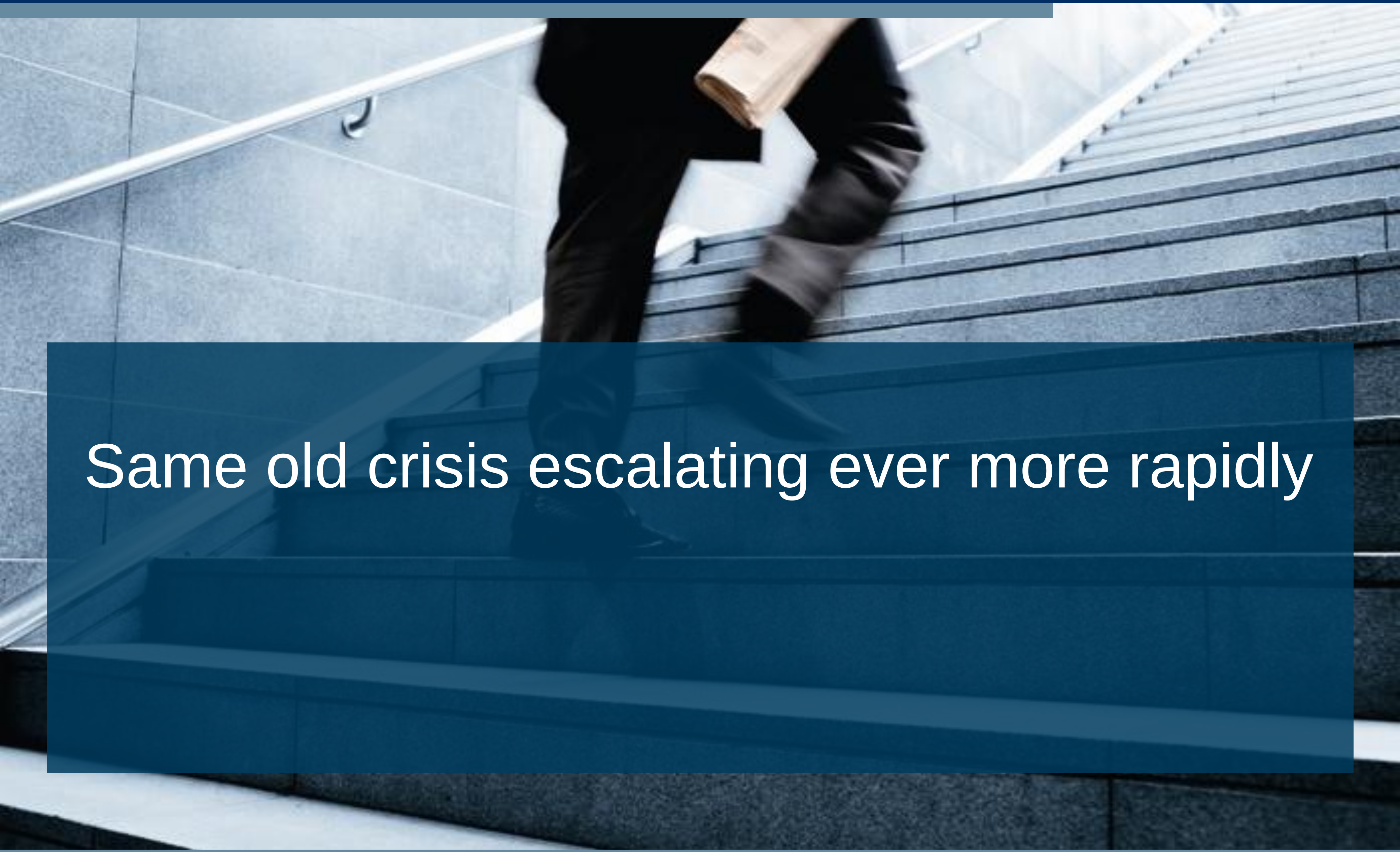
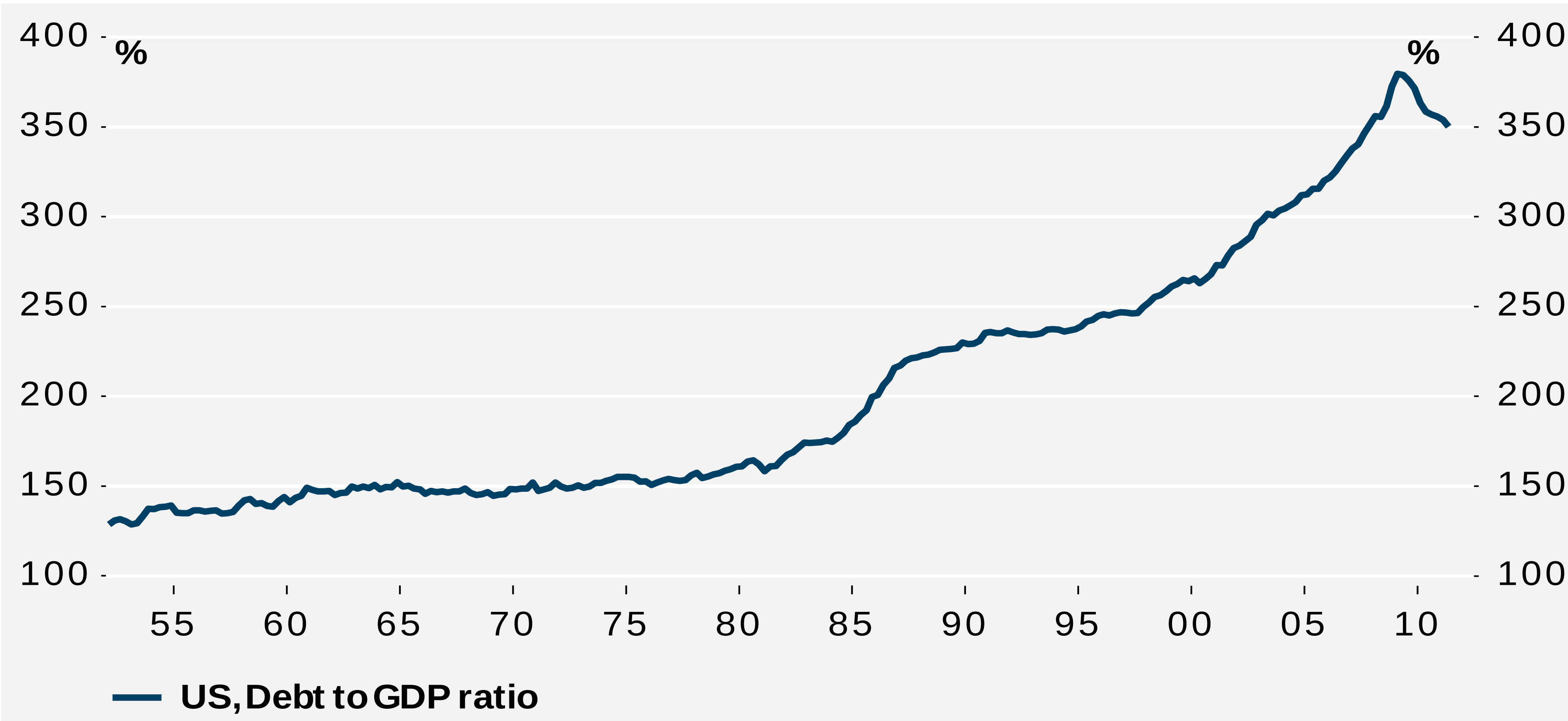
Danske Markets



# Same old crisis escalating ever more rapidly

Danske Markets

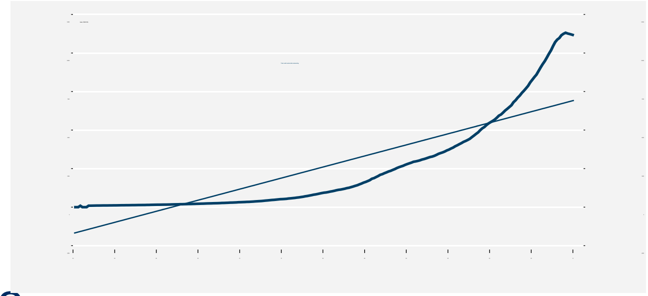
# Exactly when is enough enough...?

