

JVB Financial Group, LLC

CRONIN'S CORNER MONTHLY

A Perspective on the International Economy

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The vicissitudes of fortune that swirl across the cosmos have not yet it seems landed on earth, certainly not on the continent of Europe and most unfortunately not onto the tip of your humble author's pen. Once again this month's tritful treatise lollops across the Byzantine unit that is Europe. Since our last installment the nimbus that has been threatening Europe – for what now feels like forever – has darkened. Nostrums lacquered with spindoctored politicking and voodoo economics have drawn the farrago that is Europe even deeper into the event horizon of what has now become a global financial black-hole. The fractured political base, the cross border discord and the dearth of solutions have raised questions of the extreme and the susurrations of the unthinkable have now become excruciatingly audible. "Default", "exit" and "collapse" could come to define an apocalyptic patois of a European legacy. A toxic triad, but how close are we now to their realization?

If the people of Athens have a patron saint it is probably the Greek Goddess 'Athena' – (obviously the deductive rationale for this isn't that far fetched) The Acropolis that overlooks the city below is itself a temple that was erected in her honor about five hundred years BC and seems to have withstood the sweep of time better than the modern Greece that has adopted it. Athena herself was a deity of many sides, but the fact that she was the Goddess of courage, wisdom and inspiration smacks of a dolorous irony that maybe only the Athenians themselves can fully appreciate.

When Greece became the twelfth nation to adopt the Euro in 2001, the event was met with a Panglossian parade of banter from the European Central Bank. As the Euro-zone's reach broadened so did the power of the Euro and thus the paragon that was deemed Europe was re-creating itself. However, even back then concerns bubbled and many argued that leaving weaker nations into the Euro-zone could, in the long run, jeopardize its sustainability. Such conjecture was dismissed and the Euro-zone forged ahead. Then it emerged in 2004 that the Greeks had lied about the state of its finances in order to be allowed and adopt the Euro as its currency. In fact the mandatory ceiling of three percent of GDP for a

country's deficit had been breached by Greece as far back as 1999 but promises were made (and worse, they were believed) that the fiscal deficit would be curtailed and the country's finances subdued in order to appease the ECB's criteria. Oh Athena, where were you then? Neither wisdom (the Greek duplicity) nor courage (the ECB intervening immediately after the caper was rumbled) in any way, form or scent was to be discerned and it was this dissolute jamboree that has helped create the destabilization of the global financial and economic platform as we witness it today. If the issue had been addressed back in 2005, before the financial crisis in 2008 that served to exacerbate the problem into a plight, then we might not have the financial hysteria that we currently see with Greece seemingly, almost inevitably, on the threshold of default.

At the time of writing Greece's already severe fiscal austerity measures are being scrutinized and likely to be twisted further as loan installments to the insolvent nation are becoming increasingly saturated with frustration and political hesitation. The determination will be made by the Troika (ECB/IMF/EC) to decide whether the country is doing enough to reduce its deficit and if it is, then the latest loan tranche will be approved and we will wait until December for the same song and dance to occur all over again. It seems obscenely obtuse that Greece's insolvency will not be recognized by the Troika. The fact that these loans have no way of being paid back and that the draconian austerity measures being imposed upon the Greek people will not succeed and will in fact prolong Greece's recession, render the whole operation futile. The time must surely be approaching wherein the Greeks can no longer truckle to the demands of the IMF et al. and must recognize that the austerity measures will do irreparable damage to the economy or the IMF et al. must acknowledge that the loans are doing irreparable damage to the very foundation of the Euro-zone. Either way, a Greek default is imminent. A clear forecast of its consequences is obviously difficult but certain resultants seem obvious. Rampant write-downs of Greek debt from anywhere up to eighty percent is possible and contagion fears would become pandemic.

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Upon its arrival the immediate reaction would be a surge in peripheral yields. We would probably see Italian and Spanish debt skirt the dreaded seven percent zone and funding costs could once again become prohibitive. Portugal and Ireland would become the obvious targets of further default hysteria as being bail-out recipients investors would take a Greek precedent and apply it across the region. Although Ireland's excruciating austerity measures seem to be working having achieved over twenty billion Euros of savings since 2008, which has resulted in yields plummeting from their all time highs, a Greek default would probably undo all the hard work that has been done. The exposure that European, and especially French, banks have to Greek sovereign debt has become ubiquitously publicized and a default would probably result in many European institutions needing to be recapitalized. French exposure is estimated to be close to sixty billion Euros, which is nearly twice as much as their German counterparts, and when it comes to Italian exposure the French are on top again with over four hundred billion Euros in debt on their books. A default would drive the Libor-OIS spread even higher as banks would grow increasingly reluctant to lend to each other and the Euro would sell off. We would surmise then that a Greek default might finally convince the ECB to cut rates and reverse the injudicious tightening that they embarked upon earlier this year as vast liquidity injections would have to be implemented. The next step after Greece defaults we think would then be the commencement of the questioning of their very status within the Euro-zone itself. Whilst they cannot be removed from the EZ (No exit clause was ever written into the constitution) the Greeks themselves could abdicate from the Euro, flee the Euro-zone and abandon a union that many in Greece (and most likely Germany) now feel is a blight destined to ruin their country. However, the repercussions of such a move could be cataclysmic. The Greeks would have to reinstate their old currency, the Drachma, which would immediately plunge and there would surely be a run on the banks as any deposits that are left there would still be in Euros, and would be promptly removed before they could be converted into the new fiat currency. With little or no capital these banks would have few options for help (remember the ECB would no longer be an option) and Greek bank failures would further decimate the recession riddled economy. Outside of Greece the contagion fears would pummel the Euro which would consequently,

perhaps fatally, threaten the whole structural integrity (and we use that word very carefully) of the whole Euro-zone. Therefore, we think it very unlikely that a Greek exit from the Euro-zone is currently an option despite some Dutch and German penchant for the idea. However, at one time one would also have thought that a Euro-zone member defaulting on its debt would have been inconceivable but if the 'ignes fatui' that is Europe has taught us anything, it is that anything is possible.

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