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First Trust

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Monday Morning Outlook

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Triumph of the Euro?

With local interest rates soaring to 10% and even air force pilots on strike, it looks like Greece is going to get the financial aid it's been asking for, in the form of about $160 billion in loans over the next three years from the European Union and International Monetary Fund. Without these loans, it is doubtful Greece would have been able to rollover its debt at any interest rate. Greece would have defaulted.

By contrast, if Greece still used the drachma instead of the euro, we all know how their fiscal profligacy would have ended: with a major devaluation of the local currency and higher inflation. With a devaluation, everyone who earned wages and salaries in drachma – in the public and private sector alike – as well as every (domestic or foreign) investor locked into earning drachma-denominated interest or investment returns from bank deposits, government and corporate debt, or equities would have taken a haircut.

But with Greece using the euro, devaluation is not an option. As a result, Greece's pain will be concentrated in the sector that is causing most of the problem: government. The conditions of the bailout, decided on by the EU and IMF, require Greece to freeze government salaries, eliminate bonuses (amounting to two months' pay), and lift the retirement age to 60 for government workers. The aid package also requires Greece to raise its value-added tax to 23% from 21% and also increase some excise taxes, but there will also be other large (as yet unspecified) cuts in government spending, too.

While the tax hikes are disappointing, we believe the focus on restraining government spending, rather than using devaluation, represents a triumph of the euro.

We realize that some investors have been spooked by the recent debt turmoil in Greece and the risk of it spreading to Portugal and Spain. However, one of the lessons of the early 1980s was that US equities can still do very well even when foreign economies are in turmoil.

In 1982, Argentina, Mexico, and Venezuela all defaulted. Brazil and Chile defaulted in 1983. Smaller countries that defaulted, Costa Rica, the Dominican Republic, Ecuador, Panama, Peru, and Uruguay, rounded out the list of almost every Latin American country. In 1983, the eight largest US banks had 260% of their capital lent to Latin American countries. Despite this, in 1982-83 the total return on the S&P 500, including both share appreciation and dividends, was 49%.

Today, as far as we know, no US financial institution has any kind of significant exposure to Greece or any other European country. We are not saying that European debt problems are not significant. But when the US is recovering from a steep recession, debt problems elsewhere can be a wall of worry we end up climbing.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
5-3 / 7:30 am	Personal Income - Mar	+0.3%	**+0.6%**	+0.3%	+0.0%
7:30 am	Personal Spending - Mar	+0.6%	**+0.9%**	+0.6%	+0.3%
9:00 am	ISM Index - Apr	60.0	**61.0**	60.4	59.6
9:00 am	Construction Spending - Mar	-0.5%	**-0.2%**	+0.2%	-1.3%
sometime	Domestic Auto Sales - Apr	4.2 Mil	**4.2 Mil**		4.3 Mil
during the day	Domestic Truck Sales - Apr	4.6 Mil	**4.6 Mil**		4.7 Mil
5-4 / 9:00 am	Factory Orders -Mar	-0.1%	**-0.3%**		+0.7%
5-5 / 9:00 am	ISM Non-Man. - Apr	56.0	**56.8**		55.4
5-6 / 7:30 am	Q1 Non-Farm Productivity	+2.5%	**+3.2%**		+6.9%
7:30 am	Q1 Unit Labor Costs	-0.5%	**-1.8%**		-5.9%
7:30 am	Initial Claims - May 1	440K	**448K**		448K
5-7 / 7:30 am	Non-Farm Payrolls - Apr	+188K	**+175K**		+162K
7:30 am	Manufacturing Payrolls - Apr	+16K	**+20K**		+17K
7:30 am	Unemployment Rate - Apr	9.7%	**9.6%**		9.7%
7:30 am	Average Hourly Earnings - Apr	+0.1%	**+0.2%**		-0.1%
7:30 am	Average Weekly Hours - Apr	34.1	**34.1**		34.0
2:00 pm	Consumer Credit – Apr	-$4.0 Bil	**-$7.2 Bil**		-$11.5 Bil