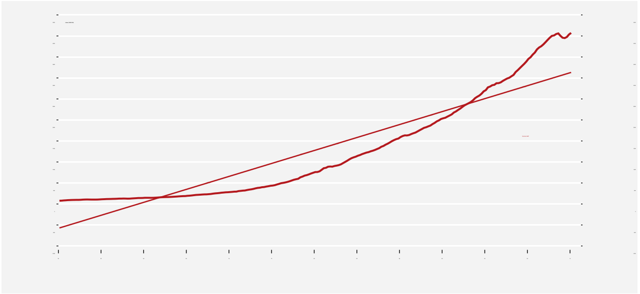




# The only viable solution to a balance sheet crisis is to devour an evil-tasting cocktail consisting of:

1. **Bankruptcy/Write-downs /[Savings]**
   - The Numerator/Debts would fall
   - No, or at least less, ”moral hazard” involved. The costs would be incurred upon investors that basically haven’t done their homework properly. **But**. It would also entail adverse developments for labour (who also happen to be *voters*)

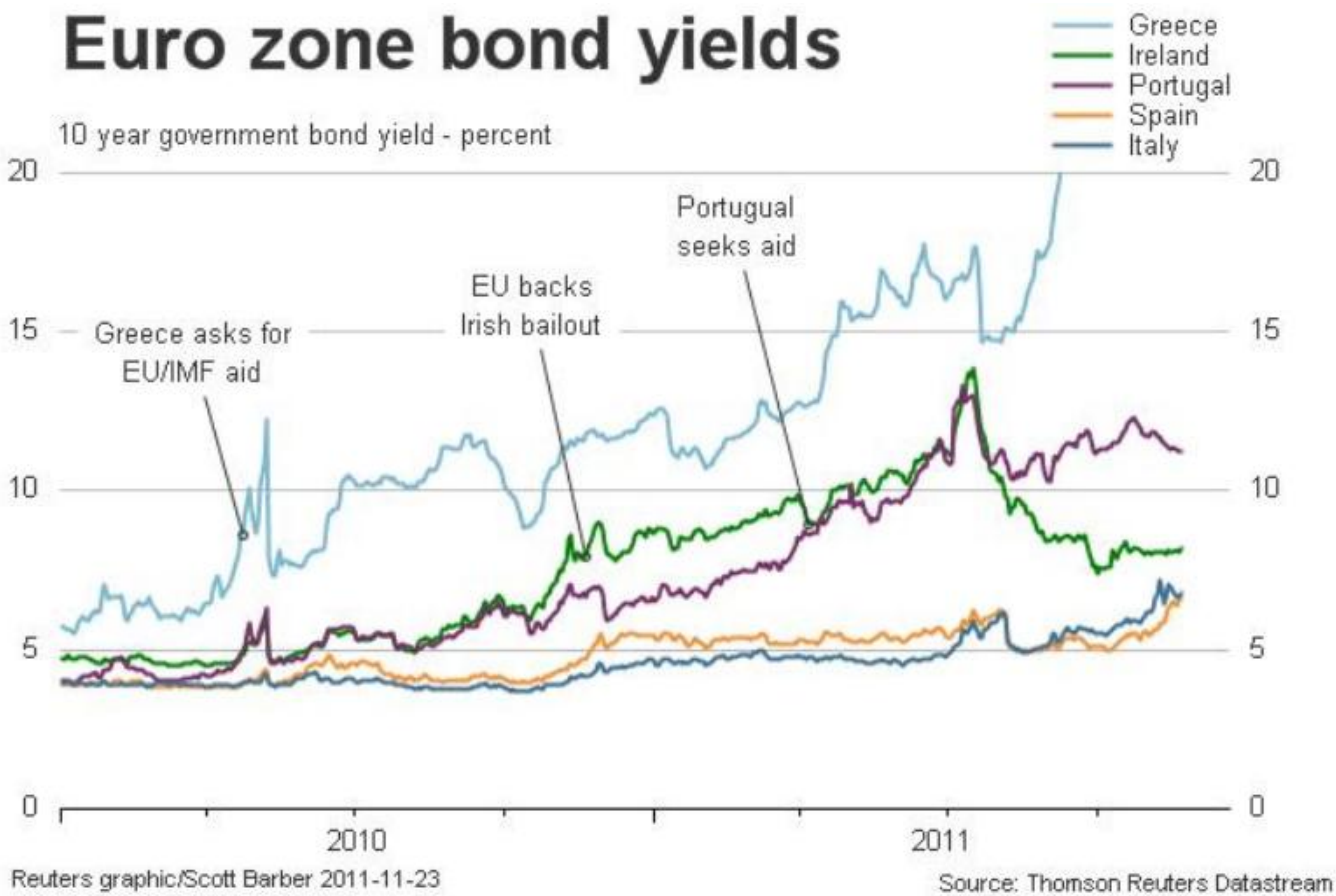




2. **Inflation/Nominal income (Nominal GDP)**
   - The Denominator/Incomes would rise
   - Severe moral hazard and would forever rule out the possibility of a long term credible stabilisation policy instrument. Can probably only be achieved through higher inflation
   - ”Weak dollar policy”



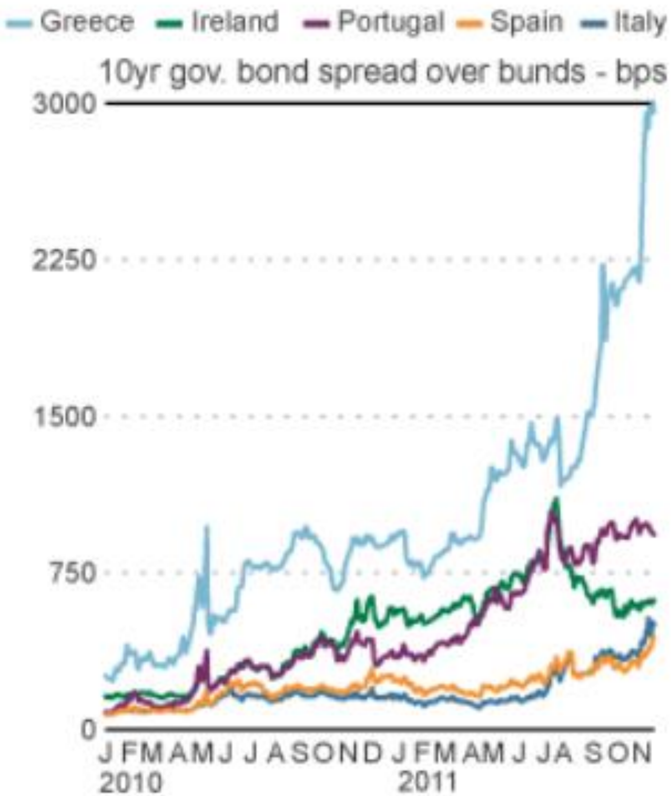
# A never-ending story… (France recently hit 200bp)



