



# Corporate Conference Call

2 February 2010

**Paul Robinson**

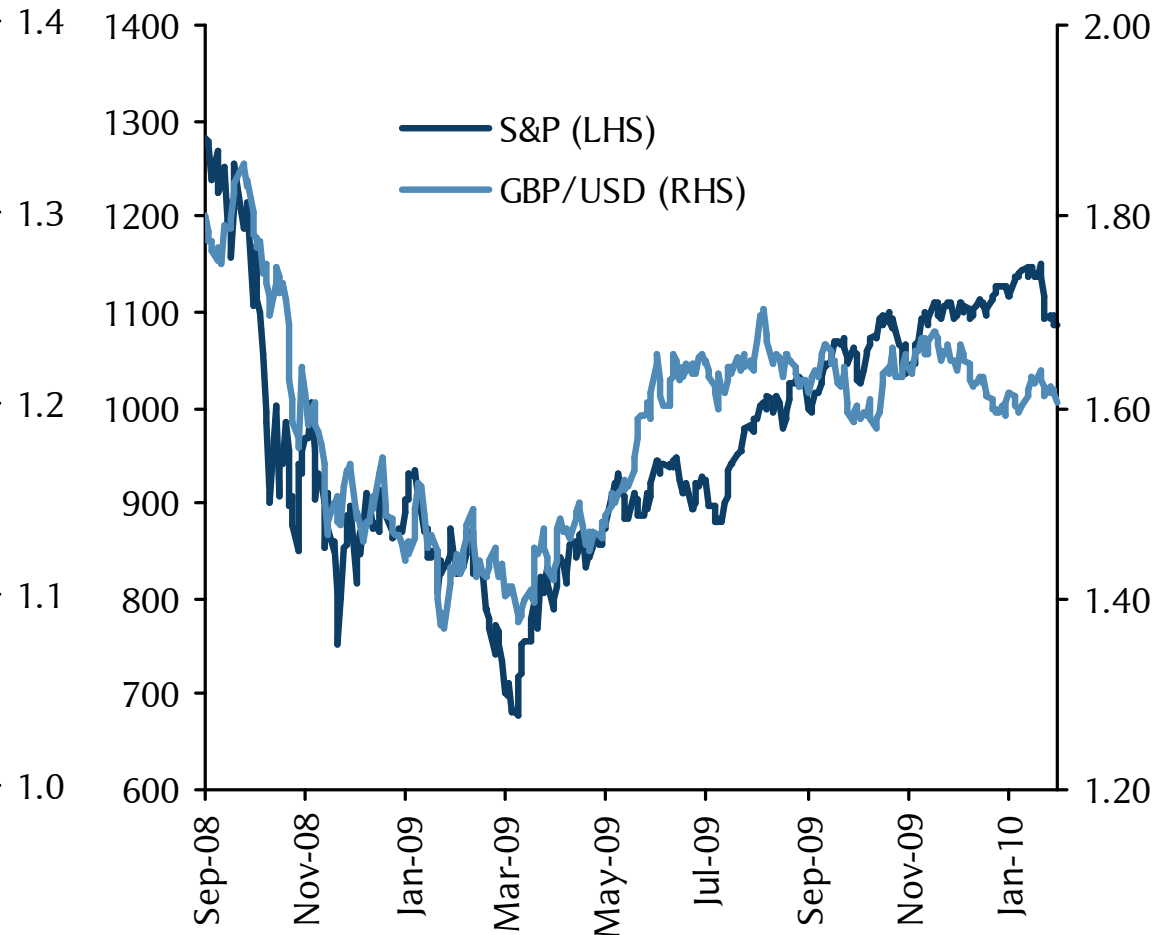
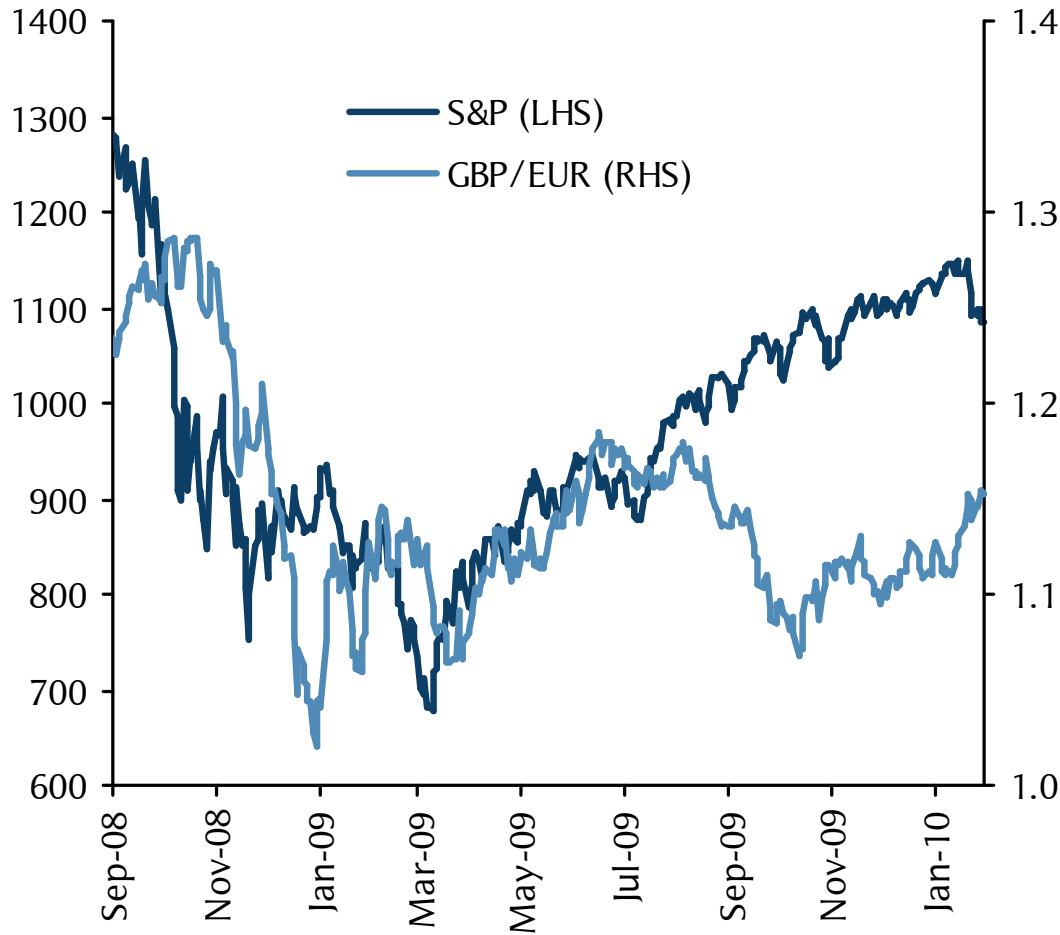
Chief Sterling Strategist

