

Americans and their counterparts around the world have lost faith in their governments, and rightly so[3]; and the governments have come closer to exhausting all of their viable economic options. As this becomes increasingly clear, and as governments thrash about trying to find solutions that do not exist, and as politicians continue to lie—which after all is what they are most proficient at doing—the economic tsunami will continue to take its toll and run its course worldwide during the balance of this decade.

It will get very ugly, economically, socially and politically. Barack Obama will be swept out of office in the United States, and this process has begun already. It will accelerate with November's elections. He is caught in the twin pincers of an economy in decline that he cannot influence except negatively, and an Afghan war that cannot be won. Republicans and Independents do not support him now; and his own Democrats are deserting him.

The slippery slope out the White House door will follow, like it did for Lyndon Johnson prior to the presidential election of 1968, when the political consequences of the Vietnam war made him unelectable. Obama will return either to Chicago or Honolulu to lick his wounds and set up his presidential library, and assume an "elder statesman" role—similar to Bill Clinton—after only one term in office.

The efforts of Jean-Claude Trichet, or "Mr. Euro," will prove similar to measures undertaken to put Humpty Dumpty back together again. Trichet is not "Superman," and he will lack the necessary skills; and the policy options will have been exhausted. Panics may ensue in the financial markets; and the recent crises may seem like child's play by comparison to what is coming. The "Band-Aids" that Trichet, America's Federal Reserve Chairman Ben Bernanke and others applied will be ripped asunder as the economic tsunami continues its relentless and unforgiving advance globally.[4]

Hold on tight. It is apt to get very ugly. The euro zone will unravel, which is likely to be a relatively small but critical part of what will be happening worldwide; and financial turmoil will engulf the euro-zone nations. There will be nobody of consequence in charge economically or politically in the United States or other countries. And the human suffering and chaos will be unfathomable.[5] Throw military and national security issues into the mix, and the results may be explosive.

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[1] Timothy D. Naegele was counsel to the United States Senate's Committee on Banking, Housing, and Urban Affairs, and chief of staff to Presidential Medal of Freedom and Congressional Gold Medal recipient and former U.S. Senator Edward W. Brooke (R-Mass). He practices law in Washington, D.C. and Los Angeles with his firm, Timothy D. Naegele & Associates, which specializes in Banking and Financial Institutions Law, Internet Law, Litigation and other matters (see www.naegele.comand http://www.naegele.com/naegele_resume.html). He has an undergraduate degree in economics from UCLA, as well as two law degrees from the School of Law (Boalt Hall), University of California, Berkeley, and from Georgetown University. He is a member of the District of Columbia and California bars. He served as a Captain in the U.S. Army, assigned to the Defense Intelligence Agency at the Pentagon, where he received the Joint Service Commendation Medal. Mr. Naegele is an Independent

politically; and he is listed in Who's Who in America, Who's Who in American Law, and Who's Who in Finance and Business. He has written extensively over the years (see, e.g., http://www.naegele.com/whats_new.html#articles), and can be contacted directly at tdnaegele.associates@gmail.com

[2] *See* http://www.naegele.com/documents/CurrencyUnionTeeteringMr.EuroWasForcedtoAct.pdf; *see also* http://online.wsj.com/article/SB10001424052748703467004575464113605731560.html?mod=WSJ_hps_MIDDLETopStories

[3] *See, e.g.*, http://naegeleblog.wordpress.com/2010/09/24/washington-is-sick-and-the-american-people-know-it/

[4] *See also* http://naegeleblog.wordpress.com/2010/09/09/are-afghanistan-iraq-and-pakistan-hopeless-and-is-the-spread-of-radical-islam-inevitable-and-is-barack-obama-finished-as-americas-president/ and http://naegeleblog.wordpress.com/2010/05/16/will-the-eus-collapse-push-the-world-deeper-into-the-great-depression-ii/

