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Macro Market Insights

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Robert Levy
MA (Economics)
Director
rlevy@bordergold.com
(604) 535-3287
www.bordergold.com

Four Years On

Does Greece returning to the sovereign debt markets indicate the worst of the euro crisis is now behind us? That question cannot be answered with any certainty. But does the fact that this country was unable to go to the public debt markets since 2010, and now has auctioned 5 year notes below 5 per cent bear any long-term implications? The answer is a resounding no.

To start with background, Greece had their first public debt auction since March of 2010 last week. Only a meager 3 billion euros were auctioned, but demand was so strong the Greek Treasury was able to do fill the orders at a lower than anticipated yield. Some sources had demand at more than 20 billion euros. As interest rates in North America continue to see upward momentum, it might still be safe to suggest that the bull market in bonds isn't over in Europe.

The Eurozone has advanced significantly from the dark period referred to as the Euro Crises. So much of this is attributed to those oft-quoted words of the European Central Bank President Mario Draghi, insisting to do whatever it takes to save the euro. And to the dismay of many pundits, confidence has been restored in the Eurozone without any market intervention or extraordinary monetary stimulus.

What is also astonishing about the relatively low yields (compared to 4 years prior) of peripheral euro nations' debt is the unpriced risk in depreciation of the euro measured against the US dollar. The debate still continues as to whether a monetary union of that size and cultural divergence is actually sustainable in the long term. And given a forecasted dire outcome by many that would be associated with a collapse of the currency, the euro continues to defy forecasts and even appreciate in this tepid economic growth environment.

Beyond a low growth environment, there are a myriad of additional factors why Greek debt is attracting such high demand. Foremost, it's because interest rates will more likely see downward pressure in the Eurozone. The euro denominated countries still sees disinflationary characteristics in many of its markets, and bizarrely it is in tandem with an appreciating euro currency. Both factors contribute to or are associated with downward moves in interest rates.

Importantly, investors are convinced that Mario Draghi and the European Central Bank stand ready, and potentially will act in the near future to unleash their own version of Quantitative Easing. Should this be the case, a weaker euro will ultimately prevail and create the sudden selloff many are anticipating, but the mere fact that investors are still convinced the ECB will act and be effective means there is already some level of assistance being provided to the markets through instilled confidence.

The final factor is all about austerity. The euro crises was about debt, and governments are all implementing policy with the focus of fiscal rebalancing and restraining public spending. This is not a bullish call on Europe, but highlighting that EU member governments are relatively sounder from a fiscal standpoint (thus, this is damning with faint praise given recent history).

Greece's return to the bond market was extremely well welcomed, but for the investment opportunity in an environment that will continue to see downward pressure in European interest rates. This is not to minimize that Greece still has a painful road ahead. Following six straight years of recession, the Greek economy now produces 25 per cent less output. Public debt is still 175 per cent of GDP, which essentially requires Greece to seek outside funding should their economy hit another speed bump. And not forgetting a tragic scene of unemployed youth, there's no reason to believe they're close to being back to normal just yet.