



The solvency of nations: is it a crisis?

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Fractious Europeans and the Euro: The melodrama in **Greece**, which may perhaps expand to **Spain, Portugal** and **Ireland** too, illustrates why the world prefers to use the U.S. dollar as a reserve currency. The U.S. dollar's advantage is that it is the currency for the world's largest, most cohesive political, banking and economic entity: Europe is not all that cohesive. The Greek fiasco will benefit gold and the U.S. dollar.

Will Greece be rescued? For some analysts, the Greek drama marks another chapter in the global financial crisis. The first one was about the solvency of banks; this one is about the solvency of countries. That is true: but is it a global crisis? Greece's public-finance problems have been brewing since before 2001 when Greece joined the Euro-union. Greek national debt has stood at over 100% of GDP for the past decade and successive governments have failed to tackle deficits; worse yet, Greece has apparently 'cooked the books' to meet Euro standards. The European spat is a crisis of confidence for the Euro (and for the holders of Greek debt) but will get resolved (as will the **Iceland** situation), without causing a broad global financial panic. It is worth noting that for now, the benefit to German exports of a lower Euro, are greater than the cost of the bail out. Greek debt, which totals about U.S. \$400 billion but of which only U.S. \$40 billion needs to be refinanced this year, is not big enough to make lasting waves. Countries, of course, do often default on a portion of their debt as did **Argentina** in 2001, **Ecuador** in 1999, **Russia** in 1998 and **North Korea** in 1987. This is normal. If no one defaulted there would be no risk premium. At this juncture, U.S. \$40 billion is not an insurmountable amount for France and Germany to pony up, though the real issue is how Greece will manage its total debt --- in particular the portion held by German and French banks (no one cares about money the Greeks owe each other) --- and continuing deficits which are in stark violation of Euro rules. It may be easier to bail out French or German entities that hold the Greek debt.

U.S. National debt: In 2010 the problem for stock and bond markets is the prospect of Fed tightening and not concern about the level of national debt. Many analysts believe that better-than-expected U.S. economic growth in the first half of 2010 will trigger Fed tightening in the second half. Better-than-expected-growth will also be a boon to U.S. government coffers. In the longer term (2011/12 and on), concerns about U.S. debt may well emerge as the U.S. dollar drops in tandem with weaker global and U.S. economic growth. Inflation could also be a factor in that time period, though that is beneficial to debtor nations. But for now, concern about U.S. debt is premature, especially as U.S. bond auctions continue unabated. The Euro situation of course helps.

Ottawa closing the tap on bank support: This week's **Federal budget** is expected to make reference to the fact that the Government made available approximately \$133 billion in backstop financing since October 2008 (cue applause from Government front benches) and that it is now being withdrawn because markets and institutions have returned to normal conditions. What may not be highlighted is that very little of the Federal financial aid was ever used. In the U.S., most big banks have paid back (with interest) all Federal aid, so there now seems to be no valid reasons left to support the belief that the financial system or banks are fundamentally unstable. Even the 'doomsday' crowd has conceded the point and has shifted its focus to currencies and sovereign debt instead.

Canada's Q4 GDP: Canadian GDP growth in Q4 was "astonishingThe Canadian recovery seems to be in a self-sustaining position", reported **Yanick Desnoyers, Assistant Chief Economist, NBF** upon the release of the Canadian data. Canada's real economic growth increased at its fastest pace in Q4 2009 since 2000. Domestic demand showed a second quarter of out-performance, in the neighborhood of 5% and is now down 0.6% compared to its pre-recession peak. Real gross domestic income increased by a "stellar" 8.5% on an annualized basis. Monthly growth was 0.6% in December, the best monthly showing since 2006. Another very strong number is therefore expected in the first quarter of 2010. Note that the U.S. economy grew by a rate of 5.9 percent in the fourth quarter of 2009, also exceeding forecasts and while not overall as strong as Canada's growth, in our view, the stage is set for continued economic growth in 2010 and this is expected to surprise financial markets.

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