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Market Memo: With Greece, it's about time

As of 02-21-2012
The tentative agreement reached over the weekend to provide Greece with a second bailout may not prevent an ultimate default by the euro-zone's fiscally weakest member. But that doesn't really matter all that much to the markets. What the deal does is buy time, and that's all the markets really want.

To be sure, the $173 billion agreement struck in this morning's wee hours isn't done yet. Multiple things must happen between now and March, including parliamentary approval of the bailout by several European Union countries, including Finland, Germany and the Netherlands. Moreover, at least 90% of banks, investment funds and others holding Greek debt must participate in the debt swap that essentially wipes out more than half of the face value of their current Greek bonds and roughly 70% if the present-value calculation of the new bonds that would replace the old bonds is used. It's a Hobson's choice of getting back roughly 30 cents on the dollar or potentially nothing at all.

Finally, all this assumes that Greece's political leaders don't backtrack in the face of likely worsening pressure by an angry citizenry frustrated by a fifth year of recession and 20% unemployment. It doesn't help that the new bailout requires Greece to relinquish some of its sovereignty, with an EU-led panel overseeing the dispersal of funds based on Greece's ability to carry through tough reforms, including additional cuts in pensions, the minimum wage, health-care and defense spending, as well as layoffs of state employees and asset sales—moves that could worsen Greece's economic plight.

Watch Spain and Italy

Still, the feeling is that this bailout package is headed for approval, lifting the markets' confidence about a more favorable outcome for Europe, where a moderate recession appears to be priced in but something worse is not. It helps that the deal comes a week before the European Central Bank is set to provide a second massive batch of low-rate three-year loans to European banks. Some $650 billion of such loans were made in December, boosting liquidity among European banks, improving their capital positions and lessening stress in the euro-zone's most troubled major sovereign-debt markets. Indeed, yields on 10-year Spanish and Italian bonds have fallen considerably the past two months, to just above 5% and just below 5.4%, respectively.

Spain and Italy are the European countries that the markets are really focused on—not Greece. The markets just want to see Greece make it to July, when a new permanent funding facility supported by all EU members is scheduled to replace the temporary bailout fund. This would effectively reduce the negative effects of a Greek default, if there is one, and leave the door open for Greece to exit the EU without severe consequences to other EU members. In other words, while time may not heal all wounds, in the case of the euro-zone and its ongoing debt crisis, it sure can help the healing process.

Ihab L. Salib
Senior Portfolio Manager, Head of International Fixed Income Group

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Also by Ihab L. Salib

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Federated®
Federated Investors Tower
1001 Liberty Avenue
Pittsburgh, PA 15222-3779
Telephone: 412-288-1900