

The IMF Will Need to Bail Out Europe

The FT has a very good summary of the current state of play in the European debt crisis. Yet another weekend summit critical to the survival of the Euro is upon us. Once again, bottom-up analysis of investments is held hostage to the macro issues at play.

The EU is designed to seek consensus and is antithetical to the type of strong leadership now required. Since no single leader will be held responsible if the whole edifice crashes down, all the political calculations are based on domestic politics. It's democratic, but ill-suited to the problems they're facing.

The FT article highlights some important points regarding the European Financial Stability Facility (EFSF). Although €440 billion sounds like enough money, particularly if used as a first loss guarantee (theoretically increasing its firepower by 4-5 times) that's not what's really available. Prior bailouts of Greece, Portugal and Ireland have reduced this to €250BN – and unsurprisingly these countries have withdrawn their pledges to the EFSF. In addition, €230BN comes from Spain and Italy, and since Spain is quite possibly one of the future recipients of bailout funds the ultimate available funds shrink further.

For many months it's been clear that German taxpayers would be writing a check – either to Greece or to their bondholders. But even that is looking less clear without sufficient bailout funds available. So it appears that the IMF will ultimately ride to the rescue. They've apparently already been asked, but the U.S. and U.K. both opposed such a move. One can only imagine the outcry in Congress at such a move. So making such support politically acceptable will no doubt require another

round of robust risk reduction, since only when voters are poorer will they accept the need for U.S. money to bail out Europe.

But of course the U.S. is a net debtor as well. Things will work out – they invariably do when there's no alternative. But the stage is set for macro issues to overwhelm everything else.