JVB Financial Group, LLC

CRONIN'S CORNER MONTHLY

A Perspective on the International Economy

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The summer months oft times bring hoards of tourists to the shores of Ireland. Some have come for the spectacular scenery and some to perhaps indulge in regressive genealogy, but one rarely visits the Isle with the intention of getting a sun tan even in the promising months of July or August. Inevitably, the hospitality and historic lore blares plenty of warmth into the hearts of any visitor and within these environs it's all but impossible to feel the frigid fingers of a summer dampness. Unfortunately, however, the Irish spirit continues to be assaulted by a ravaging recession. When we last spoke of Ireland's economic malaise, in December of last year, our forecasts were regrettably bleak. As this year has progressed the news from across the pond has continued to deteriorate at an alarming rate which has almost pushed the country to the brink of a complete economic collapse.

Technically, the Irish economy is already in a depression. This is usually defined as a contraction of ten percent, or more, in economic output from peak to trough. As with many, if not most, of the global community, this year's growth will be anything but, and negative numbers will dominate. Next year we will see a similar scenario but as 2010 draws languidly to its own demise we may expect to see a mediocre recovery begin to dawn. By then however, the damage will have been done. Having fallen three percent in 2008, GDP in Ireland will likely fall over eight percent this year and next year will see a contraction of at least two percent. Irish unemployment will inevitably topple the ten percent level and by next year an unemployment rate of fifteen percent is completely feasible. This performance will eclipse the crisis in Finland in the early nineties when the Soviet Union broke apart depriving the Finns of their biggest market. The Celtic tiger that roared and made the Irish economic model a festoon upon which the Europeans could parade the Euro zone has been obliterated. The severity of the Irish implosion can be traced back to fundamental flaws that existed within the Irish economy that were exposed with the onslaught of the global meltdown. One of them is structural and these probably exacerbated and indeed contributed to the swiftness of the Irish collapse. Wage inflation in the Isle had been about twenty percent higher than the European average before the recession. This disparity prompted companies, like Dell for example, to relocate their operations and consequently the computer maker has moved its manufacturing operations to Poland as part of a cost cutting program. To put that in perspective, Dell was Ireland's second largest private sector employer and the country's biggest exporter. Therefore, the impact of such corporate exits cannot be overemphasized. The severity of the Irish story is compounded obviously by the global malaise and the unprecedented events that have unfolded in the global financial theater. The root of the problem though has to be traced back to the collapse of the Irish property market.

At its peak, the level of property and building construction in Ireland accounted for over fifteen percent of the economy's output resulting in a foaming bubble that caused house prices to triple between 2000 and 2006. This enormous contribution resulted in a disproportionate amount of people being employed in the construction sector and once property prices imploded the inevitable became a harsh reality. The nation's banks were hugely instrumental in fueling the property mania as by 2005 the offer of 100% mortgages had first time buyers hooked. Thus, with 100% financing available anyone who could even theoretically meet the repayment requirements was approved for a mortgage.

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This inevitably led to speculation which disastrously led to an already mature property bubble becoming even more inflated. The Irish banking system had uncharacteristically over exposed itself to a lofty property market. Funded by excessive foreign borrowing the banking sector continued to supply funds for property development. Construction became ubiquitous and by 2006 sixty percent of the banks' assets were property related lending – this figure was under forty percent in 2002. This ubiquitous construction found its support for many years, not only in the Irish population itself but also in the vast amount of immigrants that had flocked to Irish shores during the boom years. However, as the economy began to melt and unemployment started its upward surge these vast amounts of Eastern European immigrants began to return home. The housing equation had lost another critical variable and housing demand capitulated even more. The banks' over exposure to property development has now threatened the Irish financial system as the country's main financial institutions remain on life support. The government has had to guarantee the liabilities of the main commercial banks, has already nationalized one bank and has agreed to purchase non-performing loans of up to ninety billion Euros. This is to be accomplished by the creation of a 'Bad Bank' of sorts that will then buy the impaired assets that are stagnating on the balance sheets of the country's banks. As tax revenues have plummeted and unemployment benefits have soared the deficit has swelled and now carries the unfortunate charter as being Europe's largest. To fund this deficit, the Irish government is going to have to borrow many more billions of Euros in the debt markets and as the country's debt rating has fallen, this could prove to be more expensive. In the first quarter of this year, spreads on Irish sovereigns stretched to over 280 basis points over Bunds as fears of default and even speculation as to whether Ireland could stay in the Euro had investors fleeing. However, since then the global perception has changed. As the rate of deterioration of the global economy has slowed risk appetites have sharpened, equity markets have rallied, and Irish debt has tightened. However, none of these facts have resulted in an improvement in the Irish economy, and they cannot detract from the real economy of Ireland and the real negative effects that this recession is generating. In fact the only positive news the Irish economy has received lately was from U2.

Following a series of concerts in their hometown, it is estimated that the Dublin quartet generated over fifty million Euros in revenue for the capital. If they could be convinced to keep their world tour in Ireland then Irish officials might finally find what they are looking for. •

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