# Plan

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- This month has seen modest weakness in equity markets
- Yet sterling has appreciated against the EUR, though not the USD
  - ▶ What explains this break from past behaviour?
- The Greek crisis
- UK data and the MPC reaction
  - ▶ This month's MPC decision is probably the most important since at least last August

# GBP has become less closely correlated with “risky” assets – why?



# The Greek Crisis

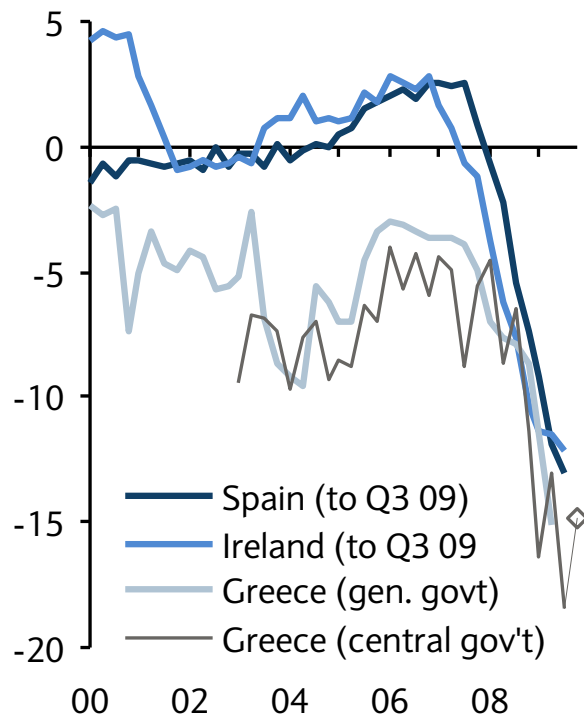
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- The Greek government has a very large fiscal deficit adding to an already huge level of debt
- There have been widespread concerns about the reliability of the Greek statistics and the political will to cope with these problems
- The problems are exacerbated by a huge current account deficit
  - ▶ Which means that the Greek economy needs to attract very large inflows of capital if the economy is not going to face a sharp contraction of domestic demand
- And membership of the euro zone which means that Greece has no independent monetary policy or ability to devalue its exchange rate
- It has led to wider concerns about the state of the euro zone