[5] *See also* http://naegeleblog.wordpress.com/2009/12/16/the-great-depression-ii/#comment-750 and http://naegeleblog.wordpress.com/2009/12/16/the-great-depression-ii/#comment-745

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7 responses

28 09 2010

 **naegeleblog** (12:08:08) : edit

Ireland, Portugal Stir European Fears

This is the title of a Wall Street Journal article, which goes on to state:

> Financial markets are on edge as crisis-hit euro-zone countries try to pull off a daunting task: protect their banks while slashing budget deficits against a backdrop of economic stagnation and soaring joblessness.
>
> Some economists say it can't be done and see it as increasingly likely that one or more of these countries will eventually have to tap a massive rescue fund set by the European Union and International Monetary Fund, stirring fresh uncertainty about the 16-nation currency bloc.
>
> . . .
>
> Greece is already operating under a separate EU-IMF bailout package that largely covers its funding needs into 2012. But even that rescue has failed to quell doubts in financial markets about Athens' ability to repay its debts further down the road.

See http://www.naegele.com/documents/IrelandPortugalfuelregionalwoes.pdf

Reply

28 09 2010

Smilin' Jack (13:14:38) : edit

Another fair assessment of what is going on here in the U.S., and worldwide by Timothy. You said it before, and the Wall Street Gang had better stop sipping Starbucks and heed the warning you are telling us….

Reply

5 10 2010

 **naegeleblog** (13:59:34) : edit

IMF Admits The West Is Stuck In Near Depression

The IMF is conservative, and is reluctant to admit that the "Great Depression II" is upon us, for fear that panics may erode economies even more—which will happen when the economic realities are realized fully around the globe. An article on this subject in UK's Telegraph is worth reading.

See http://www.telegraph.co.uk/finance/comment/ambroseevans_pritchard/8039789/IMF-admits-that-the-West-is-stuck-in-near-depression.html

Reply

6 10 2010

DWBrown (04:19:27) : edit

The situation is grim – probably grimmer than generally realized, but it's not a foregone unavoidable end that we can't escape. In general people will try to remove themselves from the path of a speeding train.

Europe is in some ways in better shape. While several countries went too far accumulating debt and entitlements the diversity of problems among several countries will help them. Spain and Ireland and the UK participated with the US in the global excess in housing. Germany, Italy, and others did not. Spain bought into the alternative energy hype and is learning that lesson.

I was surprised at the resurgence of discredited voodoo economic myths in the US and the readiness with which Bush initially and then Obama jumped on the Keynesian stimulus bandwagon. The lesson from the Great Depression and more recently, Japan, is that spending does not itself create sustainable economic growth.

The government here in the US is – by funding Fannie and Freddie takeover of the housing markets – stopping the market prices resetting in housing thereby ensuring no real recovery can take hold. It would be better – would have better – for the government to dismantle the 'too big to fail' banks selling off the parts to banks that knew better and to allow prices in the markets to reset providing generous aid to displaced families to get through until recovery got underway. The $800 + billion in stimulus had little to do with the economy and everything to do with political payoffs and payments to states structured to force permanent shift to bigger government.

In any case Europe is in for some tough times ahead. And we are in the same boat with them due to the series of Basel accords regulating banking worldwide. The situation is so difficult in part because of the original Basel accord that took effect in the early 90′s. That global banking agreement was a response, in part, to the Japanese banks rampaging worldwide using cheap money generated by their 1980′s bubble working its way through Japan and spilling out globally via its banks. Basel I was designed to level the field among global banks, but in an example of unintended consequences, it also made sure that any systemic flaws in the accord would impact all the major global banks and their home country financial systems thus laying the groundwork for a series of financial crises globally and the failure eventually of the banking systems.

There were at least two major infections injected into the global system by the original Basel I and that continue into Basel III. Both are partially responsible for the current global downturn and ensure that future crises are more likely – probably inevitable.