# Ratings… (France soon under ’negative watch’ by Moody’s )

## Euro zone credit ratings

| Country | S&P | Moody's | Fitch | 5yr CDS |
|---|---|---|---|---|
| Greece | CC | Ca | CCC | 5,367 |
| Ireland | BBB+ | Ba1 | BBB+ | 715 |
| Portugal | BBB- | Ba2 | BBB- | 1,111 |
| Spain | AA- | A1 | AA- | 381 |
| Italy | A | A2 | A+ | 489 |
| Belgium | AA+ | Aa1 | AA+ | 285 |
| Germany | AAA | Aaa | AAA | 93 |




Sources: Thomson Reuters

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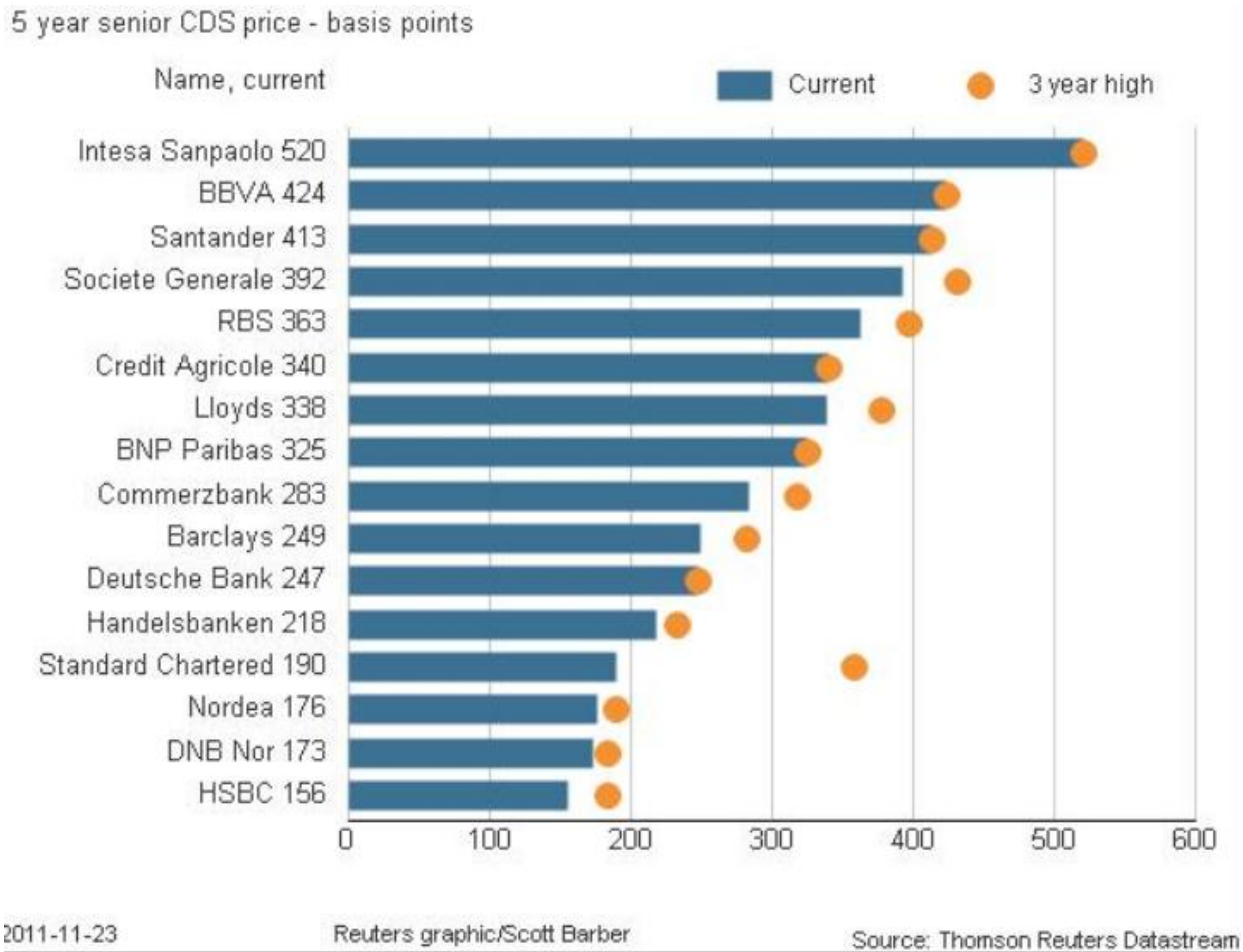
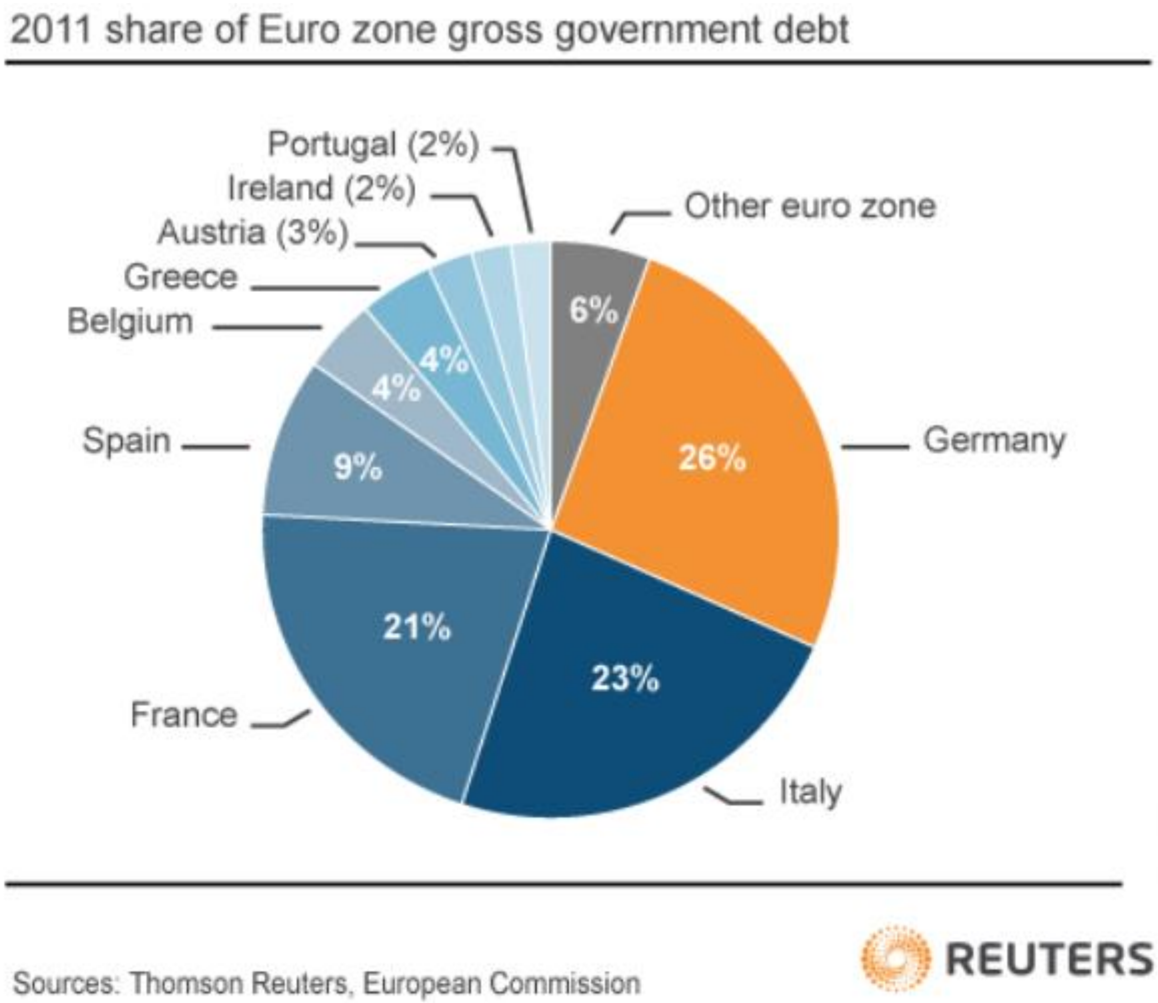
# Banks on the verge of bankrupcy…



