

## Euro: Will the bad situation become even worse?



The euro approached a six-month low against the yen and the dollar on concern the European Union (EU) will fail to take sufficient measures to help Greece tackle its fiscal deficit, damping demand for assets in the region. In fact, Greece's debt woes continue to weigh on the euro, notwithstanding any potential bailout. After fudging its accounts to win entry into the euro a decade ago, Greece, representing 2.7% of the euro-area's \$13 trillion economy, posted the highest deficit in the currency's history last year, according to Bloomberg. The Greek deficit soared to 12.7% of GDP last year and the government has promised to cut it below the EU's 3% limit by 2012. To exaggerate the recent worries, Greece needs to sell 53 billion euros (\$73 billion) of debt this year, equivalent to about 20% of its GDP and faces bond redemptions of about 8 billion euros on both April 20 and May

19. After a three-month long plunge in Greece's bonds amid speculation it was facing the threat of default, the euro region's leaders last Thursday ordered the country to slash its budget deficit and warned investors they would be willing to defend the country from speculative attack if necessary. German Chancellor Angela Merkel and her counterparts pledged determined action to support Greece's efforts to regain control of its finances. They stopped short of providing taxpayers' money or diluting their own demands for the country to cut the EU's biggest budget deficit. Although the strategy still gives Greece breathing space to address its budget woes, the pledge from the region's leaders still lacked specifics and officials are now working on measures such as establishing a lending facility for Greece, with each country making a contribution

according to its size. Euro has fallen over 4% against the dollar this year on concern nations with the biggest debt burdens will struggle to meet their obligations. Investor attention now turns to a meeting of finance ministers in Brussels on Feb. 15-16. In no doubt, the European strategy echoes then-US Treasury Secretary Henry Paulson's 2008 effort to intimidate markets with financial force. In 2008, Paulson won powers from Congress enabling a government rescue of Freddie Mac and Fannie Mae. With the Greek crisis testing Europe's ability to run a common currency with 16 separate national fiscal policies, leaders want to avoid Paulson's fate. To conclude, it still takes some more time, but the reality is that the risk of the EU not supporting Greece has now gone. **E**

## Microscope

In fact, Germany actively proposed resolutions for resolve the problem as Germany's banks may have more at risk in Greece, Portugal and Spain than global counterparts, adding to pressure on Chancellor Merkel to forge an EU aid package for Greece and avoid contagion, according to Bloomberg. According to the recent data from the Bank for International Settlements in Basel, German banks had foreign claims of \$330.8 billion related to the three countries on Sept. 30, while French banks had \$306.8 billion of claims and U.K. lenders \$156.3 billion. It is widely expected that since German banks' large exposure to these countries, the country definitely plays a role in the government's push for measures to stabilize Greece. German government is concerned about euro stability and risks to the EU, but it also wants to save German banks from further writedowns. However, there is still political uncertainty. Lawmakers from Merkel's coalition partner, the Free Democratic Party, are threatening to prevent her from turning the moral support offered by European Union leaders into financial aid. They're backed by polls showing public opposition to such a move. **E**

### MARKET BRIEFING

#### YTD % (local curr)

<b>US DJ</b>
10,144 (-2.7%)
<b>Nasdaq</b>
2,177 (-4.0%)
<b>Euro Stoxx 50</b>
2,680 (-9.6%)
<b>HSI</b>
20,290 (-7.2%)
<b>Japan NK225</b>
9,963 (-5.5%)
<b>China Shanghai Composite</b>
2,985 (-8.9%)
<b>Singapore</b>
2,753 (-5.0%)
<b>India BSE30</b>
16,152 (-7.5%)
<b>Brazil BOVESPA</b>
66,128 (-3.6%)
<b>Aus All Ord</b>
4,575 (-6.3%)
<b>US-10yr Bond</b>
Yield 3.71%

As at 11/02/10

## Insight: "Liquidity Analysis"

Since the global economy is recovering from serious downturn in 2008, many central banks and governments have done something to withdraw excessive liquidity in the financial markets. Besides China, the major economy - the US is preparing for the tightening era. Last week, the Federal Reserve announced to be in talks with money-market mutual funds on agreements to help drain as much as \$1trillion from the financial system as policy makers prepare for the first interest-rate increase since June 2006, according to Bloomberg. The central bank is looking to the \$3.2trillion money-market mutual fund

industry because the 18 so-called primary dealers that trade directly with the Fed have a capacity limited to about \$100 billion. In addition, money-market funds may welcome the opportunity to trade with the Fed after the financial crisis reduced the supply of safe assets in which they can invest. In one example of demand for such assets, auctions on four-week Treasury bills have attracted an average of \$5.47 in bids for every dollar sold this year, compared with an average of \$3.77 last year, according to Bloomberg data. Yields on the four-week bill fell to five basis points from 20 basis points a year ago. On the other hand, the Fed is also considering reverse repurchase agreements with mortgage lenders Fannie Mae and Freddie Mac, indicating that the central bank will withdraw the excessive liquidity very soon. **E**

## Financial "In & Out"

**IN:** Australian dollar may resume its bull run on optimism that interest rate would rise further after a better-than expected employment figures were released.

**OUT:** The US dollar would face sell-off pressure amid rising risk appetite in the financial markets as well as the concern that the US will maintain the low interest rate level for a long time. **E**



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