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First Trust

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Monday Morning Outlook

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Greece is Not Lehman Brothers

In the aftermath of The Panic of 2008, it's easy to understand why many investors are so "jumpy" lately. It seems that at the slightest sign of trouble, investors head toward the exits, to avoid getting stampeded like they were back during the mortgage security meltdown.

Sovereign debt defaults, and the potential for problems in Greece to spread around the world, are the most recent fear. This issue has undermined confidence, but the ultimate danger to the US economy has been vastly overestimated. Greece's government owes about $400 billion, which is just 4% the size of the $10 trillion US mortgage market. As of yet, we know of no major financial institution, either in the US or abroad, with solvency issues because of Greek debts.

Of course, this is not the main issue. Many fear that a Greek default could drive up interest rates for other sovereign debt and in other markets, drive down debt values, and perhaps kick-off another financial panic. Fortunately, the potential for this issue to spin out of control is very small. In fact, there is a very good chance that this entire episode leads to some sanity in government spending and a better, more market-friendly future.

As of 2008, Greece had a top income tax rate of 40% and a value-added-tax (VAT) of 19%. In addition, employers paid 28% of salary for social security, while employees paid 16%. The debt issues in Greece have little to do with revenue; they have everything to do with the worldwide inability of governments to spend within their means. The same is true in the US. It is not tax rates that are the problem; it is spending that threatens solvency. Just look at Illinois and California. If these states raise tax rates again, more people will leave, hurting the attempt to raise revenue.

Even if Greece, Illinois, California or the United States itself repudiated their debt – declared they would make zero payments – they would all still have substantial annual budget deficits. At that point, the only fix would be to cut spending because potential lenders would go on strike.

This is a structural problem, not a systemic and cyclical one. The housing crisis was an easy-money-induced-bubble. The issue with sovereign debt is partly caused by easy money (meaning central banks have helped to mask the pain of spending and taxes), but mostly caused by politicians and voters who greedily spend future generations' resources today. It's ironic, but markets and investors (the ones many populists like to berate) make up the system that will help protect these future generations from the greed of politicians and voters.

In the end, the only way for Greece and other political entities to fix their budget problems is to cut spending. Politically, this is very difficult. But, in tough times like today, when everyone is feeling the pinch, it is just as hard to convince other (EU or US) taxpayers to bail out the scofflaws.

We suppose that this could all end horribly; if governments refuse to cut spending and markets refuse to fund that spending. Then debt defaults, like dominoes, could start one-by-one. However, there are already pressures being applied to Greece by other members of the EU – and very similar pressures will likely be applied to states in the US that are in trouble.

As a result, this could be the beginning of a more sane budgeting process, with politicians and voters finally coming to the understanding that there is no such thing as a free lunch. If that happened, fear would turn to cheer very quickly.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
2-16 / 7:30 am	Empire State Mfg Index - Feb	18.0	**16.0**	24.9	15.9
2-17 / 7:30 am	Housing Starts - Jan	0.580 Mil	**0.585 Mil**		0.557 Mil
7:30 am	Import Prices - Jan	+1.0%	**+0.7%**		0.0%
7:30 am	Export Prices - Jan	+0.4%	**+0.3%**		+0.6%
8:15 am	Industrial Production - Jan	+0.8%	**+1.0%**		+0.6%
8:15 am	Capacity Utilization - Jan	72.6%	**72.8%**		72.0%
2-18 / 7:30 am	PPI - Jan	+0.8%	**+1.3%**		+0.2%
7:30 am	"Core" PPI - Jan	+0.1%	**+0.3%**		0.0%
7:30 am	Initial Claims - Feb 13	435K	**425K**		440K
9:00 am	Philly Fed Survey - Feb	17.0	**18.3**		15.2
9:00 am	Leading Indicators - Jan	+0.5%	**+0.5%**		+1.1%
2-19 / 7:30 am	CPI - Jan	+0.3%	**+0.4%**		+0.1%
7:30 am	"Core" CPI - Jan	+0.1%	**+0.2%**		+0.1%