# …and Italy is simply too big to save



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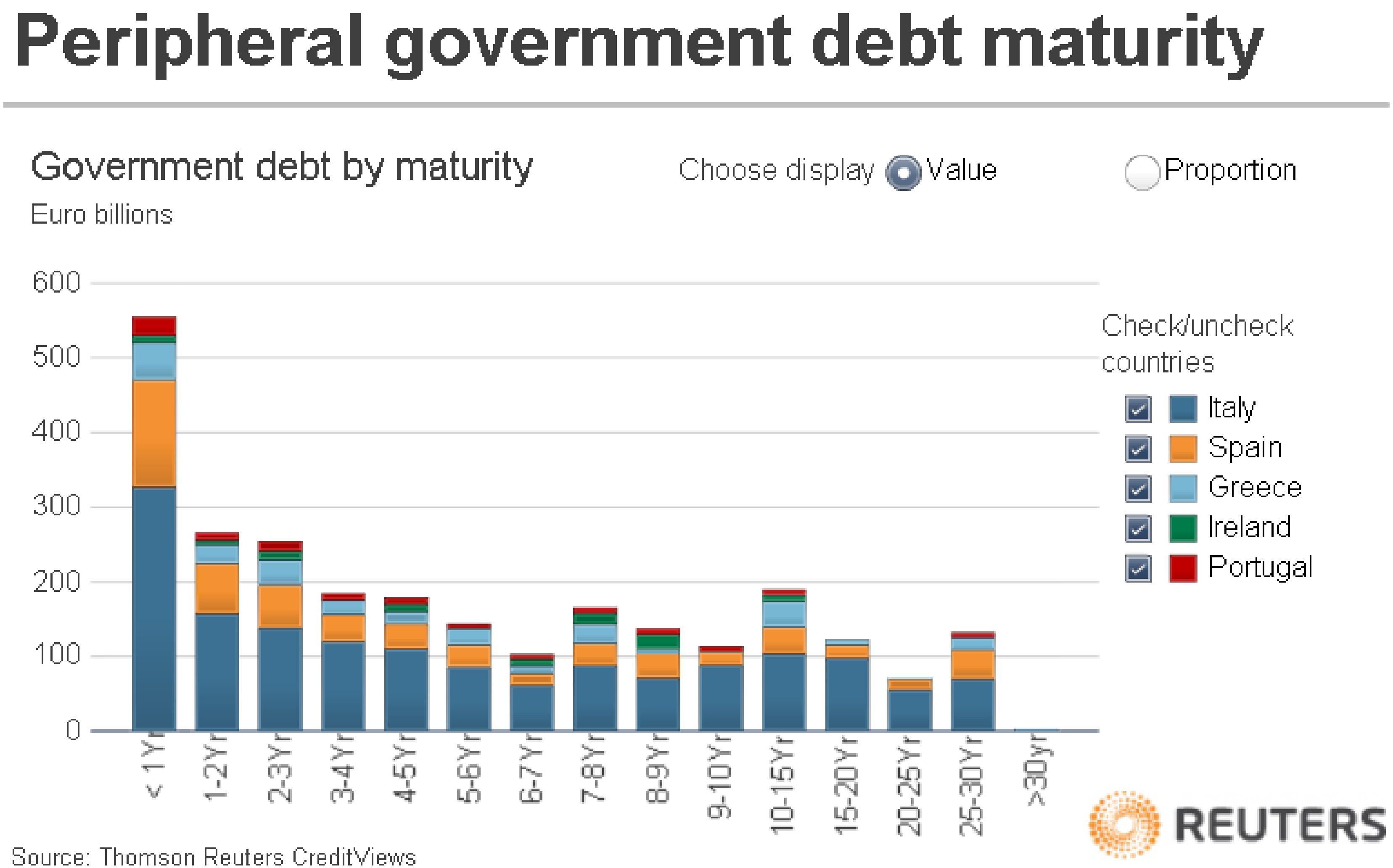
# Large *refinancing* needs in 2012… (in € bn)



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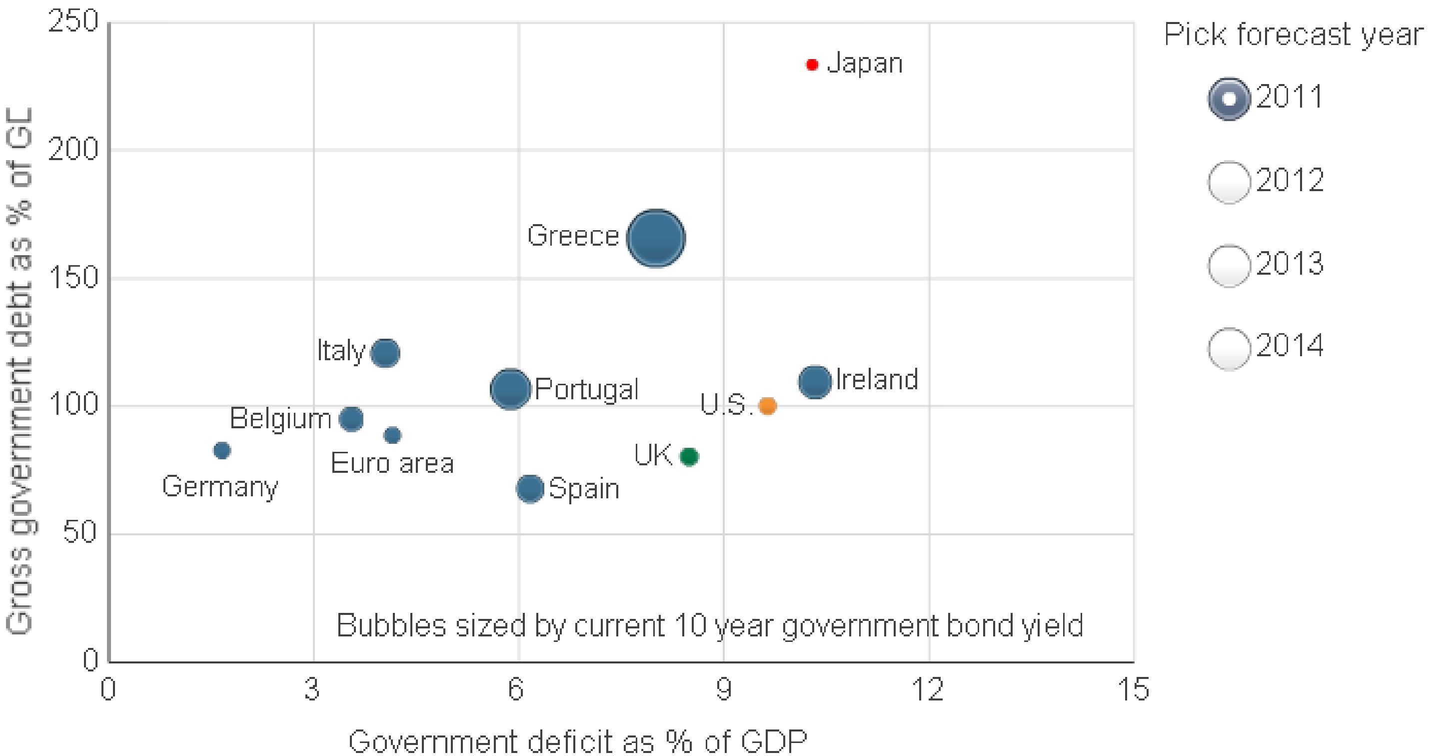
# Deteriorating fiscal balances are only a symptom