One is that Basel decreed that sovereign debt carries zero capital cost. Private debt all carries a higher capital cost. This embedded from the early 90′s into the global financial system a bias towards more sovereign debt ensuring there would be more of it and that it would be cheaper than the natural market rate. This has many implications – none too good – but what it ensured is that all the major global banks carry more sovereign debt on their books than they would have if the rates had to be competitive with private debt.

The European central bank and authorities had a difficult choice forced upon them by Greece. They could allow Greece to default and be forced to immediately deal with the follow-on defaults of almost all of the major banks in Europe (because of the substantial sovereign Greek debt they held), or, they could bail the Greeks out and allow their banks some time to get out of way of the train speeding toward them.

The key fact is that Basel retains the bias that caused the problem to begin with.

The second is that Basel allows major global banks to calculate their own capital requirements and in particular it has a provision that allows one major bank to buy a derivative guarantee from a sibling bank to reduce its capital cost for some particular private asset/exposure. Bank A sells a guarantee to Bank B to greatly reduce its capital cost who sells one to C for its asset who in turn helps A with another. The net effect is that the total capital in the system is woefully inadequate even as every 'i' is dotted and every 't' crossed as per Basel.

As far as Obama getting swept out of office, I believe his only hope for re-election is for the Republicans to retake at least the House. The good side to this is that Obama seems too inflexible to take advantage of that situation to triangulate as Clinton so successfully did to get re-election.

Reply

6 10 2010

 **naegeleblog** (07:10:40) : edit

I agree with your first paragraph. My parents lived through the Great Depression of the last century, and did not seem to be affected by it at all.

As to your second paragraph, the only country in Europe that is truly in decent shape economically is Germany, and it cannot carry the rest of Europe. Among other things, its electorate will balk politically.

I agree with your third paragraph.

I agree with your fourth paragraph, and recommend that you read the comments beneath another blog article entitled, "The Great Depression II?"

See http://naegeleblog.wordpress.com/2009/12/16/the-great-depression-ii/

There is a real argument—which I believe is sound—that the downward fall of housing prices should not have been mitigated by foreclosure relief and other factors; and that until housing prices reach their "natural" bottom, or equilibrium, there will not be any recovery in that critical sector of our economy.

Indeed, government interference with free market forces may produce negative results, rather than helping. As you know, the Great Depression of the last century did not end until the onset of World War II, despite the massive governmental programs crafted by Franklin Roosevelt's administration.

I agree with your comments about Basel. It may well represent a "house of cards" that comes crashing down. Once one or more panics set in, I believe there is nothing that governments will be able to do to stem them. One such "bubble" that I have believed for many years exists in the U.S. relates to mutual funds. Should panics set in and investors seek to cash out of such funds, a liquidity crisis may ensue that cannot be stemmed. The risks of panics such as this one are enormous.

Finally, I agree with your last paragraph, and do not believe Obama is adroit enough to handle the situation. Indeed, the twin pincers of a collapsing economy and a failing Afghan war may overwhelm him personally and politically. Throw in other factors that we do not know about yet (e.g., terrorist attacks), and he may fall like a rock politically. More and more, Americans may conclude that he is "out of touch" and "over his head," which might result in him being considered "irrelevant" politically *and* as a leader. I believe he is a "lame duck" now, or will be after the November elections.

Thank you for your thoughtful comments.

Reply

7 10 2010

 **Timothy D. Naegele** (19:22:59) : edit

The Chickens Are Coming Home To Roost

There is a plethora of bad news in the media, which will only get worse.

