

## Etsior Monthly Opinion 15 February 2010 - Greece and the future of the Eurozone

We have experienced interesting times in the Greek crisis revealing different opinions on what the monetary and economical future of Europe would be.

The Greek economy is only 3% of the total Eurozone economy and the support the Eurozone countries will give to Greece is for me evident. The cost for any euro country to leave the Eurozone would be absolutely huge: it would trigger inflation, currency depreciation, high debt interest spreads. All these inconvenient make it almost impossible and unrealistic to deliberately leave the Eurozone. But speculators have attacked the weak link of the Euro countries, Greece, with its huge deficit against its GDP (but not larger in percentage than the one of U.K.) and its reputation of cooking the books. The cost for the rest of the Eurozone would be terrible as it would question the actual future of the zone. And this is exactly what are speculators are trying to determine and what should be firmly opposed to.

They have also put the threat on the other countries currently experiencing difficulties like Spain, Portugal or Italy (I hate the generally used acronym to describe these countries. Who are those who allow themselves to induce such a depreciated image of these countries and people?), though their actual situation really differs from the one from Greece.

The attack on Greece *was really a way of testing the sustainability of the Eurozone* as well as how far each country is willing to go first to support Greece and then in terms of flexibility of the convergence criteria and supranational economical powers.

The core of the problem is a somewhat different view of the Eurozone future from France and from Germany. Both countries have pledged to help Greece, but they had different

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perspective in mind. Germany is not ready nor even willing to write a blank check. France would probably accept a stronger support mixed with flexibility. As a paradigm, this crisis has been, in my opinion, the way for each one to find out where was the red line not to be crossed; it will very likely lead to closer views and to a stronger monetary Union. But if things turn very sour, a dislocation of the Eurozone is of course possible and would be in the interest of nobody. Seen from France, the Maastricht criteria (3% deficit, 60% debt of GDP and 2% inflation) deserve to be taken with flexibility, even sometimes forgotten. There are commentators and pundits who spend time explaining these criteria should be lowered, while the Bank de France stands firm on its orthodox policy. The hope is to have an economical government of Europe, limited if necessary to the Eurozone countries, and counterbalancing the power of the European Central Bank. President Nicolas Sarkozy proposed that Eurozone heads of government should form this economic government. But he ran into fierce resistance from Angela Merkel, the German chancellor. She argued that it would divide the EU between members and non-members of the single currency and there was no parliament, commission or court to deal with the Eurozone alone. The Germans nevertheless would accept the all E.U., not only the Eurozone, to go towards an economic government.

On the other hand, the Germans see the economic stability as the corner stone of their policy. This is backed by popular support and by the constraints implemented by the 1993 Maastricht treaty ruling of the German constitutional court. The court stipulated that stability is an unalienable basis for Germany's participation in a monetary union. Should this principle be violated, *the legal basis for Germany's participation would no longer be valid.* [Article 125 of the Lisbon treaty](#) – the infamous “No Bail-out Clause” – is legally an important aspect of the overall stability of the system. And some people will no doubt argue that a Greek bail-out would violate article 125. Last year's German constitutional court ruling on the Lisbon treaty added further impediments to effective Eurozone economic governance. The court stated unambiguously that macroeconomic policy must remain the competence of the member states. So, what need to be done under these constraints? The first priority is to address the internal imbalances. While Spain, Portugal, Greece and Italy should reform their labor markets,



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Germany should be encouraged – within the limits set by the constitution – to raise domestic demand.

The second priority is to reduce expenses and government deficits: it is an illusion to believe the economical growth can really help reduce the debt as growth in the next years will probably be lower than today. Tax increases are difficult to support, so in almost all Eurozone countries, consolidation is best accomplished through expenditure cuts, not tax increases. The reduction of imbalances and public sector debt must have priority this decade. It will require very tough choices from political leaders who ran away from those choices in the last decade, in the attacked countries but also in France.

*But the worst that could happen now is a leap into the imaginary world of soft options.* That would be the end of the Eurozone (\*).

Finally to our Asian readers, we wish a Happy Chinese New Year: **Gong Xi Fa Cai !**

(\*) See the very interesting article of Wolfgang Münchau "The political constraints of the eurozone " in The Financial Times -14 February 14

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