## Government debt, deficits and bond yields

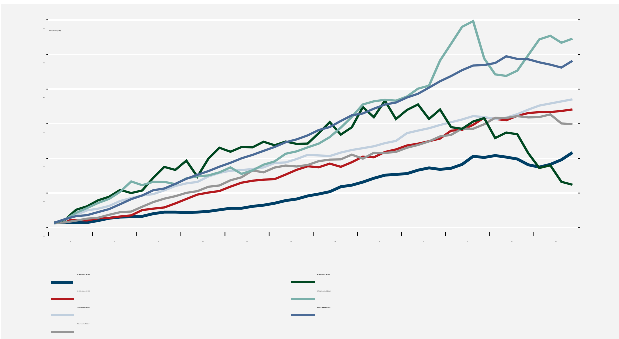


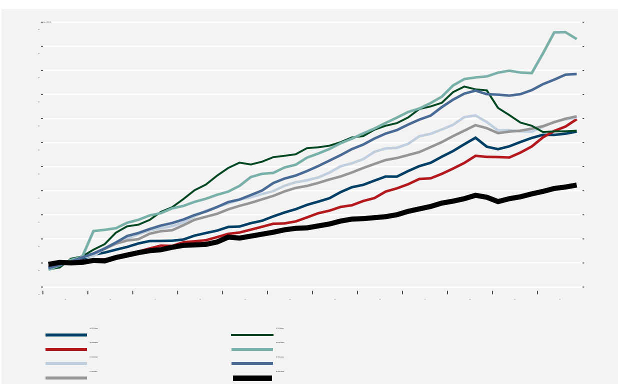

Sources: Thomson Reuters, IMF World Economic Outlook

REUTERS

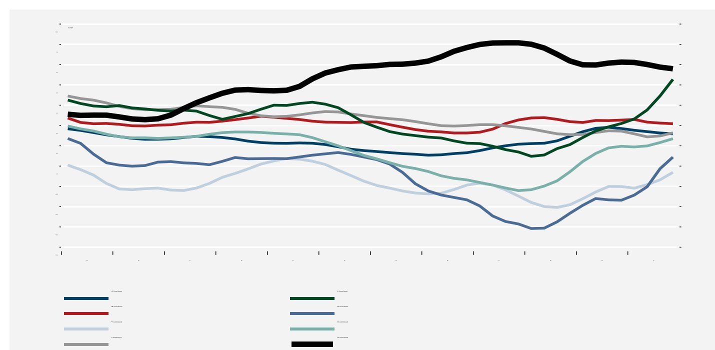


# ULC and CPI have risen, but external balances have deteriorated

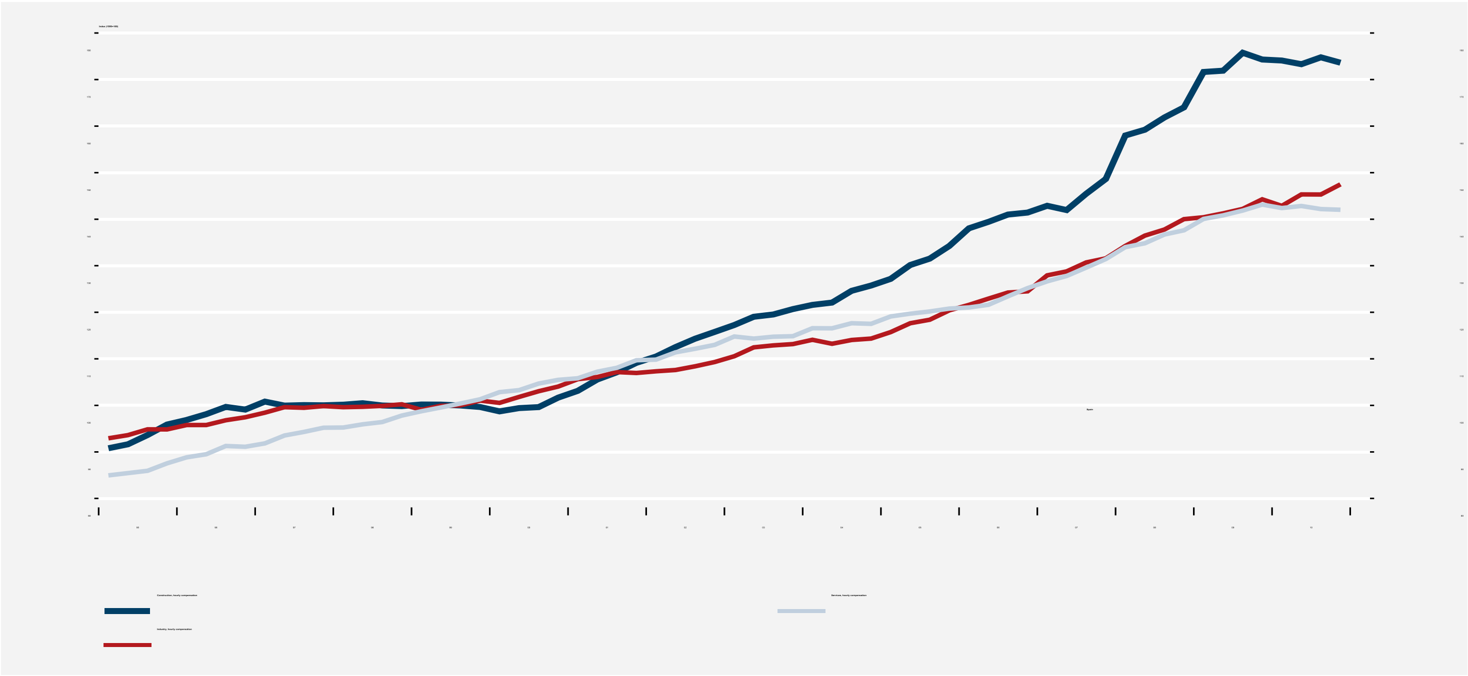




- According to the universally accepted, however empirically elusive, hypothesis of Balassa-Samuelson, nations that catch-up (in terms of welfare) do so via increased productivity in the export sector, which in turn spreads throughout the economy into domestic sectors.
- But in the case of the PIIGS and some other countries, improving welfare is driven by domestic sectors, often construction (c.f. Dutch disease/Triffin dilemma).

