

Greek tragedy puts skids under global stocks

By Tom Stevenson , 28 April 2010

Investors run scared of debt defaults spreading through Eurozone periphery.

Financial markets around the world have been thrown into turmoil as investors become increasingly convinced that Greece will fail to pay its debts. The cost of borrowing for governments throughout the region has spiralled on the prospect of a Greek default, with speculators turning their sights on other indebted European countries such as Spain, Portugal and Ireland.



“Stock markets have gyrated in recent days as investors ran for cover in the face of a fast deteriorating financial crisis.” Tom Stevenson

The yield on Greek government bonds repayable within two years soared to more than 18% as investors slashed the price they were prepared to pay for bonds on which there is a growing chance that they will not get their capital back. Ten year bond yields also hit double digits, the highest ever since the eurozone was created as the S&P ratings agency downgraded Greek government paper to junk status.

Stock markets have gyrated in recent days as investors ran for cover in the face of a fast deteriorating financial crisis. After a year of steadily rising asset prices, the past week has been a reminder of the chaos that engulfed financial markets in the wake of the collapse of Lehman Brothers.

The crisis in Greece has shown that financial crises can drag on for much longer than optimistic investors might hope, with the growing positivity engendered by massive government intervention giving way to a second wave of anxiety when those same governments themselves run into trouble.

A great unanswered question is the extent to which the problems in Greece will spill over into other countries in Europe with similar deficits. The cost of government borrowing has also soared in Portugal, Spain and Ireland and the value of the euro itself has crumbled.

On the table at the moment is a 45bn euro rescue package from the International Monetary Fund but the reluctance of European heavyweight Germany to back the plan ahead of local elections has cast the whole bail-out into doubt.

In the short term Greece needs to roll over 9bn euros of debts on May 19 but further out huge question marks remain over the amount of money needed to put the country back onto a sustainable path to recovery. Greece has a budget deficit of around 13% and public sector debts worth more than 100% of its national economic output.

A number of scenarios beckon if Greece is unable to meet its obligations. None of them are attractive. They include a “restructuring” of its debts which would involve investors accepting a “haircut” worth between 20% and

50% of the face value of their loans; a retreat from the euro, followed by a devaluation and return to the common currency at a lower exchange rate; a flat default on its debts; or an overhaul of its taxation system to address the problem of payroll taxes that are routinely evaded.

A wider question for investors elsewhere in Europe and the rest of the world is how much all of this really matters. Investors have spent many weeks shrugging off the crisis in Greece because in other parts of the world there is mounting evidence that the global economy is on the mend.

First quarter results in the US, for example, are emerging better than expected. Various surveys show improving economic conditions and even the US housing market is looking perkier than for many a month. Unemployment rates are starting to fall in many countries, a clear indication of above trend economic growth. And inflation remains under control, with substantial spare capacity keeping a lid on rising prices.

Global stock markets have experienced a remarkable year of rising prices and the latest wobbles are not surprising given the scale of the recovery. The longer a market rebound goes on the more that investors look around for reasons to bank some of the profits they have made.

The last couple of weeks have provided plenty of reasons. In addition to the crisis in Greece, the unfolding drama at Goldman Sachs has reminded investors of the problems that pushed us into the slump in the first place. In the UK, the increasing prospect of a hung parliament has caused people to question what will happen after May 6 when the markets will be less inclined to give politicians the benefit of the doubt regarding the paying down of Britain's public sector debt.

When events are moving as quickly as they are at the moment, it pays to keep calm and avoid being bumped into knee-jerk responses that come to be regretted subsequently. At times like these a diversified portfolio is worth its weight in gold (bonds, equities, property and cash too).

Note the value of an investment and the income from it can go down as well as up, so you may get less than you invested. The ideas and conclusions in this column are the author's own and do not necessarily reflect the views of Fidelity's portfolio managers. They are for general interest only and should not be taken as investment advice or as an invitation to purchase or sell any specific security. Past performance is not a guide to what may happen in the future. Investments in small and emerging markets can be more volatile than more established markets. For funds that invest in overseas markets, changes in currency exchange rates may affect the value of your investment.