
I. Two World Systems at War

Will 2017 See the End of the Euro?

by Claudio Celani

Jan. 10—The incoming Trump Administration should place on their strategic security screens, a highly probable implosion—possibly this year—of the Euro system, and prepare for this eventuality by drafting a set of policies aimed at facilitating an organized transition to a post-Euro system. These policies should include political and financial support for those countries which want to re-establish national sovereignty, consistent with views expressed by the President-elect and his collaborators during and after the U.S. election campaign.

The alternative to such an approach is a mega-bail-out of European and Wall Street zombie banks, with a multiple of those trillions of taxpayers' dollars that the Bush and the Obama Administrations spent after 2007-2008.

The most probable candidate for leaving the Euro is Italy. In one way or another, we might have a repetition of 2011, when the European Central Bank (ECB) stopped supporting the Italian sovereign debt; however, this time the Italian establishment won't easily accept further austerity recipes and might decide to leave the Euro system.

Indicative of the widespread sentiment in the country, the daily *Il Sole 24 Ore*, owned by the industrialists' association Confindustria, published a Dec. 30 editorial by its editor-in-chief Roberto Napolitano, who accused the EU institutions of victimizing Italy on the issue of its banking crisis, and stated that "Italian politics cannot accept this Europe."

Three days earlier, Italy's newspaper of record, *Corriere della Sera*, published an op-ed by two economists and former government ministers, Giorgio

La Malfa and Paolo Savona, who urged the Italian government to "ask Germany to take the initiative of rethinking the single currency."

The issue at stake is the so-called "Italian banking crisis," which is a result of the protracted decline of the Italian physical economy. Years of EU-imposed austerity policies have caused a serious recession and insolvencies. As a result, Italian banks officially own 200 billion euros of non-performing loans (NPLs), i.e. defaulted loans to companies and families—but the real figure is perhaps double that.

However, the NPL crisis was aggravated by EU regulations themselves (Basel III), which mandate an immediate death sentence for the customer, and the mathematically-certain loss of the loan.

In former times, when a customer was 90 days in default on loans (technically non-performing), the primary task of the bank was to overcome a difficult period together with its customer. Today, if problems arise in a company, the bank must immediately put on the brakes, rate the claims as "at risk," cut further financing, and cover the existing claims with large capital reserves, even if the company has assets.

Thus, *Il Sole* editor Napolitano is right when he says: "Non-performing loans have become the stigma of European banking, and behind that is the steering wheel of an international financial club where Germans and Frenchmen give the orders."

Napolitano accuses the European Banking Authority (EBA), which is part of the ECB, of fixating on the credit side of banks (commercial loans) while at the same time ignoring the leverage factor



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European Central Bank

and the derivatives exposure. The EBA, Napolitano wrote, accepts two things: a leverage of 3%, which was Lehman's leverage, and "another idea, which is deadly, concerning protection of level three assets... thus allowing French and German banks to keep on their balance sheets this sort of 'zombie bank,' without demanding higher capitalization to offset certainly illiquid assets."

Level three assets are assets which have no market, and thus no price. They are worth zero, but banks are allowed to price those assets according to internal models, and put that value on their balance sheet. This is what experts such as FDIC vice-chairman Thomas Hoening have been exposing for a long time, and also what European Parliament member Marco Zanni focused on in his [speech at the Schiller Institute in Berlin](#) last year.

Napolitano said:

All the European attention is instead concentrated on NPLs, and of course on Italian NPLs, which are admittedly high but are covered by real collateral, including real estate properties without a speculative bubble,... The result of this dominant thinking is an unbalanced business model, exposed in mid-term financing, where nobody cares about the 'rot' of level three assets and similar garbage, and everyone ends up saying that the European problem is the Italian banks and their NPLs.

Napolitano's attack came after a Dec. 27 meeting between the *Il Sole* editorial board and Italian Finance Minister Gian Carlo Padoan, where Padoan said that "a civil war" was being fought on Italian NPLs.

Padoan, Napolitano wrote, should "take the initiative and challenge a European system... based on shaky fundamentals... Italian politics can no longer accept this Europe, because at the end of this devils' circle, the most probable scenario is that French banks buy Italian banks" and might even swallow Assicurazioni Generali.

In his own way, Napolitano realizes that the world has changed: "Everything changes, Europe does not move: Trump; Brexit; the Pope coming from the end of the world; the comeback of Russia; and a widespread failure of traditional political leaderships to interpret the soul of public opinion, due to reasons that go from elitism to the depth of the economic crisis."

In their op-ed of Dec. 27, Savona and La Malfa went further, demanding that the Euro system be terminated by Germany leaving the Euro. In the alternative, a different system of national currencies should be set up,

similar to the Bretton Woods system.

Savona and La Malfa were answering an earlier interview with Clemens Fuest (Dec. 15), head of the Munich-based IFO Institute, who had stated among other things that "If the Euro is an obstacle to growth in Italy, then Italy should leave the Euro."

Along with some inevitable German-bashing, Savona and La Malfa propose the following:

The Italian government should demand, in complete confidentiality, a clarification from Germany, and ask that Germany take the initiative to re-think the single currency. This can happen in one of two ways: the first is that Germany leaves the Euro, reintroducing the D-Mark and letting it float upwards....

