Investor Insights & Outlook

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Greece: The Potential Consequences of a Eurozone Exit

The uncertainty of Greece's future in the eurozone has accelerated in the past few weeks. If Greece defaults on its debt, borrowing costs in other European countries could skyrocket. This may result in more bailouts for European countries, such as Spain and Italy. In today's interconnected global economy, Greece's woes could mean grim consequences for the U.S. and the rest of the world.

Exposure to sovereign debt: The U.S. banking system may have reduced its exposure to Greek debt, but a Greek exit from the 17-nation eurozone could intensify the risks associated with exposure to other troubled economies such as Portugal, Ireland, Italy, and Spain.

Slowdown in global exports: A further drop in the value of the euro could make it difficult for U.S. businesses to sell goods overseas, resulting from the higher dollar. This imbalance could also slow the demand for Chinese exports to Europe, potentially triggering a global recession.

Slowdown in U.S. businesses: If Greece defaults, the European economy would be adversely affected as the European Union has invested in Greece's debt alleviation plan. This could negatively impact U.S. companies doing business in Europe and considerably reduce profits.

The economic conditions in Greece have not suddenly become weak in the past few weeks; they have been depressed for years now. In order to calm Europe's economic woes, Greece will need to form a government that is in agreement with the austerity measures that Germany and the European Central bank are proposing. The upcoming elections in Greece will determine the outcome. A Greek exit from the eurozone could be chaotic, but the bigger issue is the contagion effect on other European economies.

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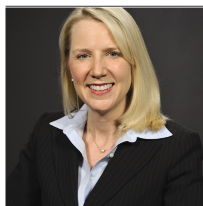

Jane Smith

jsmith@morningstar.com
312-696-6000

Everyone's economic and life situation is unique, and I keep that in mind when providing financial security advice. I believe that personalized service is essential when matching clients with the right financial security products and services. As a Financial Security Advisor, I am dedicated to learning about your personal goals. Together we will use them to build a financial security plan focused on your specific needs.

I understand my clients are in different stages of life: you might be purchasing a first home, financing a child's post-secondary education or planning for retirement. I believe a financial security plan must reflect your personal or business situation, and so will work to highlight the financial security products that best fit your goals. Once your custom-tailored financial plan is in place, we will continue working together to review achievements against your stated aims, and ensure you are comfortable everything is moving forward according to plan.

The Implications of Sovereign Debt

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- By joining the European Union, participating countries give up control over their own monetary policies and their ability to print money.
- Increased uncertainty in the market equates to greater volatility, which in turn can alter what investors thought was a safe or conservative investment.

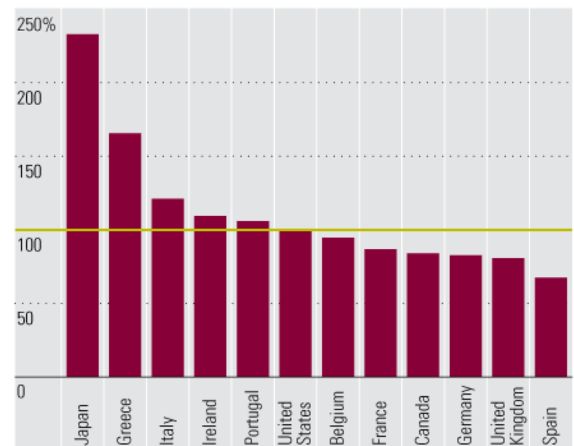
The recent European sovereign debt crisis has brought to light the insurmountable amount of debt that Greece has accumulated over the years relative to its size and the impact of this debt on its economy. One of the popular metrics used to analyze the health of a country is government debt as a percentage of GDP, more commonly known as the debt-to-GDP ratio. As we will see, there are good reasons why many are worried about the PIIGS (Portugal, Ireland, Italy, Greece, and Spain) economies.

The graph shows the estimated 2011 gross debt-to-GDP ratios of 12 countries and how they compare with each other. Six of them have ratios greater than 100, indicating that their debt is greater than their entire annual economic output. While 100 is not a magic number to determine the probability of default, it may provide an adequate warning to look deeper under the hood. Of course, the numbers by themselves don't tell the entire story. One reason why Japan and the U.S. differ from countries such as Portugal, Italy, Ireland, and Greece is that unlike countries in the Eurozone, Japan and the U.S. are able to print their own money. Therefore, Japan and the U.S. could theoretically pay back their debt simply by printing the amount of money owed. On the other hand, the European Central Bank controls printing of the euro. By joining the European Union, participating countries give up control over their own monetary policies and their ability to print money.

As the risk of default increases for a country, there are significant financial consequences. Typically, a country's credit rating will get downgraded, causing the interest rates of its sovereign bonds to rise as it becomes riskier to invest in that country. This means it will cost the government more to borrow in order to compensate investors for the additional risk of default. As domestic and international investors lose confidence in the country's equity and bond markets, a market decline may wipe out years of investors' retirement savings. If a country does eventually default, its reputation will be severely damaged and this will likely impact its ability to borrow money in the future. In 2011, the U.S. credit rating was downgraded for the first time in history. What was unique about this instance was that, instead of rising as would have been expected, interest rates for Treasuries actually declined as investors shifted their money to Treasuries in a flight to safety.

Increased uncertainty in the market equates to greater volatility, which in turn can alter what investors thought was a safe or conservative investment. Investors can still potentially lose significant amounts of money investing in government-backed sovereign bonds, even though they have traditionally been considered relatively safer investments. This risk is potentially exacerbated by currency volatility when investing in international markets.

Gross Debt to GDP Ratios (estimates for 2011)



International investments involve special risks such as fluctuations in currency, foreign taxation, economic and political risks, liquidity risks, and differences in accounting and financial standards. Diversification does not eliminate the risk of experiencing investment losses. Government bonds and Treasury bills are guaranteed by the full faith and credit of the issuing government as to the timely payment of principal and interest, while stocks and corporate bonds are not guaranteed.

Source: International Monetary Fund, World Economic Outlook Database, September 2011.