



Week In Focus

The following report is aimed at giving you a concise preview of the major events and themes forthcoming in the week ahead.



14th - 18th Mar 2011

Divided we stand...

It is almost a year since the sovereign crisis began and in the past twelve or so months, both Greece and Ireland were forced to seek EU/IMF cash, while the Iberian Peninsula with its post housing bubble Spanish economy and an uncompetitive Portugal still remain at risk of losing access to the primary markets. Given this situation it is widely accepted that Portugal will be forced to seek monetary assistance. This assumption largely stems from the fact that borrowing costs have risen to unsustainable levels which will have an adverse impact on already sluggish growth prospects. However even though the existing bailout fund is more than capable of catering for the bailout of Portugal, it is the bailout of Spain that policy makers are eager to prevent.

It is for this reason that despite apparent differences the EU leaders have formally agreed on the so-called EU pact. The agreement enables the temporary bailout facility to led up to EUR 500bln, in addition policy makers have agreed to create a new, permanent fund in 2013. The bailout fund will also be able to buy bonds directly from the Eurozone states, however the fund will not be able to buy existing government bonds which are currently being bought by the ECB and has about EUR 77bln on its books. Such measure was vigorously opposed by the German Chancellor Angela Merkel, largely because this would mean expanding the bailout fund far beyond the agreed upon size. As such, the ECB will likely continue to remain the measure of last resort for the likes of Spain and Portugal on daily basis and its Securities Market Program (SMP) will be called upon when yields on government bonds rise to abnormal levels. Instead the fund will be able to buy sovereign bonds only if a specified country is willing to sacrifice its domestic policy making ability and accepts similar austerity measures as entered by the likes of Greece/Ireland. Another blow was the fact that it was only Greece that was able to have the terms of its bailout deal modified, while Ireland which refused to raise its low corporate tax rate was unable to adjust the rate at which it currently borrows money from the EU and IMF.

Apart from debating on the success of the latest EU summit, fretting over the sovereign debt auctions, unrest in the MENA region and attempting to calculate the cost of the devastating earthquake that rocked Japan, investors will be eagerly awaiting the statement from the Fed post policy meeting. Given the current Quantitative Easing (QE) program runs out in June, together with apparent dissent by several FOMC board members has prompted speculation that the Fed may soon opt to drop the "extended period" statement, thereby indicating that another round of quantitative easing will not be taking place. Still, despite concrete signs that economic growth is now more or less self-sustainable, the Fed is yet to meet its dual mandate and since inflation remains below the sought after levels, the Fed will not be in a hurry to change its stance. As such, even though the statement may imply some sort of optimism amongst the policy makers, a combination of persistently high unemployment, risk of external shocks to the economy and depressed activity in the housing market suggests that the "extended period" statement will remain in place for the time being.