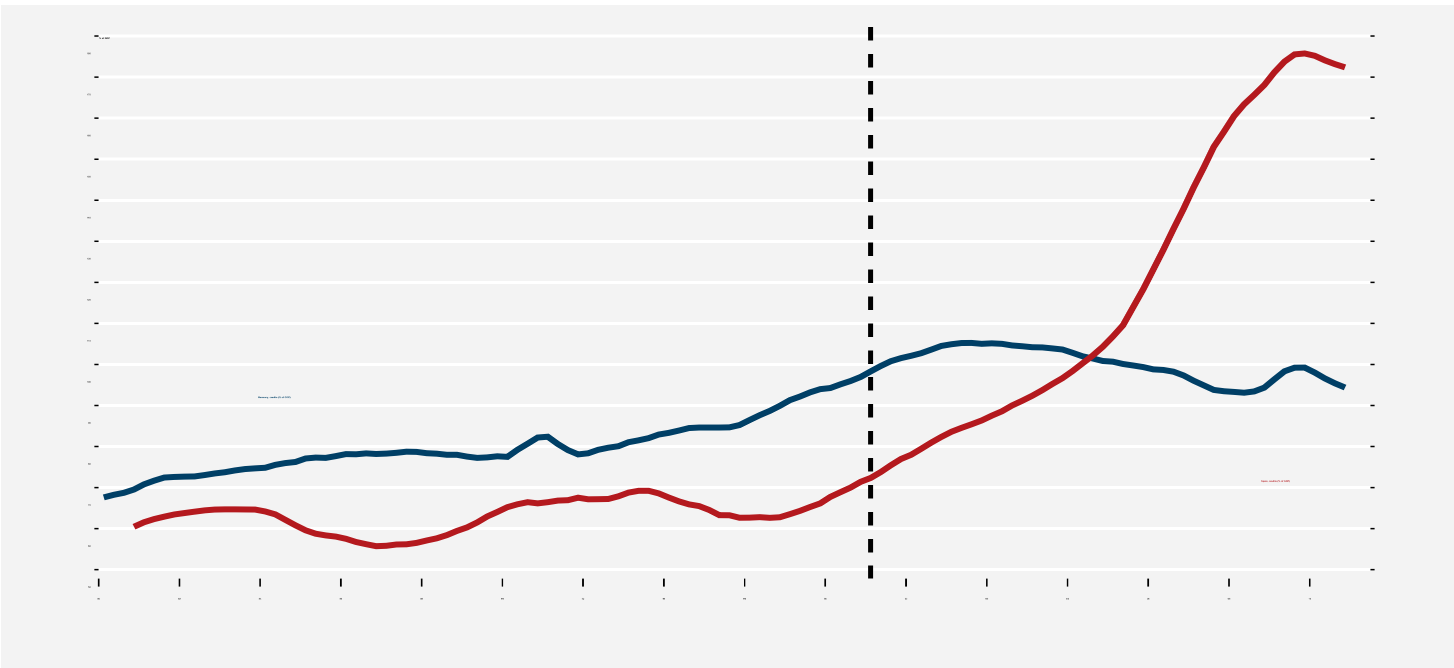


# It is *not* the exports industry that makes ULC tick

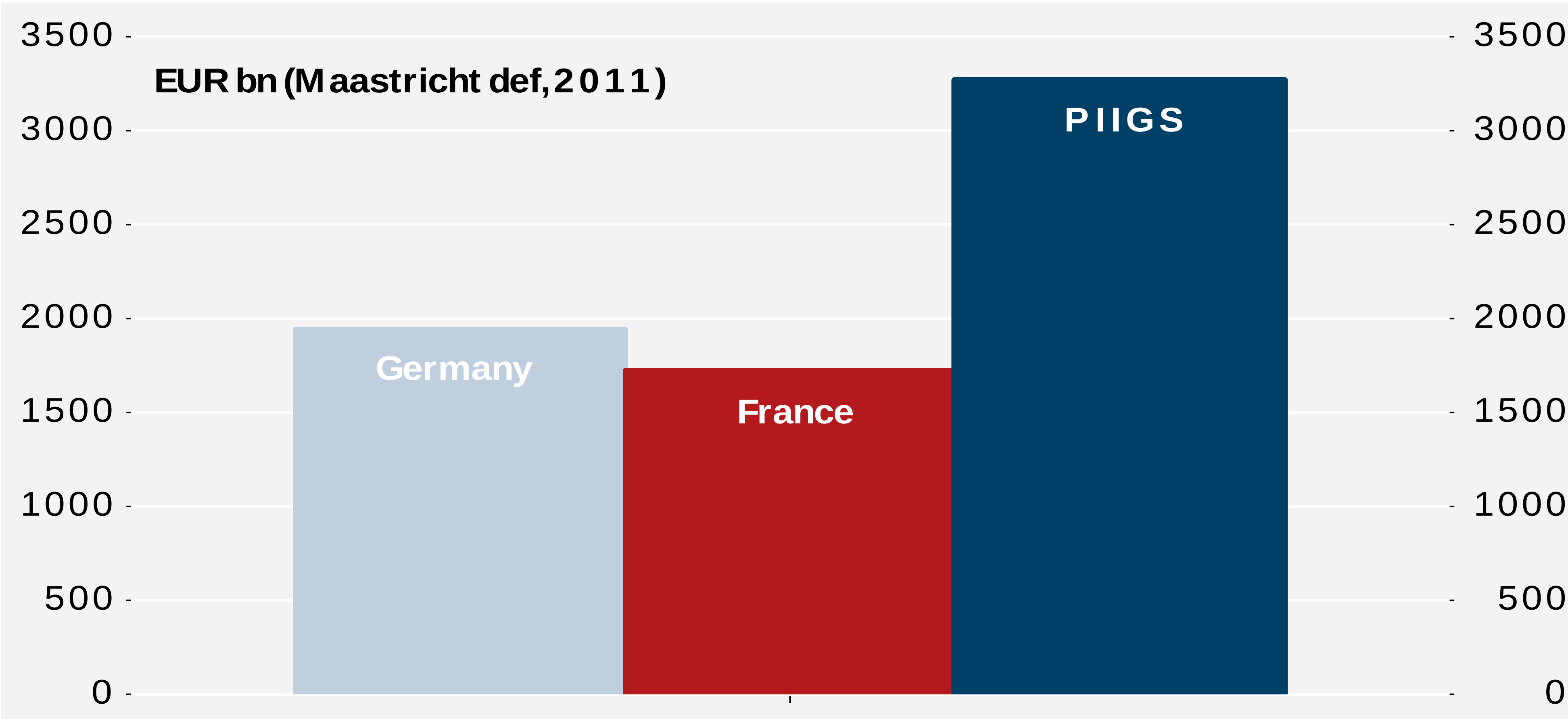




# The extreme potency of monetary policy



# What Germany is expected to take on…



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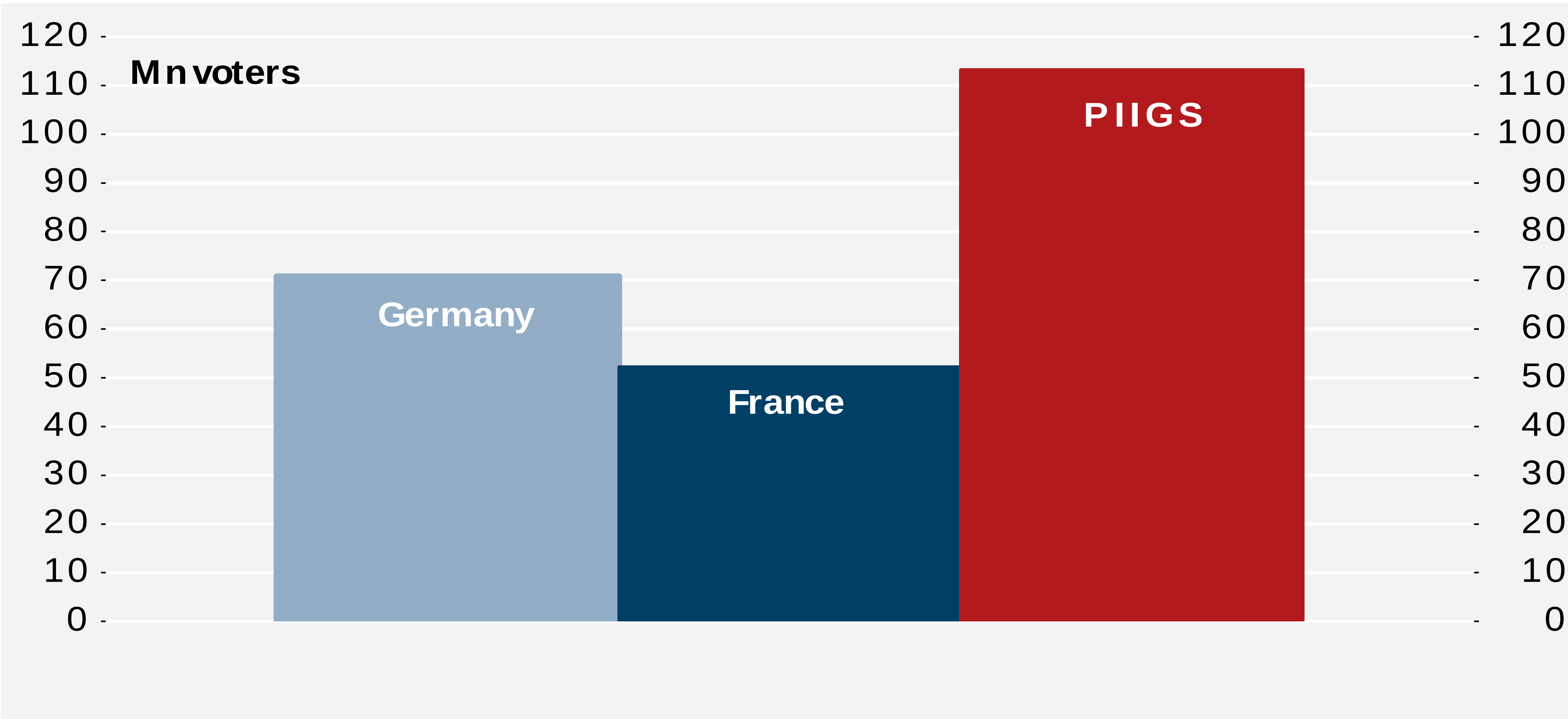
