

JVB Financial Group, LLC

# CRONIN'S CORNER MONTHLY

## *A Perspective on the International Economy*

MARCH 2010

by Keith Cronin, JVB Senior Vice President of US Credits and International Sovereign Trading

If Mel Brooks decides to make another movie, maybe Europe will provide the inspiration. The material has morphed into a spectacle and it seems like a parody upon a spoof that just continues to write itself. Between the Nazi references, some German ridiculousness and the Greek effusiveness, European nationalism seems to have been re-ignited by economic and financial tribulations. Whilst the situation in Greece has yet to contort itself into a major crisis, the recent events have strained relationships across European borders and given the world an insight into the fragility of the Euro zone marriage. When Europe day is celebrated in May every year its purpose is to rejoice at the peace and unity that exists in Europe and to promote the doctrines of European integration and enlargement. This year the 'parades' seem to have started early but the demonstrators and riot police are in little mood for rejoicing.

Since George Papandreou's Socialist party won a snap election in late 2009, Greece's recalcitrant budget deficit has been making significant impressions upon global markets and sentiment. The new prime minister's 2010 draft budget proposal in November of last year included a pledge to cut the country's burgeoning deficit which stood at close to thirteen percent of GDP which, as decreed by the membership criteria of the EU, should be no larger than three percent of GDP. Obviously then this obliteration of the threshold begot a torrent of negative resultants including a downgrade of the country's debt, global financial market angst and ubiquitous scenes of European disharmony and vociferous dismay. The most vocal critics of Greece's noxious finances have been, not surprisingly, the Germans. If there was any doubt as to which country waves the European baton, the Greek debacle has shown the world that Germany still orchestrates the economic, financial and political discourse on the continent. It wasn't the actual announcement by the Greeks that their fiscal impudence had run amok, but rather the resulting downgrade of their sovereign debt in December of last year that made the issue pungent. As the problem inherited global implications the Germans decided it was time to intervene because not only were the financial implications of the situation dire, but it was also an embarrassment to German thriftiness and to a German run Europe. Demands were issued to the Greeks that they undertake more severe austerity measures and the Teutonic temerity of such a plea had the Greeks up in arms. Greece's deputy prime minister dragged Nazi-era grievances out of the grave by stating that Germany had not adequately compensated the Greeks for the Nazi's World War II invasion of his country. This is hardly a rational way to solve a problem that requires Germany's help but the audacity of the Germans telling the Greeks how to solve a Greek problem invoked an intense ire. Of course, it's not just a Greek problem but a European one which means ultimately a German one. However, instead of ignoring this type of rant, responses came in kind

from the German right wing which suggested that Greece actually sell some uninhabited islands, historic buildings and even some art work to help dilute its debts. The Greeks were obviously not impressed and a Greek magazine showed a charioteer atop the Brandenburg Gate in Berlin waving a swastika whilst a German publication called the Greeks 'fraudsters' next to an image of a Greek statue making an obscene gesture. This circus of national divergences helps to illustrate how difficult it is for the European Union to work. Not only are the cultural and national differences over pronounced but by applying a uniform monetary policy across economies that are just as different such fiscal and economic disparities that are now on show are arguably inevitable. The German people are resolutely opposed to providing any bail-out to their profligate European neighbors and with Germany's deficit at just over three percent of GDP it's easy to discern the German psyche's abhorrence to debt and to fiscal imprudence. The pedestals upon which the oppositions to any type of bailout for Greece are perched however, will have to be dismantled. Germany will have to agree to some sort of rescue plan, not only for Greece's immediate salvation but ultimately for Germany's and Europe's steadfastness. Constitutionally an official bail-out is not permitted but this situation may now spawn the debate for a European equivalent to the IMF, but that is a long run solution. Greece doesn't have time for that. Another incentive that must surely resonate with Germany is the direct economic and financial ties that exist between the two countries. Germany's export driven economy sells almost three times as many goods to the Greeks as it buys and German banks have close to an estimated forty billion Euros in exposure to Greek Sovereign, local government, bank or Greek corporate debt (It should be noted that French banks have actually more exposure with close to sixty billion Euros in the lap of the Greek Gods) However, the amount of German exposure is probably not calamitous when held in context to the overall German banking system's balance sheet. If Greece were to default then, it is highly unlikely that we would see an avalanche of downgrades to German banks but obviously a Greek default would have negative macro-economic consequences that would resonate across the whole of Europe. Thus far, the Greeks have implemented the easy part of their deficit reducing crusade. They have simply announced austerity measures that will, theoretically, amount to over fifteen billion Euros or about six and a half percent of GDP which should satisfy even the most draconian of taskmasters. The financial markets reacted well to the announcements and we saw Greek spreads tighten and along with tighter CDS spreads and a composed moderation in the EURO versus the greenback it seemed that a potential crisis had been averted. We feel, unfortunately, that the issue is not yet resolved. As witnessed across media channels the Greek people are not willing to

### ABOUT KEITH CRONIN

Keith Cronin is Senior Vice President of US Credits and International Sovereign Trading at JVB Financial Group, LLC, and also works with the firm's New York Institutional team. With almost a decade of fixed income trading experience, he began on HSBC's retail desk and moved on to HSBC's proprietary trading desk, wherein his specialty became trading Investment grade US Corporate Bonds. Mr. Cronin is a graduate of the University of Cork in the Republic of Ireland with an Honors Masters Degree in Economics.



