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Another "New" Normal – The Eurozone in Perpetual Crisis

In June 2010, Banta wrote about the Greek and European debt crisis highlighting Greece's national economic and political dysfunction. With the highly-leveraged Greek economy exposed to the world, other southern European countries such as Portugal, Spain and Italy begin to show the frailty of their economic infrastructures. To date, no conversation in the global investment community escapes the turmoil and anxiety caused by the European sovereign debt crisis. The European political economy is in a precarious situation where each day brings new twists and turns to the direction and health of the world's largest common market. At Banta Asset Management, we aim to bring insight and clarity to the volatility of this enduring "new" normal.

Below is a brief overview of the establishment of the European Union followed by a synopsis of the Eurozone's evolving crisis.

The European Union – A Historical Snapshot of Decades of Good Intentions

- 1950 — French Foreign Minister Robert Schuman proposes integrating the coal and steel industries of Western Europe.
- 1951 — The European Coal and Steel Community (ECSC) is established, with six members: Belgium, West Germany, Luxembourg, France, Italy and the Netherlands. A supranational body, called the High Authority, is created to manage the coal and steel industries.
- 1957 — The six members of the ECSC sign the Treaties of Rome, creating the European Economic Community (EEC) and the European Atomic Energy Community. The EEC member states aim to remove trade barriers between them and form a common market.
- 1967 — The institutions of the three European communities are merged, creating a single commission, a single council of ministers and a European parliament.
- 1979 — The first direct elections for the European parliament are held, allowing citizens to vote for candidates.
- 1993 — The Treaty of Maastricht creates the European Union, paving the way for monetary union.
- 2002 — A single currency, the euro, replaces national currencies in 12 of the 15 countries of the EU.
- 2004 — In its largest expansion, the EU welcomes 10 new countries, and a new constitution is signed.
- 2005 — The move to ratify the constitution suffers setbacks when France and the Netherlands reject the document.
- 2007 — Bulgaria and Romania join the EU, expanding the union to 27 member states.

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- 2008 — The value of the euro reaches an all-time high on July 18 at 1.5843 to the dollar. But the worldwide recession begins to take its toll on the currency and European economies later in the year.
- 2009 — In December, the world's three main credit ratings agencies downgrade Greece's debt, sending financial markets tumbling and raising concerns about other weak European economies like Portugal, Spain, Ireland and Italy.
- 2010 — As the EU struggles to contain the debt crisis, Standard & Poor's downgrades Greece's sovereign debt to junk status, and cuts Portugal and Spain's credit ratings. Eurozone finance ministers meet to approve a 110-billion-euro loan package to Greece. At mid-year, the euro reaches a four-year low, falling below $1.19.
- 2011 — Greece needs even more money to prevent an economic collapse. EU leaders agree in July 2011 that a "selective default" is the only option for Greece. Under this situation, euro area nations guarantee payouts on Greek sovereign debt, and the country's private sector lenders agreed to take a loss — a "haircut" — on their debt holdings.
- 2012 — Political and economic dysfunction continues throughout much of the southern European nations as the pressure from the northern countries like Germany and France put even deeper pressure on the Greek, Spanish and Italian governments to reign in their fiscal management.

The Eurozone's Final Policy Frontier: The Current Debate between Austerity and Growth

- The typical thinking in dealing with the unsustainable, bailed out economies of Greece and Portugal (and, to an extent, Ireland) has been to impose harsh austerity measures aimed at cutting down the size of governments and making business policies more competitive. However, this has entailed steep cutbacks that have stretched throughout the economy, and the sharp drawdown in demand has cut into the revenues of the entire euro area.
- In December 2011, EU leaders agreed to a fiscal compact that would be part of a new EU Treaty. It would impose automatic sanctions on any country that failed to adhere to new restrictions on the amount of money governments can spend and those who refuse to cut their public debts to about 60 percent of GDP.
- But Greeks are not alone in growing more resistant towards austerity. Critics of current plans are concerned that they are more targeted at making sure Germany and other creditors are paid and less geared towards actually returning economies to long-term growth.
- Since Angela Merkel, Germany's chancellor, is the primary proponent of the current austerity position, she and her supporters have come under increasing fire from leaders and EU citizens outside Germany.
- Opposition to German leadership manifested in the most recent round of French presidential elections. That vote not only brought an end to the leadership of conservative Nicholas Sarkozy but to his partnership with the Germany's Merkel.
- The new Socialist French President, Francois Hollande, has since championed a much more activist response to the crisis, and even campaigned to rewrite the new Treaty to include a pro-growth component.
- Unsurprisingly, the relationship between Merkel and Hollande has proven to be fragile. His public support for Eurobonds – which would force Germany to guarantee the debts of less creditworthy countries like Italy and Spain – has led Italian prime minister Mario Monti and Spanish prime minister Mariano Rajoy to speak out in favor of such measures as well.

- Their disagreements dominated the latest EU Summit on May 23, 2012 and investors have begun betting that Italy and Spain might soon need help from international lenders to stay afloat.
- Because the three leading Greek political parties each failed to form a coalition, Greeks will have to return to the polls and vote again on June 17, 2012. Tsipras and his anti-bailout cohorts insist that EU leaders will give in and revise demands for more austerity. EU leaders, on the other hand, insist that this vote is a referendum on Greece's membership on the European Monetary Union, and that the terms of the bailout are nonnegotiable. While 75 percent of the Greek population supports the country's membership in the euro currency, about 65 percent disagree with the austerity measures.
- The game of chicken between EU and Greek leaders has led more and more economists to believe that Greece might be forced to exit the euro currency, perhaps in the short term. Should EU leaders make good on their promises, and should Tsipras win enough support to form an anti-bailout government after a new round of elections on June 17, they argue, EU leaders will withhold the next round of bailout funding. Greece would not be able to pay off its debts, and thus default in a disorderly fashion.
- Such a default would hit Greece's international lenders most severely, and it is unlikely that the ECB would continue to interact with a government that had directly disobeyed euro rules. Thus Greece would be forced out of the euro area.
- Should Greece leave, investors fear, it would compromise the fundamental tenets of the union itself. Thus, people and companies would withdraw money en masse from banks in Portugal, Ireland, Spain, and Italy, fearing that they, too, would choose devaluation and an exit from the euro area rather than years of recession and austerity.
- Ultimately, the conclusion to the crisis will only be true fiscal union, where Germany, Finland, the Netherlands, France, and other big economies will be able to transfer their wealth and business to the South. Solutions like eurobonds and a stronger central governance are not yet politically viable, but it seems apparent that the EU's identity is at a crossroads and that 2012 is a pivotal year for stability or change.

At Banta Asset Management keeping you informed about the European economy is paramount to your success as a stakeholder in the global economy. Similarly, we remain watchful of the U.S. economic indicators with real GDP growth under 2%, stubborn unemployment holding at 8.2% and inflation hovering just under 3%. These important measures combined with the continuing European uncertainty and its impact on stock markets around the world only strengthen our resolve to be astute on global political and economic developments. Staying connected is not only our responsibility, but also our best strategy to effectively navigate "the new normal".

With continued confidence,

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