# The virtues of the few does not measure up to the vices of the many



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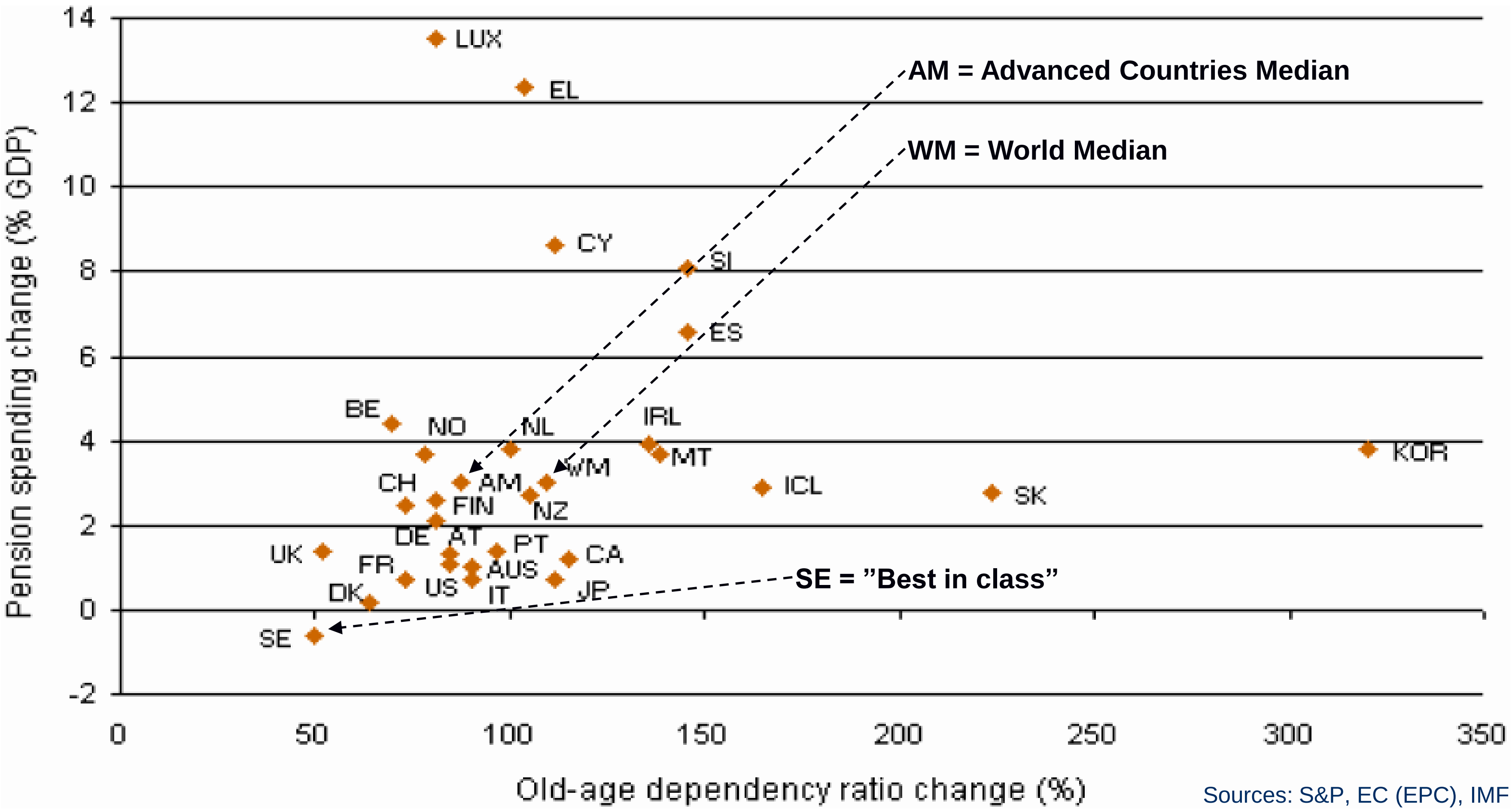
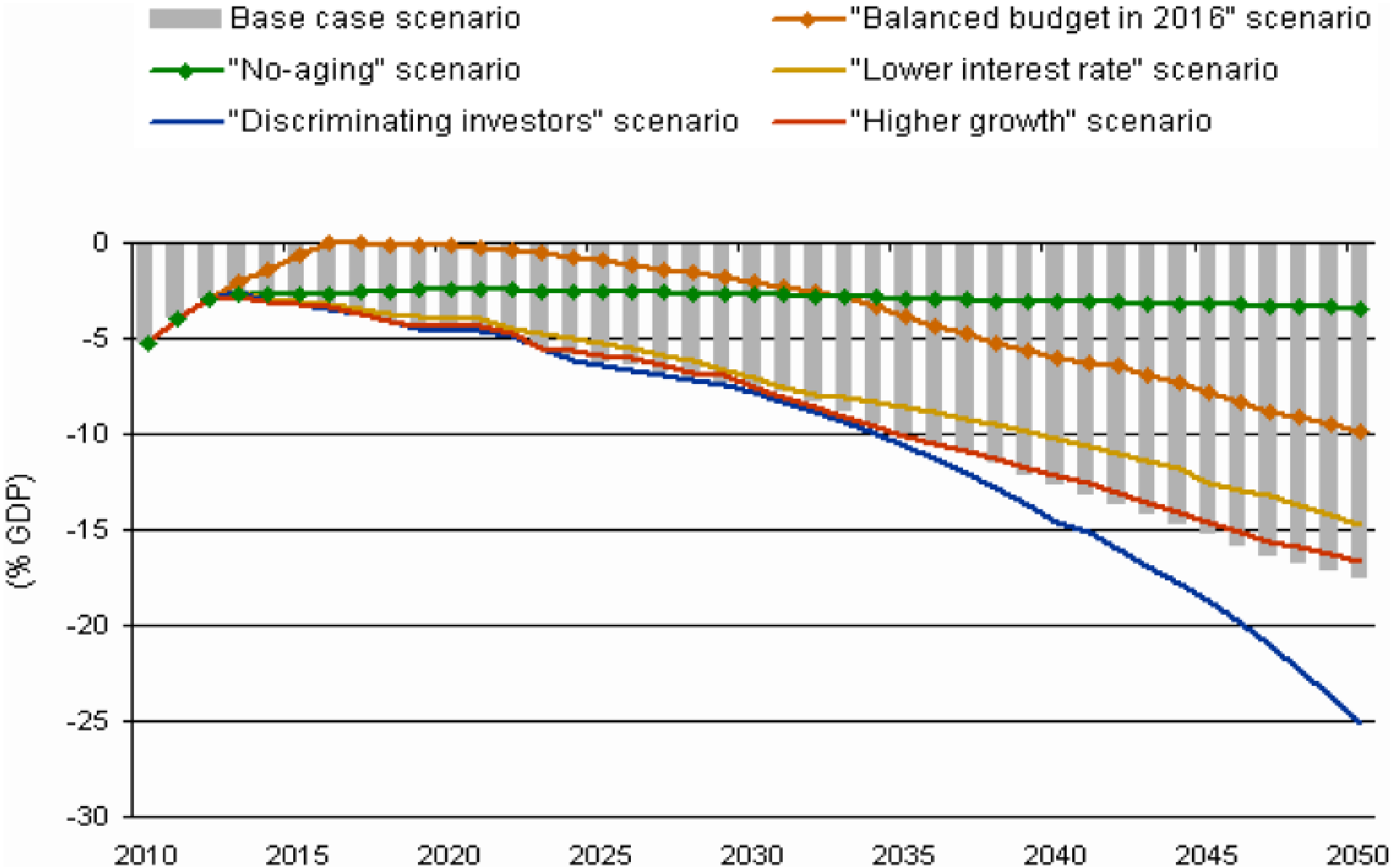
# A future painted in gray – Sweden best in class




