



## Research Notes

### Buying time / 11 May 2010

Equity and bond markets are rallying all over the planet on the back of the European and IMF financial stabilisation package. The latest bout of GFC risk aversion is being successfully unwound.

In a day eerily reminiscent of October 2008 when we were waiting for the details of the US Troubled Asset Rescue Package (TARP), the EU announced a package that has exceeded expectations, at least in terms of the sheer amount of funds being made available.

The financial stabilisation mechanism totals €500b, and is in two parts:

- 1) A Special Purpose Vehicle has been established to provide liquidity to governments by issuing bonds on a pro-rata basis by EU states up to €440b.
- 2) The existing balance of payments facility fund (which has already been used in countries such as Hungary) has been increased from €50b to €110b.

The IMF has also come to the party by extending its range of interventions to EU states that need it. This is in the same proportion as the Greek package, i.e. one-third IMF, two-thirds EU. This provides another €250b facility.

In addition the European Central Bank has agreed to buy government bonds to stabilise debt markets if required. The bank can issue short-term paper at the same time to avoid increasing the money supply.

This is all good news, but in keeping with economics as the dismal science, we make the following observations:

- 1) This is not a solution to Europe's debt woes. All this package does is buy time so that individual

governments can go back to developing, articulating and implementing strategies for medium-term fiscal consolidation. I know – worn record!

- 2) Some measure of debt restructuring in at least Greece can not be ruled out, but as we said in a recent Research Note, this can now play out in an orderly fashion.
- 3) The European Union has work to do in terms of what the fiscal rules are for membership of the Union. Existing fiscal rules have to-date been too loose. This package could be the first step on the pathway to more formalised fiscal rules that prevent Greek-style fiscal largesse. Belgium, the Netherlands and Germany have all adopted constitutional Budget rules. Watch for this to become EU-wide.

Financial markets will now give Europe another chance to get its act together. Here's hoping they don't waste the opportunity. In the meantime, we can now go back to monitoring broader economic developments as the global economy continues its gradual recovery.

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