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In and Out of Each Other's European Wallets

By NELSON D. SCHWARTZ
Published: April 30, 2010

Despite the best efforts of the [International Monetary Fund](#), the financial crisis in Europe seems full of suspense. Will [Germany](#) and the [European Union](#) actually cough up the money to help bail out [Greece](#), which is on the edge of a financial meltdown? Will the contagion spread to other vulnerable countries, like [Portugal](#) and Spain?

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But like some mystery novels where the ending is telegraphed in the opening pages, the denouement will probably be unsurprising. For all the handwringing, the reality is that the Germans, the French and the rest of Europe have little choice. In the decade since the introduction of the euro, the economies on the continent have become increasingly interwoven. With cross-border banking and borrowing, many countries on the periphery of Europe owe vast sums to one another, as well as to richer neighbors like Germany and France.

Like the alliances that drew one country after another into World War I, a default by a single nation would send other countries tumbling. If that message was lost on anyone, there was a reminder last Tuesday when [Standard & Poor's](#) downgrade of Spanish and Portuguese debt hammered stock markets everywhere, including in the United States.

The first domino is Greece. It owes nearly \$10 billion to Portuguese banks, and with Portugal already falling two notches in S. & P.'s ratings and facing higher borrowing costs, a default by Greece would be a staggering blow. Portugal, in turn, owes \$86 billion to banks in Spain; Spain's debt was downgraded one notch last week.

The numbers quickly mount. Ireland is heavily indebted to Germany and Britain. The exposure of German banks to Spanish debt totals \$238 billion, according to the Bank for International Settlements, while French banks hold another \$220 billion. And Italy, whose finances are perennially shaky, is owed \$31 billion by Spain and owes France \$511 billion, or nearly 20 percent of the French gross domestic product.

"This is not a bailout of Greece," said Eric Fine, who manages Van Eck G-175 Strategies, a hedge fund specializing in currencies and emerging market debt. "This is a bailout of the euro system."

Solutions are also not easily forthcoming. "In the end, we're all saying we don't know how to deal with it," said Dirk Hoffmann-Becking, a bank analyst with [Alliance Bernstein](#) in London. "We don't know how the channels work, or where the problems will pop up next."

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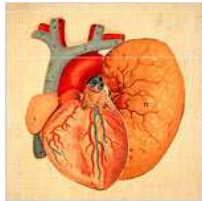
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