



EUROZONE BAIL OUT PACKAGE SOLVES SHORT TERM LIQUIDITY ISSUES

- **But package only buys time as solvency and economic problems for the periphery remain**
- **Fiscal transfers would work better than loans, says Fidelity's Greetham**

London, 11 May 2010: The eurozone bail out package addresses short term liquidity issues in the financial system and buys time for peripheral eurozone governments but without any measures to offset tightening fiscal policy there could be a risk of a double dip in those economies, according to **Trevor Greetham, Manager of the Fidelity Multi Asset Strategic Fund.**

"Euro heads of state want to address a long term structural debt issue by toughening up enforcement of the original Stability and Growth Pact, when the problem is cyclical and more urgent," **comments Mr Greetham.** "Peripheral economies were under pressure to cut government spending as markets forced sovereign interest rates higher. They are under similar pressure to cut spending if they follow the advice coming out of EU meetings or accept conditions attached to bail out funds. In my view, this is not the right course of action when the recovery is fragile and the strictures of the single currency mean policy makers can't offset the negative impact of spending cuts with currency devaluation or additional monetary stimulus, as would be possible in the US or UK.

"Successful monetary unions like that between the United States of America, ease the problem of differential economic conditions through fiscal transfers. Tax revenues in more affluent regions are transferred to pay benefits in less fortunate areas. These transfers can be large but they are all but invisible and attract little political interest. European Monetary Union would probably only survive a protracted period of weakness if there were large fiscal transfers from one country to another. Loans are not enough. However, this would only be possible with a much greater degree of coordination in terms of tax and benefits policies or the creation of a federal government to disburse funds.

"The bail out package eases near term financial strains but offers no additional



stimulus for peripheral economies. The risk is spending cuts trigger a double dip in those economies. “If asset prices drop, banks will reign in their lending in an unpredictable way. Nominal price and wage deflation in troubled countries will see the one-size-fits-all interest rate set by the ECB rise in real terms, further accentuating the downturn.

“We are hopeful that sustained economic recovery will go a long way to refill government coffers all over the world. However, growth lead indicators are peaking and the markets are likely to go after weak players from time to time until it is clear this is nothing more than a moderation in the pace of recovery.”

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