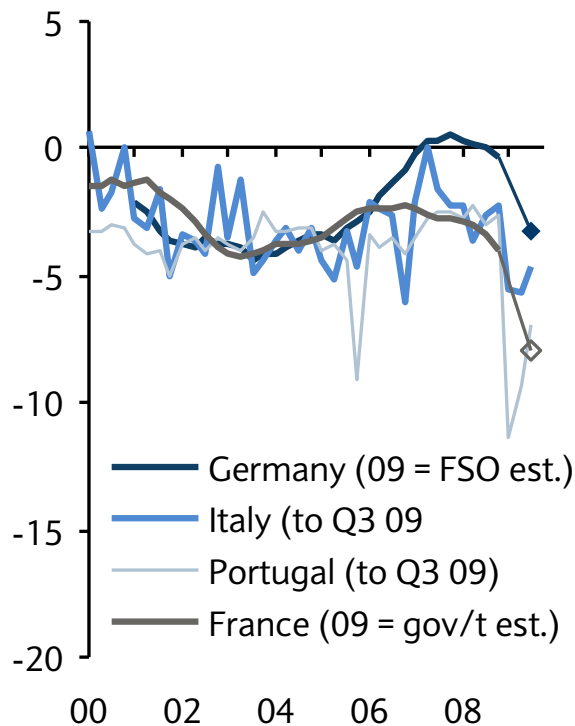
# Benchmarking European fiscal deficits

## General government balances (% GDP, quarterly, seasonally adjusted)

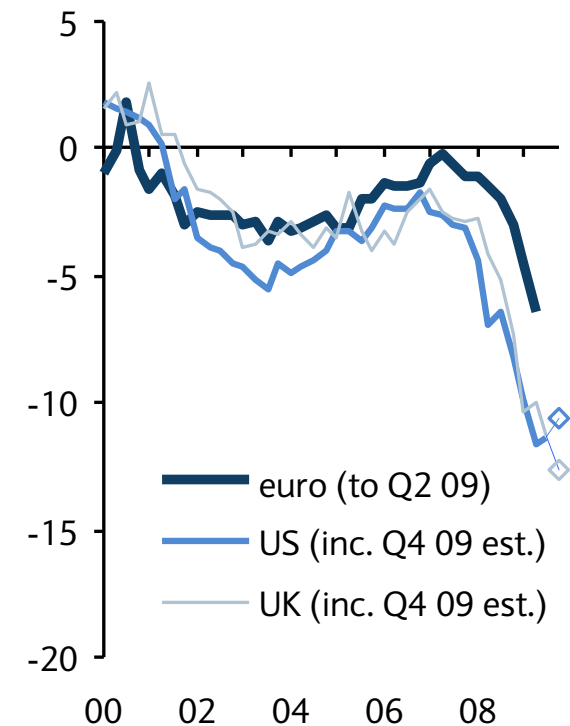
### Greece, Spain, Ireland



### Other euro area countries



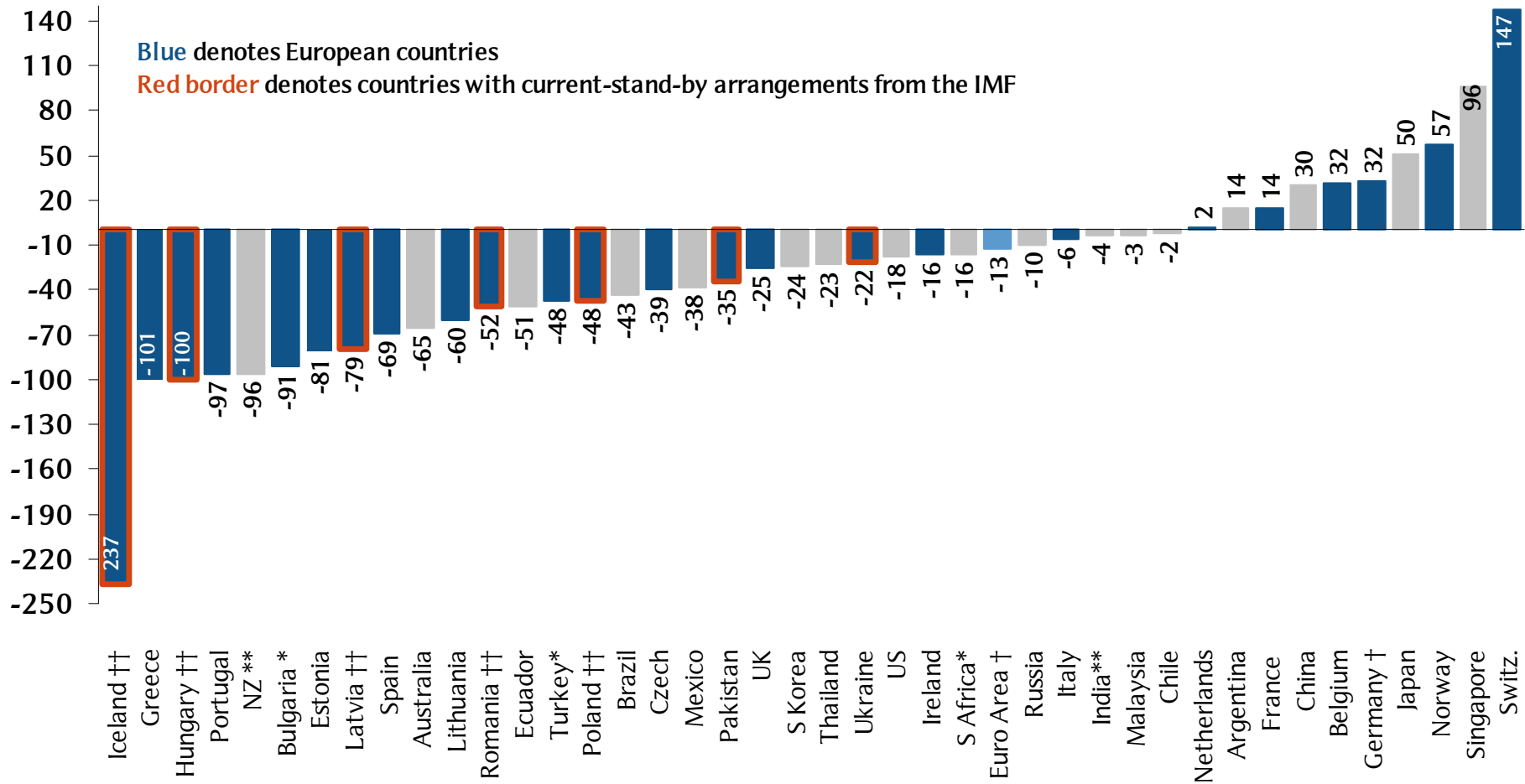
### Euro area, US, UK



Sources: national, Haver, Thomson Datastream; all seasonal adjustment by Barclays Capital Note: Greek cen. Gov't inc. Dec 09 est.

# Many countries with large external debts are within Europe

Net international investment position (% GDP, 2007)



\* 2006 data, \*\* Q2 2008, † Q3 2008, †† Q4 2008; Poland has requested support from the IMF, and the decision to approve is pending

