



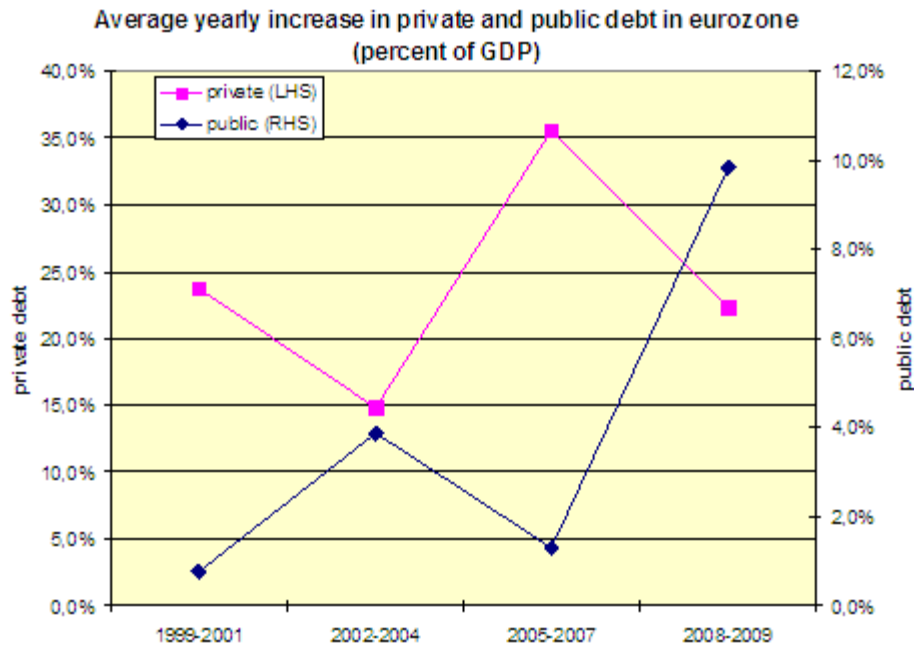
“The Greek Crisis”...

“Deficit spending is the amount by which a government, private company, or individual's spending exceeds income over a particular period of time, also called simply "deficit," or "budget deficit," the opposite of budget surplus.” This difference is usually made up by borrowing or minting new funds and occurs for numerous reasons. Today, one of the major reasons cited for deficit spending is to ensure high levels of economic activity. Whilst there is significant economic data testament to this, there is also growing evidence to the contrary and of the great influence of government deficits upon a national economy. Indeed, “the use of deficit financing to maintain total spending or effective demand was an important discovery of the economic depression of 1930” however, recently, swelling deficits have been the root cause of problems for several member states of the Eurozone, putting them at risk of default.

With Greece's budget woes considered the most grave; this article focuses on this member state and the mounting speculation of the effects on the stability of the Euro currency and the entire Euro region as a whole. The Greek crisis has sparked fears that this may be only the beginning of a deeper sovereign debt crisis that could ultimately destabilize the Eurozone. In the midst of a sluggish recovery in the global economy, the key questions right now are whether these fears are exaggerated and more importantly, how to deal with these problems.

Figure 1 paints a clear picture of the origins of the current crisis. The period in question has been organized in periods of booms and busts: the boom years were 1999-2001 and 2005-2007 whilst the bust years were 2002-2004 and 2008-2009. Upon further scrutiny, private debt increases much more than public debt throughout the period. Further, private debt increased drastically in the boom years while public debt growth dropped. The opposite happens during the bust years with private debt growth slowing down and public debt growth accelerating. Noteworthy is during the last 2008-2009 period of bust, public debt increases by 10% of GDP per year.

Figure 1



Source: ECB, Quarterly Euro Area Accounts. Note: 2009 is until second quarter

To explain further, the government steps in when the economy enters a recessionary state in light of the pile up of private debt during the boom years. Measures taken by the government include increased social spending in addition to issuing its own debt to bail out private institutions for the debt that is implicitly guaranteed by the government, specifically bank debt. This feature is particularly pronounced during the last boom-bust cycle that led to unsustainable private debt growth forcing governments to add large amounts to its own debt.

The Eurozone government debt stood at 85% of GDP at the end of 2009; and according to market players, “the Eurozone is miles away from a possible debt crisis”. The same however, cannot be said for some individual countries, in particular Greece. The economy is plagued with a weak political system that has been adding government debt at a much higher rate than the rest of the Eurozone, in addition the country has a debt level exceeding 100% of GDP. Greece is currently facing its worst debt crisis in decades amid the global recession and has come under political pressure from the European Union to straighten out its finances and obey deficit limits intended to support the shared euro currency.

According to Greek officials, the debt spiral is not anticipated to force the country to default on its payments and have pledged to do anything necessary to improve the current financial and economic position. The Greece economy entered into a recession in 2009 after years of robust growth. Greek Prime Minister George Papandreou announced a raft of measures intended to reduce the staggering public debt by 2012 at the latest, and gradually bring the budget deficit of 12.7% as at 2009 to below the Euro zone’s requirement of 3% of GDP by the end of 2013. Despite these, the newly elected government has the challenging task of convincing international markets and investors that its measures would be sufficient. This is evidenced by the price the risk of Greek government bonds 250 basis points higher than the risk of German government bonds. According to Paul De Grauwe a member of the Group of Economic Policy Analysis, advising the EU Commission President, the growing skepticism of the financial markets has a lot to do with “the poor

communication by the EU-authorities that have given conflicting signals about their readiness to give financial support to Greece if a sovereign debt crisis were to erupt," The Greece economy is "struggling under a massive debt of over 294 billion euros (412 billion dollars), a runaway public deficit estimated at 12.7% of output, a triple downgrade of its sovereign debt ratings and doubts over dodgy data."

