

## JANUARY 2010 COMMENTARY

### The Issue Is Not Solely A Greek One

Countries with low levels of debt relative to GDP and who are fiscally responsible are rewarded with lower interest rates and more stable currencies. That's classic economic theory and, albeit greatly simplified, one of the fundamental tenets of the Maastricht Treaty which brought wildly different countries, from a social perspective, together in an economically homogenous union. Member states of that union, the European Monetary Union (EMU), are now just as different economically as they are socially, at the forefront of which is Greece.

Greece is in financial trouble. It has a debt-to-GDP ratio approaching 200% and a fiscal deficit of 10% and yet it enjoys the benefits of a, relatively, stable currency, the euro, and interest rates which, at 1%, are at generational lows. If Greece were not a member state of the EMU it would have four rather unpalatable choices in front of it:

1. **Currency devaluation** - either through endogenous efforts or through market forces. As a member state of the EMU this option is not directly available, though the euro's near 10% fall against the US dollar recently is evidence of indirect market forces at work.
2. **Massive fiscal spending reform** - in the form of spending cuts, higher taxes or a combination of both. Various papers have been published indicating that Greece will have to reduce government spending by 4% per annum over the next few years simply to return to a balanced budget. The inevitable social revolt and backlash precludes any politician from taking this tack if they have a modicum of desire to be re-elected.
3. **Outright default.** Greece's financial position at present is akin to that of Argentina and Russia before they defaulted, and is nowhere near the economic requirements of the EMU; there is even some speculation that Greece may never have met these requirements in the first place. The political and economic heft the EMU enjoys is far too great to risk on the default of a single, minor, member state.
4. **Sovereign bailout.** Were it not for the massive amounts of liquidity washing around the EMU at present, Greece would already be in default. What is required is a dedicated sovereign bailout aimed squarely at the Greek economy. The most likely source of the funds required is Germany.

EURUSD, Daily  
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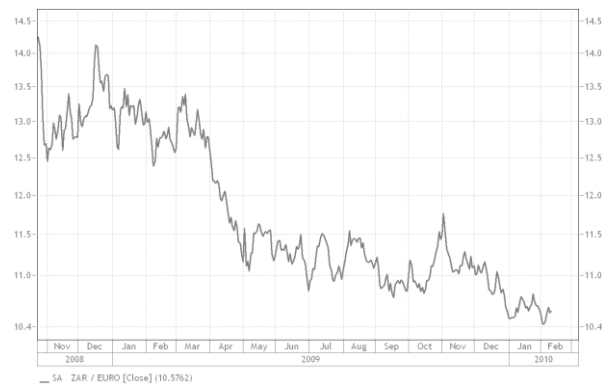
Currency devaluation and default are non-starter options. Fiscal spending reform will happen, though not on a scale to make any meaningful, immediate difference. A sovereign rescue plan of some kind is the only real solution, but can Germany on her own underwrite the entire EMU?

Portugal, Italy and Spain are not too far behind Greece - collectively known as the PIGS countries, though we prefer Stratfor's "Club Med" terminology - in terms of economic difficulty. So, too, is Ireland but they have made significant strides in overhauling fiscal spending. Can Germany assume the debt burdens of all of these nations without collapsing herself, particularly when France and Denmark may themselves be in some financial strife? Maybe, maybe not. What is certain is that the EMU provides Germany access to socio-political and geo-political options not available to Germany on her own. A German-sponsored (though not solely funded), condition-laden sovereign rescue plan is almost inevitable.

What, then, for the euro? The same question could have been asked of the dollar given California's disastrous fiscal position. Greece is no more likely to leave the EMU than California is likely to leave the United States. And consequently the euro is not at greater risk of continual weakness for these reasons alone, some may even argue that a Germany-sponsored underwriting program for the EMU *strengthens* the Union and consequently the euro.

One last thought: Greece's most recent sovereign debt issue was conclude at yields of around 6%. This, relative to central interest rates of 1%, is a multiple of 6. South African central interest rates are at 10.5%. What would the rand be trading at if the South African government could only raise money at around 65% per annum?

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## JANUARY 2010 DATABANK

	Index Value	Last Month	Year-to-Date	12 Months Ago
SA Repo Rate	7.00%	0.00%	0.00%	-4.50%
JSE ALSI	26,675.95	-3.58%	-3.58%	29.68%
ALBI	299.82	0.27%	0.27%	1.69%
R157	8.38%	8.39%	8.39%	7.42%
USDZAR	7.62	2.94%	2.94%	-25.18%

All charts and data are sourced from I-Net Bridge.