The other is to replace the current mechanism of the single currency with a mechanism of fixed but adjustable exchange-rates, allowing a downsized European Central Bank and the European Investment Bank (EIB) to assume the features of the two Bretton Woods Institutions, the IMF and the World Bank; with the Euro as a reference currency for national currencies (as the Special Drawing Rights were supposed to become), and the EIB working to improve convergence among European countries.

If both options are rejected, then member countries should carry out "fully independent monetary and fiscal policies, and wait and see."

The ECB at War Against Italy

This discussion took place in the aftermath of a decision by the Italian government to bail out Monte dei Paschi di Siena bank (MPS), and a confrontation between Rome, the Frankfurt ECB, and Berlin on whether the bail-out (*de facto* a nationalization) should also include a bail-in, i.e. a confiscation of junior bondholders.

Not only did the ECB and the German government insist that 40,000 retail customers who bought subordinate MPS bonds should be expropriated, but on Dec. 26, the ECB sent a letter to the Monte dei Paschi di Siena Bank, demanding that the bank build a higher capital buffer than previously agreed upon, and raise 8.8 instead of 5 billion in new capital.

In his interview with *Il Sole*, Finance Minister Gian Carlo Padoan did not hide his resentment of this action, which he called "not transparent."

The case of Monte dei Paschi di Siena, the oldest

active bank in the world and a systemic bank, is exemplary of way the EU first destroyed the banking system, and then punished the citizens for its own mistakes.

MPS has a commercial side and an investment side. The MPS crisis was generated first by debt incurred in the investment side, and eventually aggravated by non-performing loans currently amounting to 47 billion euros.

The single major cause of the MPS crisis was its acquisition of Antonveneta Bank in 2008. MPS purchased Antonveneta from Santander at an official price of 9 billion euros, but a total cost of 19 billion euros. To conceal this debt, derivatives contracts were purchased, which increased the debt. It is presumed that MPS was looted in order to bail-out Santander, which was in a precarious situation after having bailed out ABN Amro. In other words, MPS was sacrificed to bail out one part of the bankrupt financial system.

One single person, ECB chairman Mario Draghi, bears responsibility for that. Draghi was the Italian central banker as well as the head of the international Financial Stability Forum. In 2008, he authorized the Antonveneta purchase, even though the supervisory department of the Bank of Italy had warned, one year earlier, that this was a bad deal. Furthermore, Draghi fraudulently authorized the purchase at a “total cost” of 9 billion euros, mixing price with cost.

Today, the same Draghi is pushing MPS to bail in (confiscate) owners of subordinate bonds, those very bonds that he had authorized MPS to issue to cover part of the “costs” of the Antonveneta purchase! Should 40,000 small investors, depositors who were sold those bonds in a fraudulent action, be punished because of mistakes made by Draghi and Co.?

The Italian government has moved to nationalize MPS, and promises not to bail-in those bondholders. The ECB and the German government have signaled that they won't accept that, and insist on a bail-in. If Rome caves in to that, there will be ruinous consequences.

Meanwhile, the elephant in the room has not disappeared, namely Deutsche Bank with its 45 billion euro derivatives portfolio, and other zombie banks which the ECB is keeping alive with an extension of “Quantitative Easing” until the end of the year. This is an unsustainable situation, and if nations want to survive, they should move pre-emptively with a financial reorganization according to Glass-Steagall principles, before the situation explodes in an uncontrolled way.

All the major U.S. banks are exposed to European banks, and vice versa. An explosion of the European

banking system means an explosion of the trans-Atlantic system.

The Two Evils

Meanwhile, a second evil has materialized with the publication of the December inflation figures for the Eurozone, which threaten to accelerate the dissolution of the Euro system.

After years of stagnation, inflation has jumped to 1.1% for the Eurozone. However, this is the average between two extremes: whereas Germany with 1.7% is close to the ECB target of 2%, Italy with 0.4% and an annual rate of -0.1% is officially in a deflation.

If the figures for the Eurozone keep rising and approach the German level, the ECB cannot possibly continue its monetary expansion policy, which was motivated by the aim of reaching the 2% inflation target—or better, “below but close to” 2%, as the official ECB mantra has repeated. Representing many in Germany, including mainstream media, Munich-based IFO institute head Clemens Fuest told the *Frankfurter Allgemeine Zeitung* Jan. 4 that “this inflation leap is a signal for ending the expansive money policy of the ECB.... If these figures are confirmed for the Eurozone as a whole, the ECB should terminate the asset purchase program in March 2017.”

But if the ECB drops the zero-interest policy and the Assets Purchase Program (APP), this will cause a Eurozone debt crisis, with its epicenter in Italy. Italy must roll over 260 billion of euro debt in 2017, and if the ECB stops purchasing bonds, yields on that debt will skyrocket as in 2011.

Italy has been a master pupil of the EU in the last twenty years, by running a primary surplus each and every year. The price of this is a declining growth in the same period, and the current deflation (-0.1% in 2016). Deflation is a symptom of collapsing demand, and the trend ensures that the debt/GDP ratio will rise.

According to figures released by the Parliamentary Office of the Budget, Italy has paid over 1.7 trillion euros in the last 20 years in interest on its government debt, as much as an entire year of GDP. Of the 260 billion euros of government bonds which Italy is to issue in 2017, 214 billion are to roll over old bonds and 47 billion are to pay interest.

This scenario would add up to the so-called “Italian banking crisis” which we have described above. Faced with this explosive combination and the choice of either submitting to the Troika or leaving the Euro, Italy might easily choose the latter option.