In December 2009, ratings agencies Standard and Poor's (S&P) and Fitch downgraded Greece's credit rating on doubts that recent measures announced by the centre-left government would be able to tame the country's ballooning public debt. According to S&P, the downgrade reflected the view that the measures the Greek authorities have recently announced to reduce the high fiscal deficit are unlikely, on their own, to lead to a sustainable reduction in the public debt burden. Furthermore, it is believed that the government's efforts to reform the public finances would face domestic obstacles that would likely require sustained efforts over a number of years to overcome.

There are mixed views on whether or not bail-outs in the Eurozone are illegal. According to the Maastricht Treaty, "*the no-bail-out clause only says that the EU shall not be liable for the debt of governments, i.e. the governments of the Union cannot be forced to bail out a member state. But this does not exclude that the governments of the EU freely decide to provide financial assistance to one of the member states.*" The Eurozone governments have the capacity to bail out other governments, and it is expected that they are very likely to do so in the Eurozone if the need arises. Whilst an outright default by the Greek government remains a remote possibility, any bailout from the other Eurozone governments is very likely due to "pure self-interest." Indeed, a significant part of Greek bonds are held by financial institutions in Eurozone countries whilst more importantly, a failure to bail out Greece would trigger contagious effects in sovereign bond markets of the Eurozone. This would only result in investors having lost funds holding Greek bonds "to dump government bonds of countries, like Spain, Ireland, Portugal, Belgium that they perceive to have similar budgetary problems."

One decade later, after the introduction of the euro, the common currency of 16 of the 27 EU member states, the euro has come under severe pressures, reaching a 5-month low towards the end of January 2010. Analysts doubt whether the government in Athens will be able or willing to address Greece's financial problems and if not, the other 15 nations using the euro "will suffer the consequences."

According to EUbusiness, 20 of the EU's 27 nations are running deficits above the threshold, after the deepest global recession since the 1930s wreaked havoc with public spending. Whilst the focus of market players' is still on the Greek crisis, their attention have broadened to other EU member states after Spain said its deficit might be worse than previously thought and officials in Portugal reported difficulty in selling treasury bills. The Euro zone represents the second largest economy in the world and during the past decade, the euro became the second largest reserve currency after the U.S. dollar. With the Euro zone such a powerhouse in the world economic order, the current crisis in Greece is very much reflective of the statement that 'the survival of the European Monetary Union is based on the extinction of nation-states.'

FINANCIAL & ECONOMIC INDICATORS

As at 4 February, 2010

| <u>Exchange Rate/US\$</u> | <u>Closing Value</u> | <u>Previous Week</u> |
|---------------------------|----------------------|----------------------|
| Yen | 89.05 | 89.92 |
| Euro | 1.37 | 1.40 |
| Jamaica | 89.69 | 89.67 |
| Guyana | 204.90 | 204.70 |

| <u>Commodity Prices</u> | <u>Closing Value</u> | <u>Previous Week</u> |
|--------------------------|----------------------|----------------------|
| Crude oil (US\$/bbl) | 73.14 | 73.64 |
| Natural Gas (US\$/mmbtu) | 5.47 | 5.33 |
| Gold (US\$/Troy Ounce) | 1,063.70 | 1,087.10 |

Eurobond Indices (As at 4-02-10)

| | |
|--|------|
| Lehman Brothers Global Aggregate Index (Return % YTD as at 5 Feb 10) | 0.17 |
| JP Morgan EMBI+ (Basis points) | 315 |
| JP Morgan Central America and Caribbean Index (CACI) (YTD return %) | 1.10 |

| <u>Policy Interest Rates (%)</u> | <u>Closing Value</u> | <u>Previous Week</u> |
|----------------------------------|----------------------|----------------------|
| United States | 0.15 | 0.13 |
| Euro Zone | 1.00 | 1.00 |
| Japan | 0.11 | 0.10 |
| Brazil | 8.75 | 8.75 |
| Trinidad | 5.00 | 5.00 |
| Jamaica | 12.50 | 12.50 |
| Barbados | 2.50 | 2.50 |

| <u>Market Interest Rates (%)</u> | <u>Closing Value</u> | <u>Previous Week</u> |
|----------------------------------|----------------------|----------------------|
| US 90-day T-Bill | 0.09 | 0.07 |
| US 10-Yr Treasury | 3.61 | 3.64 |
| 3-month UK Libor | 0.62 | 0.62 |
| Japan 90-day T-Bill | 0.28 | 0.28 |
| Brazil 90-day T-Bill | 8.75 | 9.17 |
| TT 90-day T-Bill | 1.29 | 1.36 |
| Jamaica 90-day T-Bill | 11.35 | 15.34 |
| Barbados 90-day T-Bill | 3.40 | 3.40 |

Sources: Bloomberg, J.P. Morgan, CMMB, Central Bank of Trinidad and Tobago, Bank of Jamaica, Central Bank of Barbados, www.lehman.com

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