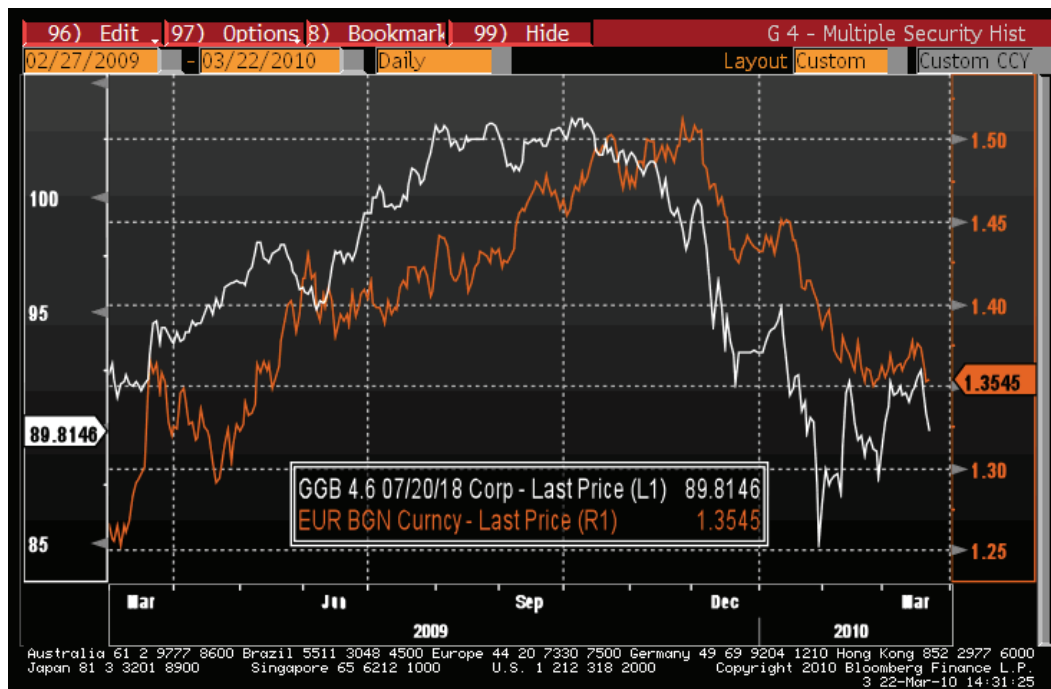
(Continued on page 2)

(Continued from page 1)

accept these austerity measures with an abundance of glee. The harsh revenue raising measures that have been announced will include higher taxes on items from gas to electricity to cigarettes as well as cuts to pension subsidies and have been successful as an appeasement to Greece's European tutors. However, we feel that the economic base upon which these austerity measures were founded will continue to remain extremely weak thus making it incredibly difficult for the Greek officials to actually see them successfully implemented. It's difficult to see where Greek economic growth will come from. Domestic demand is already weak and with higher taxes on the way, this will only stifle the Greek consumer even more. For these measures to realistically work or to seriously make an impression on the deficit, the Greeks would have to devalue their currency and try and export their way to a more tolerable quotients. Of course the Greeks can't devalue their currency because they are part of the Euro so maybe the solution is for Greece to leave the Euro until they can get their imbalances in order. If they were to

leave and operate under the old Greek Drachma for example they would certainly have more flexibility with policy but that could then create another issue. The debt that Greece has outstanding is in Euros. If they were to return to a Drachma type unit it would be significantly weaker than the Euro and that would make the servicing costs on the outstanding Euro denominated even debt more prohibitive than it is now. Therefore we think that the possibility of the Greeks leaving the Euro is, at this stage, negligible. The Greeks may have no option now but to turn to the IMF for assistance, a recourse which would certainly be encouraged by Germany. However we feel that if Greece turns to the IMF it may be interpreted as a sign that Europe is not willing, or capable, of helping its member states and that could further heighten investor fear in an already timorous Euro. The next major test for Greece will be in April and May when there is about twenty two billion Euros of debt maturing. We expect by then that some sort of resolution will have been achieved, and, even when it has the market, will dare not take its eyes off of Spain and Portugal. •

Keith Cronin  
March 2010



AS GREEK SOVEREIGN PRICES HAVE COME UNDER RENEWED PRESSURE THE EURO IS EXPERIENCING BROAD WEAKNESS, ESPECIALLY VERSUS THE USD.



JVB FINANCIAL GROUP, LLC  
MEMBER FINRA - SIPC

2700 N. Military Trail, Suite 200 / Boca Raton, FL 33431  
(561) 416-5876 • www.jvbfinancial.com

**For Broker Dealer, Institutional, and Advisor Use Only**

This material is intended for broker dealer, institutional, and advisor use only, and is not to be distributed to individual investors. This document has been furnished to you solely for your information and may not be reproduced in any manner or provided to any other person. The information contained herein is based on sources that we believe to be reliable, but we do not represent that it is accurate or complete. Nothing contained herein should be considered as an offer to sell or a solicitation of an offer to buy any financial instruments discussed herein. All references to prices and yields are subject to change without notice. Any opinions expressed herein are solely those of the author. As such, they may differ in material respects from those of, or expressed or published by or on behalf of JVB Financial Group, LLC or its officers, directors, employees or affiliates.