See, e.g., http://www.time.com/time/nation/article/0,8599,2024065,00.html ("Encountering Anguish and Anxiety Across America") and http://www.bloomberg.com/news/2010-10-05/food-stamp-recipients-at-record-41-8-million-americans-in-july-u-s-says.html ("Food Stamp Recipients at Record 41.8 Million Americans") and http://news.yahoo.com/s/afp/20101007/bs_afp/forexasiajapanus_20101007100939 ("Dollar tumbles to fresh 15-year low against yen") and http://www.gallup.com/poll/143426/Gallup-Finds-Unemployment-September.aspx ("Gallup Finds U.S. Unemployment at 10.1%") and http://www.cnbc.com/id/39626759 ("US Cities Face Half a Trillion Dollars of Pension Deficits") and http://www.cnbc.com/id/39626607 ("California to Sell 24 Government Buildings")

The American economy and other economies globally are collapsing. The "Great Depression II" is upon us, which economic historians will describe with some precision 20-40 years from now. Yes, there will be "green shoots" from time to time—as there were during the Great Depression of the last century, which only ended with the onset of World War II, not because of any governmental intervention.

See, e.g., http://naegeleblog.wordpress.com/2009/12/16/the-great-depression-ii and http://www.americanbanker.com/issues/173_212/-365185-1.html and http://www.realclearpolitics.com/news/tms/politics/2009/Apr/08/euphoria_or_the_obama_depression_.html and http://www.philstockworld.com/2009/10/11/greenspan%E2%80%99s-legacy-more-suffering-to-come/

Even Alan Greenspan—who is responsible for, and triggered the economic calamity that global economies are facing—is forecasting gloom and doom in a Financial Times article entitled, "Fear undermines America's recovery." He is the architect of the enormous economic "bubble" that burst globally. No longer is he revered as a "potentate." His reputation is in tatters, and he is disgraced. Giulio Tremonti, Italy's Minister of Economy and Finance, perhaps said it best:

> Greenspan was considered a master. Now we must ask ourselves whether he is not, after [Osama] bin Laden, the man who hurt America the most.

That speaks volumes. However, the human suffering and economic devastation that Greenspan's actions (and inactions) spawned are not limited to the United States, but are truly global in scope.

See http://www.ft.com/cms/s/0/4524339a-d17a-11df-96d1-00144feabdc0.html

Reply

25 10 2010

 **Timothy D. Naegele** (09:34:42) : edit

"Green Shoots For Housing Mowed Down"—And Become Dead Weeds

The Wall Street Journal has an article by this title about the American housing market and its effect on the U.S. economy, which states:

> [T]he foreclosure debacle . . . is roiling housing just as some positive signs were emerging. . . .
>
> . . .
>
> The trouble won't necessarily show up in housing reports this week. . . .
>
> . . .
>
> [T]hese figures will reflect conditions mostly before banks temporarily halted foreclosures due to questionable affidavits. More telling may be recent declines in the weekly mortgage-applications survey from the Mortgage Bankers of America, which showed purchasing activity off nearly 40% from a year ago.
>
> For their part, banks are moving to restart foreclosures and reassure buyers that markets are functioning. But the legal logjam mightn't clear quickly, given what are expected to be renewed challenges from homeowners' lawyers and skeptical judges.
>
> The upshot is the level of new foreclosure sales, a key driver of current housing activity, may be damped for months. Home prices may initially benefit from having fewer foreclosures in the mix. But any rise is likely to be short-lived, especially if buyers hibernate until the fiasco gets sorted out.
>
> Moreover, once the legal problems clear, a backlog of discounted properties will flood the market. Economists at Wells Fargo Securities noted last week that there are two million homes in the process of foreclosure and another two million with mortgages 90

> days past due. They expect home prices to fall an additional 5% to 8% next year.
>
> Falling prices and legal uncertainty, meanwhile, may lead "to even more conservative appraisals and even tighter underwriting standards," the Wells Fargo economists reckon.
>
> That, in turn, could blunt the benefit from superlow mortgage rates, currently around 4.2% for 30-year loans. It could also prompt the Federal Reserve to try to drive borrowing rates even lower. While a housing rebound mightn't be a must for an economic recovery, a renewed housing downturn almost certainly will undermine one.

See http://www.naegele.com/documents/GreenShootsforHousingMowedDown.pdf

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