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Greece II



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Is the Greece Euro Fiasco Over?

By David Pierce, Director Business Development

Last month we sent you out our views on what was going on with Greece, and how it would impact the value of the Euro. The last two days have been filled with news that the European Union and the IMF are going to now offer loans to allow Greece to borrow money at attractive rates has been big news. In light of this, we thought it would be prudent to take another quick look at Greece and more importantly the Euro and the other countries that make-up the European Union.

Is this a good deal?

While this sounds all warm and fuzzy on the surface, it is not a cure-all for Greece's problems. Let's take a quick look at the numbers. The EU has offered to lend Greece money at the Euribor rate plus 3%, plus an additional .5% fee. With 1 year Euribor trading at 1.224, this makes the all-in rate to Greece 4.724%, versus the current 5.1% that the Greek Government Bonds are trading at, thus saving the government .376% on their short term money. This morning Greece was able to sell 6 month bonds at 4.55%, and 12 month bonds at 4.85% which is as good as or better than they could receive from the EU, or the IMF (although they are looking at longer 3 year notes with the EU).

When looking just at the raw numbers, it does not look like the deal they are offering Greece is that great from a rate standpoint! But, the real issue for Greece is access to liquidity. The fear is nobody will be willing to loan them anything! Greece has almost 12 Billion Euro's worth of bonds maturing in the next 45 days, and no money to pay the bill, this requires them to go back to the market and raise money. So assuming that Greece now has access to all the additional funds they need, is the problem solved? Well, not so quick let's take a look at the broader picture.

Problem solved?

Increasingly it appears that Greece will be unable to finance a budget deficit that is more than four times the European Union's limit of 3



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percent of gross domestic product. Prime Minister George Papandreou needs to raise 11.6 billion Euros by the end of May to cover maturing debt, with another 20 billion Euros required by year-end. Last week the government estimated its 2009 shortfall to be 12.9 percent of GDP, the biggest in the euro's history.

While Greece has pledged to meet deficit-cutting goals, no real details on how this will happen have been given. Discussions with Greece on further conditions for this aid are still ongoing. The IMF and the European Central Bank "may have conditions of their own," German Finance Ministry spokesman Michael Offer told reporters in Berlin yesterday. "Given this information, we really do not have a clear picture of what the bail-out package truly will look like."

An even more important consideration than whether or not Greece can actually get access to funds is what they are going to do to change their spending habits, and raise additional tax revenue. In this recessionary economy, increasing tax revenues from companies and people who are already struggling is going to be a tough job. Additionally, cutting government spending in these times usually equates to cutting government jobs, a very unpopular idea right now.

The Bigger Issue.

We can all agree that Greece is not the economic engine that drives the EU, in fact it accounts for only 2% of the total Euro GDP. So why is the current debt crisis in Greece taking such a big bite out of the Euro? Well first and foremost, all of the EU countries are supposed to comply with the Maastricht treaty (the treaty on the formation of the European Union). In addition to rules about free trade, it specifically spells out from a financial standpoint, how countries are to maintain their internal financial house. Greece has been blatantly ignoring the rules, spending money like there is no tomorrow and is now asking the other

countries to bail them out, the Maastricht treaty expressly forbid this as one of the rules of joining. From a market standpoint, if the other countries run to Greece's rescue, it will demonstrate how the rules of the Maastricht Treaty and the European Union have been null and void. In other words, it greatly undermines the rules and valuation models for the Euro that most traders have lived by.

Are other Countries in trouble?

This issue is not just with Greece alone, Spain Portugal and Ireland are also well outside the guidelines set forth in the Maastricht treaty. Currently Spain's deficit as a percent of GDP is 9.5%, Portugal's is 6.4%, and Ireland's 9.6%. All of these countries are also feeling the effects of the current economy. This begs the question, how many countries can the EU afford to bail out to keep the Euro intact?

Germany and France are the main economic engines driving the Euro. If they continue to support the smaller economies from a financial basis this will become a huge drag on their economies as well.

Outlook for the EU

The currency futures market has huge net short positions on the Euro, indicating that speculators believe the Euro will continue to weaken in the short to medium term. Another indicator of the direction of the Euro is the change in consensus forecasts. According to Bloomberg, the forecast for the Euro has moved from 1.45 at the beginning of this year to the current forecast of 1.33. The market is waiting to see some signs of a true economic recovery in the entire EU. In more practical terms, the investing community wants to see how these economies are able to implement their fiscal austerity programs. These economies need to grow enough to increase their tax base to not only get in line with the EU, but so they can pay back their loans. The next few months should be a very interesting economic study!