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By Valentino Sy

A Greek Tragedy

Developed in Athens in the 6th century B.C., Greek tragedy or tragic drama is a form of art based on human suffering. A tragedy is performed by an actor, who plays various roles by changing masks, whose actions the chorus comments upon in song and who exchanges dialogue with the leader of the chorus. The philosopher Aristotle said in his work *Poetics* that tragedy often involves a great person who experiences a reversal of fortune.

Greek's reversal of fortune

The current turmoil in the finances of Greece resembles a Greek tragedy, one that turned from good to bad. The Greek economy was one of the fastest growing economies in the eurozone from 2000 to 2007, expanding at an annual rate of 4.2 percent. Foreign capital flooded the country causing bond yields to fall and allowing the Greek government to run large fiscal deficits. Its stock market more than tripled its value from 2003 to 2007.

But the 2008 global credit crisis had a huge effect on the Greek economy. Two of the country's largest industries are tourism and shipping, and both were badly affected by the downturn with revenues falling 15 percent in 2009. To keep within the monetary guidelines of the European Union (EU), the government of Greece had misreported its official economic statistics using derivatives to hide its actual level of borrowing.

In November 2009 the Greek government revised its deficit target from an estimated 6 percent to 12.7 percent while its accumulated public debt was estimated at 121 percent of GDP, the highest ratio in the EU. By the time Greece reached a bailout accord with the EU and IMF in May 2, 2010, the Greek stock market has fallen by half.

Source: Technistock, Wealth Research

To Be or Not To Be. To Default or Not Default.

Last Friday, global markets headed by Greece sold off sharply ahead of a deadline for investors to agree on Greece's second international bailout package. This second bailout which calls for a "private sector involvement" is due to generate 54 billion euros of funding for Greece by 2014 and 135 billion euros by 2020 while resulting in losses to investors of about 21 percent of net present value of their Greek debt holdings.

Accepting this new round of help has serious political repercussions for Greece. Greek Prime Minister George Papandreau is currently seeking mandate for more rigorous reforms and austerity measures, including plans to cut 20,000 public sector jobs amid protests and demonstrations.

The stakes are also high for the European Union. Already, the German government is preparing to shore up German banks in the event that Greece fails to meet the terms of its aid package and defaults.

Contagion Effects

Similar to the 1997 Asian Financial Crisis where Thailand was the epicenter that eventually spread to other Asian crisis, Greece was the epicenter of the sovereign debt contagion in Europe (see *IPIS Theory*, February 22, 2010). The Greek crisis spread to other EU nations with huge fiscal deficits and large public sector debt such as Portugal, Ireland, Italy and Spain (which together with Greece are known with the acronym PIIGS).

Like the Asian crisis, the problems not only spread to peripheral countries such as Indonesia, Malaysia and the Philippines but even to stronger economies such as South Korea and Hong Kong. In fact, the Hong Kong government put up its Tracker Fund after it acquired a substantial portfolio of Hong Kong stocks to minimize market disruptions during the Asian Financial Crisis.

In Europe today, even strong countries such as Germany and France are affected by this Greek tragedy because they are the ones seen picking up the tab over this whole EU sovereign debt mess. In the past six weeks alone the German stock market has lost 30 percent after Greece's credit rating was downgraded by Fitch to CCC, just one notch above default.

History does not repeat itself, but it rhymes

Looking at what happened during the 1997 Asian Financial Crisis, we know that the extent of the damage to the economy and the stock market could be very severe. Thailand's GDP shrank 10.5 percent in 1998 and Indonesia's GDP declined by 13.1 percent. Meanwhile, the Philippines experienced a mild recession of 0.6 percent in 1998.

Asian currencies such as the rupiah, the ringgit, the peso and the won followed the baht's demise and were devalued against the US dollar. In order to shield itself from further currency swings, Malaysia pegged the ringgit to the US dollar in September 1998. In a similar manner, Switzerland recently pegged the Swiss franc to the euro in order to shield itself from huge capital inflows coming out of the euro.

Thai stocks fell as much as 70 percent while Indonesian and Philippine stocks declined as much as 60 percent before the markets bottomed out in September 2008 or 14 months after the Thai baht collapsed (see chart below).

Source: Technistock, Wealth Research

This year Greece is already experiencing its third consecutive year of recession. The Greek government announced last Friday that it is expecting its economy to shrink by more than 5 percent this 2011. Meanwhile, its stock market has already fallen by 70 percent since the crisis began in November 2009.

Dysfunctional politics

While the extent of the damage to the stock markets between Greece now and the TIPs (Thailand, Indonesia,

Philippines) during the Asian financial crisis are almost the same, it appears that the problem of Greece and the EU's sovereign debt crisis as a whole may take a much longer time to resolve.

In retrospect, the swiftness of the restoration of public confidence in TIPs during the 1997 Asian Financial Crisis was due to their government initiated financial restructuring. Their governments provided the liquidity support for banks, guarantees of bank liabilities, the provision of public funds for recapitalization of financial institutions, and the creation of publicly owned centralized asset management companies.

Today, we don't find this kind of flexibility in Europe. The governments of the weaker EU countries, who are saddled with huge fiscal deficits and accumulated public debt, find it hard to take drastic structural measures without the help (in the form of bailouts) from the stronger EU members such as Germany, France and the Netherlands.

Another problem with Europe is that while they have a single monetary policy, they do not have a single fiscal policy due to political reasons. Political gridlock and dysfunctional politics are also getting in the way which prevents the implementation of controversial but necessary solutions. Asia before did not have this kind of problem. Each country was able to act on its own with complete fiscal, monetary and political independence. Unlike then, there appears to be no clear solution to the European problem yet.

Structural not cyclical

The problem now with Europe and even the US is structural and not cyclical. So the quantitative easing, the zero interest rate policy and the buying of bonds may not be the solution. In fact, there has been no concrete solution by the G7, the ECB or the US Fed. This is the dilemma.

Unlike Thailand, Indonesia, the Philippines and other Asian countries which were able to devalue themselves out during the 1997 Asian Financial Crisis, Greece and Portugal and the rest of the problematic EU countries cannot devalue.

Safe haven

While there is no clear resolution yet to the Greek/EU crisis, we advise investors to focus on countries that will not be affected by a slowdown in global economic growth. Paradoxically, the Philippines & the rest of the ASEAN region are proving to be a safe haven in this time of uncertainties. Because we do not have the structural problems of the EU and the US, and we have a much healthier fiscal and current account balances, the Philippines is considered to be a less risky investment destination.

The Philippine peso is now a more stable currency compared to the euro, the US dollar and even the commodity currencies like the Aussie dollar and the Canadian dollar. Moreover, in today's volatile environment, investing outside the country now is proving to be riskier because of the many landmines and uncertainties that are lurking.

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