The European Union and the Euro – Sink or Swim?

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The deep financial problems affecting Greece, Portugal, Spain, Italy, the underbelly of the EU, and other countries, such as Ireland, are causing a very serious major crisis that undermines the foundation of the Union and has a negative impact on world economies still trying to recover from the 2008 shake out. Will the EU survive this storm or will its fabric be so tarnished as to lead to its deline and end, with the breakup of the eurozone leading the way.

The Euro has enjoyed a good run. Twelve years of easing global credit helped to hide the growing pains of one of the world's youngest currencies. However, the Euro is beginning to show all the characteristics and insecurity of an embattled new currency.

Was this well-intentioned path destined to fail from the start? Should this Union fail it could be because expansion was too fast to accommodate many countries of much smaller populations and economies with weak governments, differing cultures and battered histories. This has been further burdened by many differing historical accounting methods, different views on value, and too few checks and balances. Perhaps the hurdle rates for entry were too low?

However, one must also take into account that there will be huge global pressure for the EU to sort itself out, not least from the US and China, so what one must expect will be a series of running repairs amidst occasional major surgery, and the resuscitation of the Union. Political considerations are likely to override straightforward economic ones.

During good times, the differences between countries did not matter. Strong economies hid the incompetence of many eurozone governments.

Today, things are very different, as always when stresses in relationships can no longer be hidden. Citizens of some of the member countries are questioning the value of being part of an association that does not appear to benefit any of its members.

Last year, German citizens were asked to provide most of the funding for a bailout package for Greece. Germany lent the money with the proviso that Greece would take action to bring its budget under control. Now, one year later, Greece has not changed anything and, predictably, it needs more money to stave off bankruptcy. The EU is once again asking Germany to foot the bulk of the funds required with the proviso that Greece will really respond this time.

The German government, quite naturally, is up in arms over why it should keep funding an apparent ‘basket case’. The German people simply see their hard-earned tax dollars going to benefit strangers in another country – strangers who appear to have a laid back lifestyle - at the expense of German workers.

The hard truth is that the EU is trying to force Germany to be the main player within the EU for a bail out of Greece in order to keep the Union intact. One extreme but unlikely option would be to see Germany back out of the European Union. Such an action would mean the effective end of the EU, the ramifications of which would be globally destabilising, with the Eurozone coming off worst.

A large number of Greek citizens do not want the money as they make clear in turbulent protest. They would rather default, declare bankruptcy and wipe the slate clean, rather than take on more burdensome debt and be forced to change their standard of living. But they do not yet see that life is not so simple and they would still not be free of uncomfortable impacts unless they take a much firmer grasp of their predicament and do something positive about it. They would still be hurt. As is it frequently said – "there is no such thing as a free lunch". The issue in Greece is compounded by weak government with strong links to its past, but which desperately needs some fresh competent faces. Right now the government is out of touch and unable to communicate with the people.

As we write, the Greek government has accepted the proposed EU/IMF terms, but this does not mean that the days ahead will be easy, particularly since the citizens have yet to be placated. It will be interesting to see if the package can be sugared with investment in development, such as infrastructure, that can sustain employment and encourage the recovery of growth, something that Malaysia's Dr Mahathir understood well in 1998 at the time of the Asian Economic Crisis and which helped Malaysia to minimize the impact of that crisis and hasten recovery. The lack of this detail was a severe downside to the austerity measures imposed on Indonesia at that time and delayed its recovery. Greece will need these support packages.

Similar approaches will need to be adopted for the other recalcitrant members of the EU; Greece is only the first patient.

Perhaps the EU will have to find a mechanism where sick countries that have run into serious economic and fiscal difficulties and cannot meet their operating requirements can be separated into a 'care room', where the required repairs and surgery, if needed, can be undertaken, while minimizing the impact on the citizens of the country affected, albeit the details of such would be complex and vary for individual countries.

But let us return to the currency and what the RIO Club can do

Members will have seen that the Euro has been surprisingly strong over the past year. It is up about 15% versus the US dollar. This is mostly due to Ben Bernanke running the dollar printing presses full time, not the perceived strength in the eurozone. However**,** that strength is not likely to continue as the other political and financial difficulties have to be addressed. The problems in Europe could well see the Euro decline and significantly so, and I believe that that is what will happen.

Greece - pertinent facts ; Eurozone finance ministers (EU, ECB and IMF) gathered two weeks ago in a desperate bid to avoid a Greek default, but also the global financial fallout that such a scenario would entail. Greece was given two weeks to adopt the austerity plan in exchange for more international aid to the tune of US$17bn to meet summer expenses. With the July 3rd deadline fast approaching, this has just been accepted despite the street riots.

The set payback for the Greek government is in quarterly instalments of the USD158bn bailout package granted to the country last year. Greece must also work out a fresh bailout package of some USD145bn for 2012 and beyond, officials have stated.

It is not just RIO that sees danger ahead; Standard & Poor's (S&P) have given Greece the firm's lowest credit rating, moving to CCC from B. Yields on 10 year Greek bonds approached 18 percent, the highest in the 17-nation euro area's history.

It should also be highlighted that the ECB President, Jean-Claude Trichet, said risk signals for financial stability in the Euro area are shining bright "red" as the debt crisis threatens to infect banks.

Such comments must be music to the ears of those Members who have invested in RIO Professional Investors Fund, which retains trades positioned to benefit from any further bad news. During May alone this fund posted a gain of +1.6% is it any wonder with all the bad news. The fund is about to add to its asset class; a small percentage of money invested within the fund is being allocated to rare earth metals. Although I forecast stellar return from this new holding, the percentage allocation will be less than 1% of the total Fund, in order to retain the current low risk exposure.

Target returns RIO Professional Investors Fund remain unchanged at 12% per annum; I predict that my current strategy and trading methods will continue to produce an out performance in relation to the target return; current trend should see us outperform the main markets though the summer months.

William Gray
The RIO Club