



financial services group

MONTHLY MARKET REPORT APRIL 2010

Asset Management

APRIL 2010 COMMENTARY

From January 2010...

Paraphrasing from the January 2010 edition of this Report:

“If Greece were not a member state of the EMU it would have four rather unpalatable choices in front of it: currency devaluation, massive fiscal spending reform, outright default and sovereign bailout. 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.”

A sovereign rescue plan is exactly what has happened. First in the form of a 110 billion euro facility from a consortium of partners aimed squarely at Greece, followed in short order by a more broadly focused 500 billion euro-stability fund cobbled together by various EU-member governments, to the tune of 440 billion, and an emergency EU fund for the remainder. These two packages may be supplemented further by 250 billion euros from the International Monetary Fund (IMF).

The 500 billion euro fund being a brilliantly astute move in that it props up shaky member states (like Spain, Portugal, Italy and Ireland) without explicitly mentioning them by name.

Between the release of our January Report and the IMF facility the euro fell from 1.40 to the US dollar to 1.32, or close to 5%. Between the IMF facility and riots in the streets of Syntagma Square, which tragically resulted in the deaths of 3 people, including a pregnant woman, the euro fell a further 5% to 1.27.

EURUSD, Daily
Jan 09 - May 10



Throwing good money after bad?

Is 500 billion euros enough? Or is it 500 billion euros too many?

When combined Greece, Italy, Spain, Portugal and Ireland owe France 700 billion euros. They collectively owe Germany a further 500 billion euros. The euro stability fund does not absolve any of these troubled nations from their debt obligations; it simply replaces short-term debt with longer-term debt. It exchanges one set of creditors for another. What's more it does so in an environment where the interest burden attached to new debt is higher and has to be funded by a nation less likely to be able to afford these loans (see 'Numbers that won't stack neatly' below). The problems are not going away; they're simply being kicked further down the road.

Here's another dynamic to consider: not only do Greek, Italian, Spanish, Portuguese and Irish banks owe French and German banks money, they owe each other money. Portugal owes Spain close to 70 billion euros. Were Portugal to default Spain would have to write off an asset it can barely afford to lose. The interconnectedness of everything cannot be forgotten.

Numbers that won't stack neatly

Greece, as a member state of the EMU and a supposed adherent of the Maastricht Treaty, racked up a debt-to-GDP ratio in excess of 100%. It did so in an environment that rewarded adherents with lower debt funding costs. Greece's adherence clearly no longer holds and, now, no longer do lower debt funding costs.

In order to edge back from the default precipice Greece must enact strong austerity measures which will affect GDP growth through pull backs in government spending programs and through cuts in civil service salaries. In addition, Greece must expand its revenue line and is likely to do so through higher taxes (likely in the form of consumption taxes like Value Added Tax (VAT)). Higher taxes reduce disposable income which in turn reduces GDP growth.

Perversely, if the Greeks are successful on the income and expense lines of government's income statement they are likely to see debt-to-GDP ratios *expand* rather than contract. This is because GDP is likely to remain stagnant or even fall *before* debt is reduced.

The above scenario can broadly be applied to Spain, Italy, Ireland and Portugal. Ireland is a little further along the curve and Spain might be a bit worse off as they are already suffering a 20% unemployment rate. All of these countries, and several others around the world, are going to have to go through a painful adjustment process.

Euro Repurchase Rate, Weekly
May 93 - May 10



Buying time

What 860 billion euros in bailout packages buys isn't solely the potential stabilization of the euro, nor is it a combination of stability and perception variation. What 860 billion euros buys is perhaps the greatest commodity of all: time.

Time to enact austerity measures, time to calm an increasingly restless populace, time to redress fiscal imbalances.

APRIL 2010 DATABANK

	Index Value	Last Month	Year-to-Date	12 Months Ago
SA Repo Rate	6.50%	0.00%	-0.50%	-3.00%
JSE ALSI	28,635.76	-0.39%	3.50%	38.69%
ALBI	316.25	1.26%	5.76%	9.34%
R157	7.79%	8.17%	8.39%	8.12%
USDZAR	7.38	1.25%	-0.25%	-12.35%

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