Source: Datastream, IMF, Bundesbank, Bank of Spain, National Sources, BarCap

## Where we stand: key statistics for euro periphery

	Ratings (outlook)	Average 1992-2006			2007	2009	2007	2009	2010	2011
	S&P Fitch Moody's	Structural balance (% GDP)	Interest payments (% GDP)	Debt % GDP (€ bn)	Current account balance (% GDP)	Current account balance (% GDP)	Deficit (debt) (interest payments)	Deficit (debt) (interest payments)	Deficit (debt) (interest payments)	Deficit (debt) (interest payments)
Greece	BBB+ (watch -ve) BBB+ (-ve) A2 (-ve)	-5.8	7.5	98.1 (€129)	-14.1	-14.3	-3.6 (95) (4.1)	-14.0 (115) (5.4)	-10.1 (122) (5.9)	-7.1 (129) (6.2)
Italy	A+ AA- Aa2	-4.4	7.7	121 (€1380)	-2.4	-3.3	-1.5 (103) (4.3)	-5.4 (115) (4.8)	-5.2 (117) (4.9)	-4.8 (122) (5.1)
Ireland	AA (-ve) AA- Aa1 (-ve)	+0.5	2.6	54.1 (€42)	-5.4	-3.2	0.3 (25) (0.8)	-11.7 (65) (3.0)	-11.2 (75) (3.5)	-9.8 (85) (4.0)
Spain	AA+ (-ve) AAA Aaa	-2.0	3.2	55.1 (€330)	-10.0	-5.2	2.2 (36) (1.6)	-13.0 (56) (2.0)	-12.1 (69) (2.6)	-11.6 (81) (3.1)
Portugal	A+ (-ve) AA (-ve) Aa2 (-ve)	-4.4	4.1	67.5 (€83)	-9.4	-9.1	-2.6 (64) (2.4)	-8.1 (76) (2.9)	-8.3 (83) (3.2)	-7.9 (91) (3.5)
Euro	n/a	-3.0	3.8	69.4 (€4949)	0.2	-0.7	-0.6 (66) (2.9)	-6.1 (78) (3.0)	-6.6 (83) (3.2)	-5.9 (87) (3.4)

Source: Barclays Capital

## Adjustment: the Greek Plan

Stability Programme scenario					
	2012	2013	2014	2015	2016
Government projections	2	2.5	2.9	2.9	2.9
Deficit (% GDP)	-5.31	-4.28	-3.04	-1.81	-0.61
Debt (% GDP)	131.81	135.93	138.25	138.81	138.17
Zero growth scenario					
	2012	2013	2014	2015	2016
Government projections	0	0	0	0	0
Deficit (% GDP)	-6.31	-6.53	-6.74	-6.96	-7.21
Debt (% GDP)	135.33	145.07	155.21	165.27	175.79

Source: Barclays Capital; Update 11th January. Note: interest rate is 2% for all countries in real terms, even when inflation is 4% in which case nominal rates are 6%

