First Trust
Monday Morning OUTLOOK
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Europe, Not a Repeat of 2008

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Some are drawing parallels between today's European debt problems and the sub-prime problems of 2008. We don't think European debt problems will cause a recession in the US. However, there are clearly similarities between the two events.

Those similarities result from the role of government. Both the 2008 panic and today's European debt crisis result from policy mistakes. In the US politicians of all stripes decided that using subsidies and regulations to boost homeownership was a legitimate goal. All of these policies came together in a perfect storm of over-investment in the early 2000s.

In Europe, politicians decided that the "good life" was an achievable and legitimate goal of government: a 32-hour workweek in pleasing, stress-free jobs, with early retirement, free healthcare, and long vacations.

The US built houses it didn't need. Europe tried to buy a way of life it couldn't afford. It now has 40%, or so, top income tax rates, 20%, or so, value-added tax rates and deficits as far as the eye can see. They just can't squeeze the turnip any more. The markets won't let them.

This is happening despite giving banks preferential treatment when they buy government debt, allowing them to hold no capital to back up these securities. These manipulations have allowed government debt levels to rise to unsustainable levels.

But the 2008 crisis and today's problems are not the same. European banks bought lots of US subprime debt and the US instituted, and foolishly enforced, mark-to-market accounting. This turned what would have been a contained financial fire into an out-of-control inferno.

Banks in the US do not have the same exposure to European debt. The five largest banks in the US have roughly \$54 billion of net exposure to government, business and individual debt in the PIIGS countries. These same five institutions have \$713 billion in capital.

In the early 1980s, when Latin and South American countries were defaulting, and their debt was trading at 10 cents on the dollar, the eight largest US banks had exposure to those countries equal to 263% of capital. If, the US would have enforced mark-to-market accounting on these institutions, they all would have been bankrupt. But, it didn't and the US went on to boom in the 1980s.

The good news today is that the overly strict mark-to-market accounting rules of 2008 have been corrected and the debt problems of Europe are not threatening the US like the problems of the early 1980s. Moreover, in the end, Europe will find a solution that avoids wholesale default.

Nonetheless, many investors are spooked by the threat from Europe and some recent weakness in regional manufacturing surveys. The Philadelphia Fed index, which measures manufacturing in that area, plummeted to -30.7 in August from +3.2 in July. The Empire State index, which is conducted in New York, fell to -7.7 in August from -3.8 in July.

But we think these surveys should be discounted. Sometimes, surveys are better at picking up sentiment than real economic activity. Yes, they are hard numbers, but the numbers reflect answers to questions, not hard transactions.

In addition, high frequency data is holding up much better. August vehicle sales are on par with July. Jobless claims, with data through 10 days ago, are hovering at the lowest levels since early Spring. Chain store retail sales, reported up through 8/16, are solidly above year-ago levels. Just this morning, it's been reported that Delta will be buying 100 jets from Boeing. That's on top of the 460 planes American Air ordered a month ago. Rail traffic and steel production are both showing growth as are box office receipts from theater-goers.

It's not 2008. European debt problems are smaller for banks in the US and, so far, high frequency data suggests consumers and businesses have not panicked.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
8-23 / 9:00 am	New Home Sales - Jul	0.310 Mil	**0.312 Mil**		0.312 Mil
8-24 / 7:30 am	Durable Goods - Jul	+2.1%	**+7.5%**		-1.9%
7:30 am	Durable Goods (Ex-Trans) - Jul	-0.5%	**+1.0%**		+0.4%
8-25 / 7:30 am	Initial Claims - Aug 20	405K	**410K**		408K
8-26 / 7:30 am	Q2 GDP Second Report	+1.1%	**+0.7%**		+1.3%
7:30 am	Q2 GDP Chain Price Index	+2.3%	**+2.3%**		+2.3%
8:55 am	U. Mich. Consumer Sentiment	56.0	**56.0**		54.9