## Leaving the euro: a practical guide?

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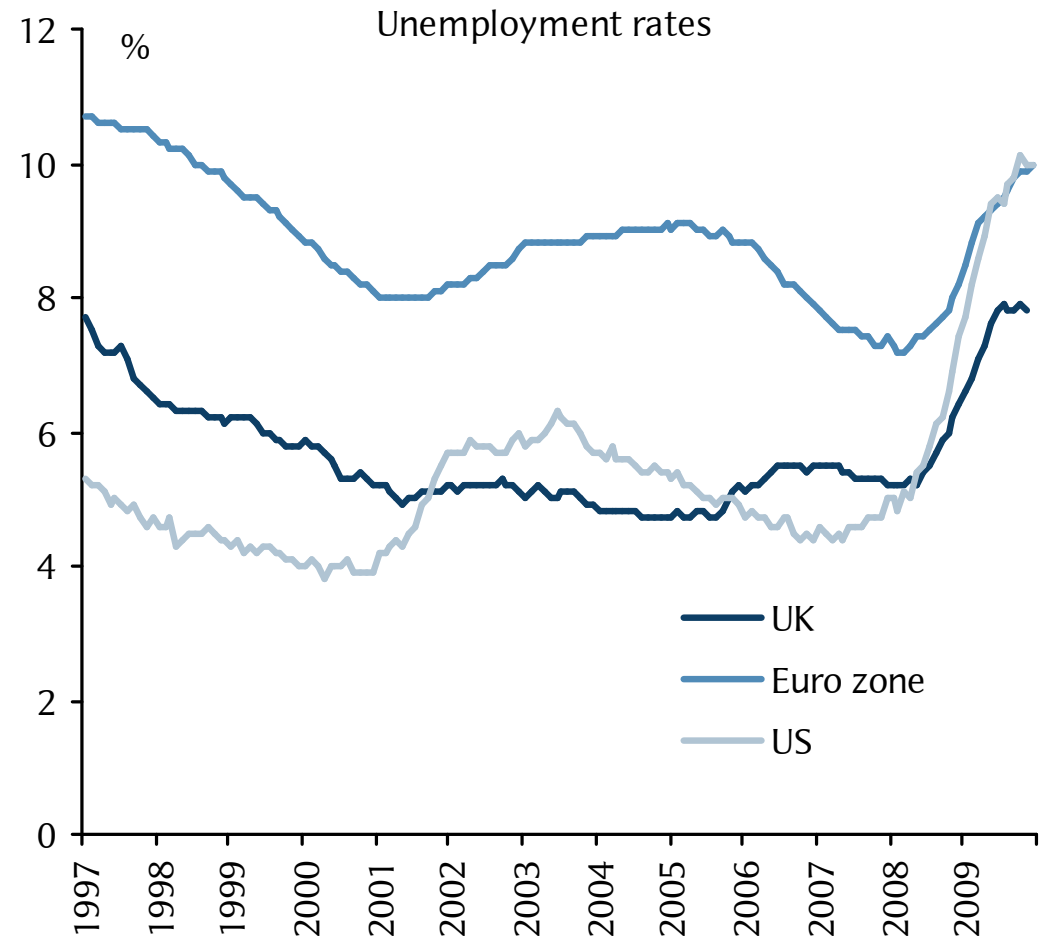
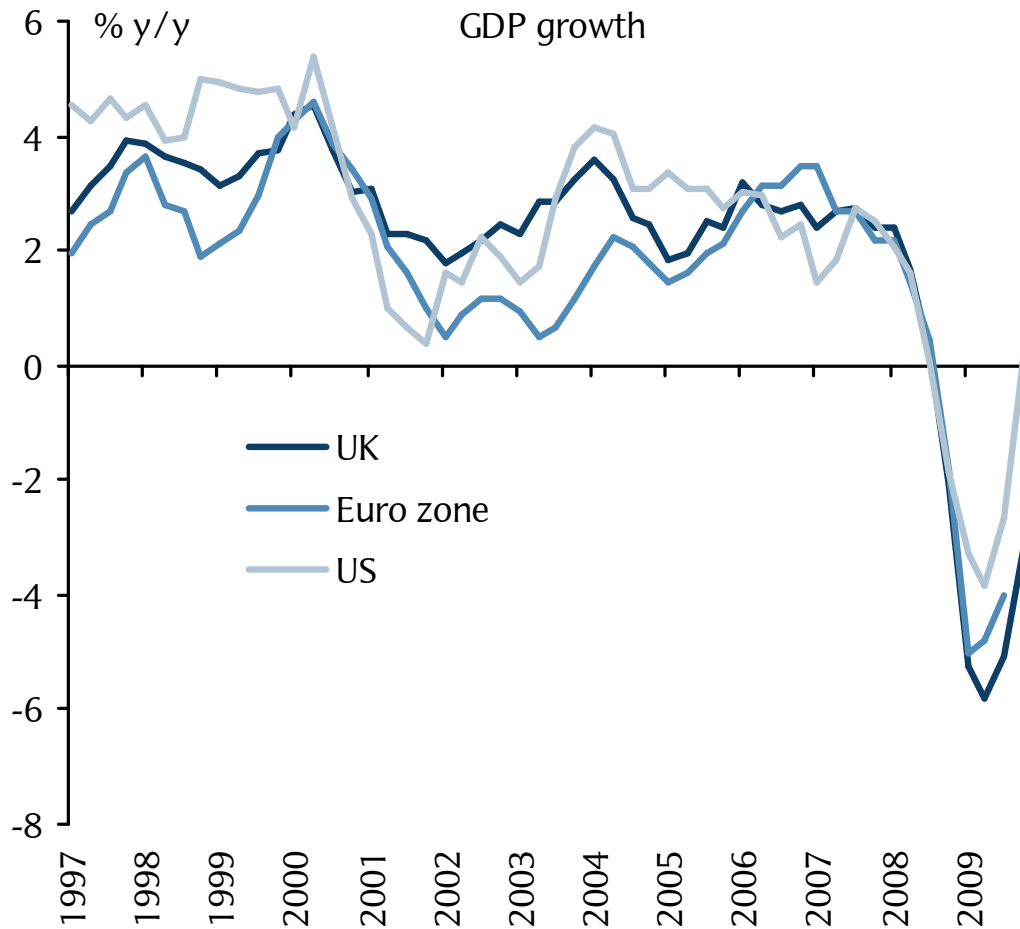
- The Lisbon Treaty only includes a clause for countries wishing to leave the EU, allowing negotiations to be done over this issue (*ECB legal paper: Withdrawal and expulsion from the EU and EMU: some reflections*)
- The Treaty has nothing for countries wishing to leave EMU; conversely all countries (except UK and Denmark) should aim to join EMU when they join the EU
- Economic costs of leaving EMU: larger debt payments (devaluation), establishing a national and credible currency, facing higher rates among others, building up reserves, etc (*see Eichengreen NBER N°13393, the Breakup of the euro area, 2007*)
- The euro construction is a political construction and not an economic one;
  - ▶ default in one periphery country would likely lead to similar issues in the other “fragile” countries.

# The Greek Crisis – implications for the EUR and UK

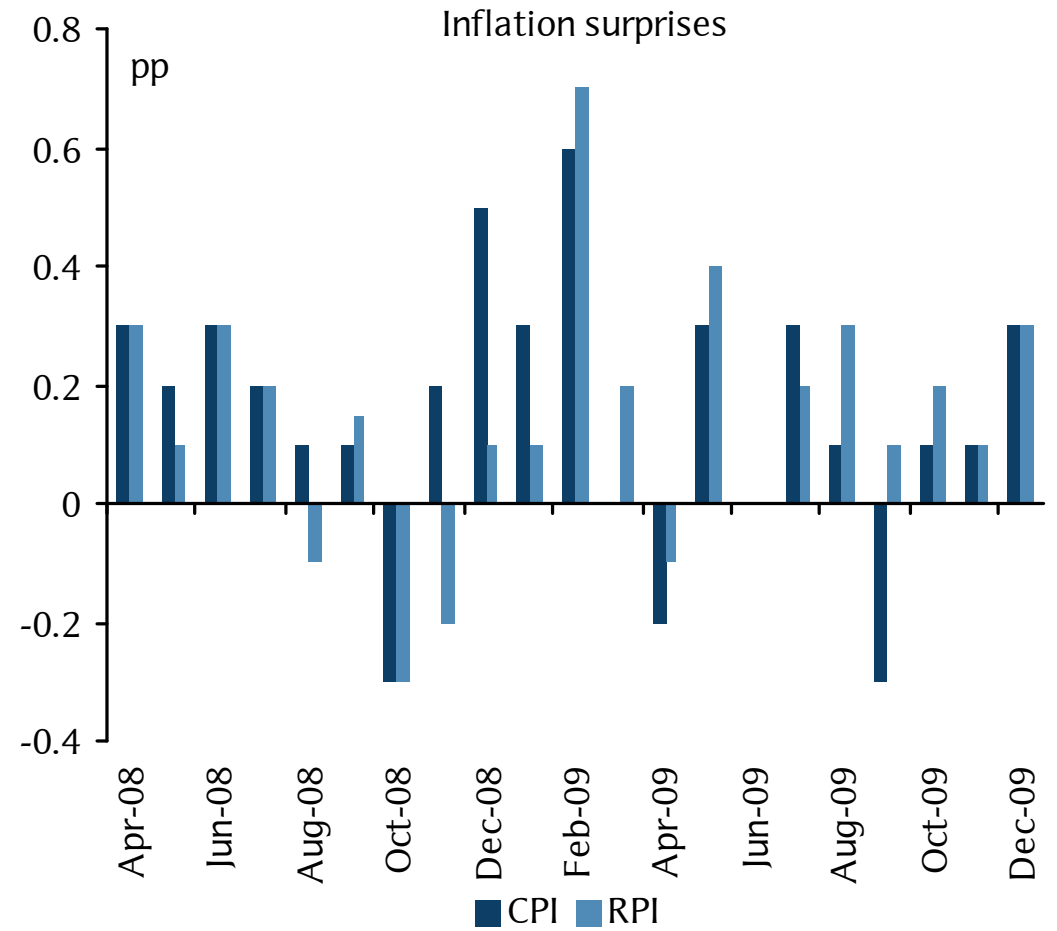
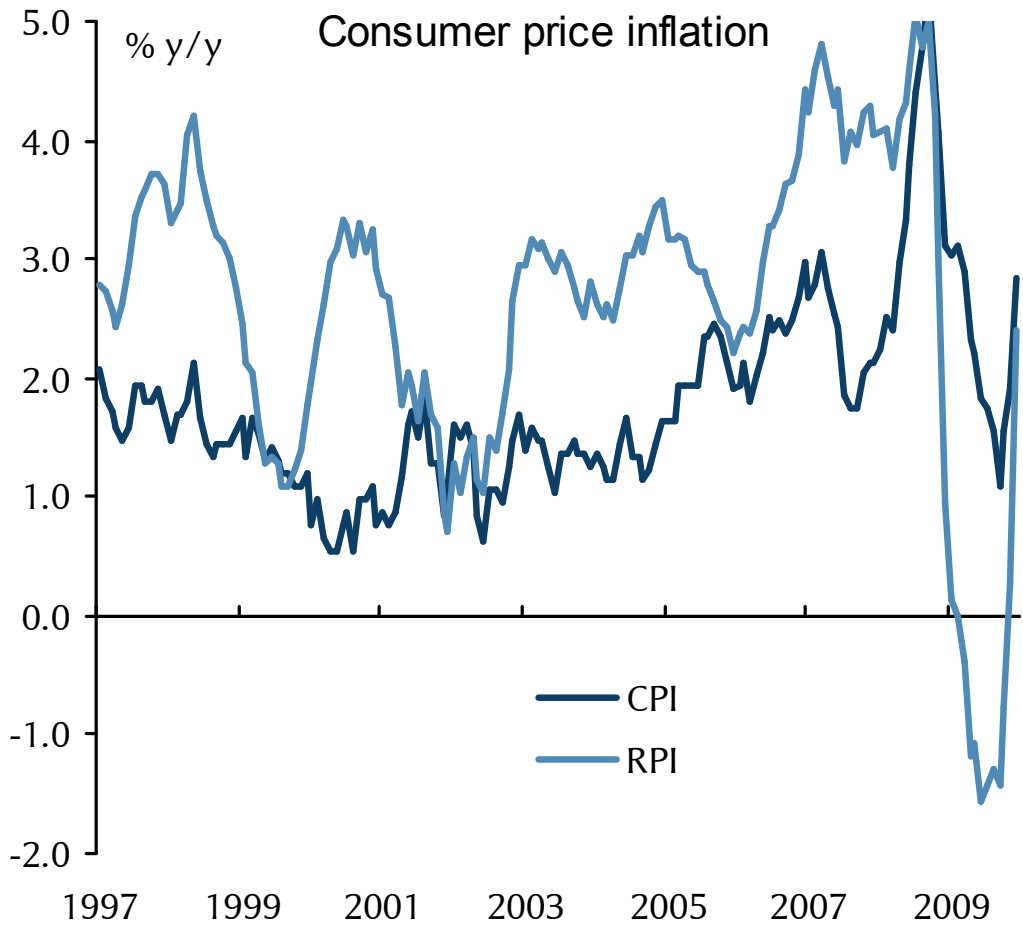
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- The EUR has underperformed other currencies in recent weeks as the crisis has raged
- This underperformance is greater than would have been suggested by moves in other financial prices (eg relative interest rates)
- And appears to reflect a significant increase in the perceived riskiness of the euro zone
- The problems are severe, and speak to a wider issue facing the euro zone – monetary but not political union
- But they are not likely to affect ECB policy very markedly
  - ▶ And therefore the weakness of the EUR may be overdone, at least in the short run
- This is an unwelcome development for the UK – GBP has appreciated but not because external demand has picked up
- The UK's fiscal issues now look less serious in relative, but not in absolute, terms

# UK data – the plot thickens



# UK data – the plot thickens



# What to make of the UK data

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- Over the past few weeks:
  - ▶ GDP was surprisingly weak ... again
  - ▶ Inflation was surprisingly strong ... again
  - ▶ Other indicators of activity were positive on the whole (eg unemployment)
  - ▶ And this week the manufacturing PMI was very strong, but money growth very weak...
- Bottom line in the short run: continued uncertainty about exactly where the economy is currently
  - ▶ Plenty of ammunition which could be used to argue for further loosening or keeping policy on hold
  - ▶ The MPC seems likely to halt its asset purchases – but to make no promises
- Longer-run the slow increase in unemployment may mean that the UK economy is adjusting relatively slowly
  - ▶ But adjustment does need to happen

# GBP implications

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- The appreciation of GBP/EUR appears to be more due to EUR weakness than GBP strength
- In the short run we would not advise chasing the move
- But the Greek and wider euro zone issues, coupled with the strength of the euro and the exceptional looseness of UK monetary policy all suggest that in the longer-term GBP is likely to appreciate further
- Though not close to pre-crisis levels

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