Sources: S&P, EC (EPC), IMF and UN

# Diagnosis: ”Lacuna elephantiasis”




Source: S&P,”*Global Aging 2010: An Irreversible Truth*”



## ” *I have never promised anything but blood, sweat and tears*”

**–W. Churchill**

### Average primary balance required to stabilise the public debt/GDP ratio at the 2007 level[1]

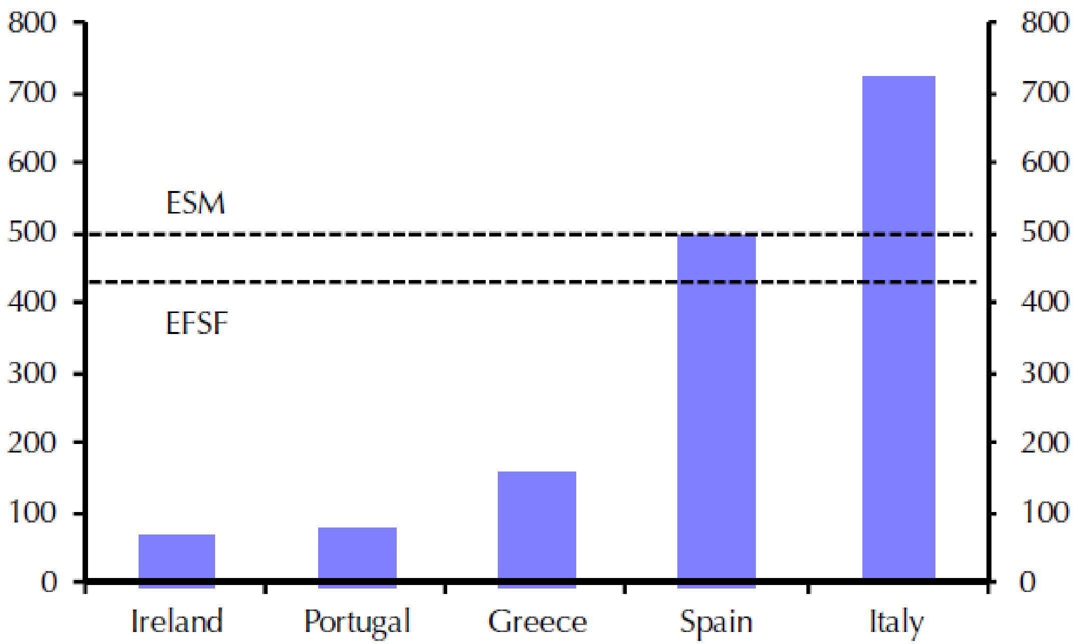
| | Over 5 years | Over 10 years | Over 20 years | *Memo: Primary balance in 2011 (forecast)* |
|---|---|---|---|---|
| Austria | 5.1 | 3.0 | 2.0 | *–2.9* |
| France | 7.3 | 4.3 | 2.8 | *–5.1* |
| Germany | 5.5 | 3.5 | 2.4 | *–2.0* |
| Greece | 5.4 | 2.8 | 1.5 | *–5.3* |
| Ireland | 11.8 | 5.4 | 2.2 | *–9.2* |
| Italy | 5.1 | 3.4 | 2.5 | *0.0* |
| Japan | 10.1 | 6.4 | 4.5 | *–8.0* |
| Netherlands | 6.7 | 3.7 | 2.3 | *–3.4* |
| Portugal | 5.7 | 3.1 | 1.8 | *–4.4* |
| Spain | 6.1 | 2.9 | 1.3 | *–6.6* |
| United Kingdom | 10.6 | 5.8 | 3.5 | *–9.0* |
| United States | 8.1 | 4.3 | 2.4 | *–7.1* |

[1] As a percentage of GDP.

Source: BIS Working Papers No 300:”The future of public debt: prospects and implications”. Auth.:Stephen G Cecchetti, M S Mohanty and Fabrizio Zampolli

# …Only ECB can measure up…

**Chart 3: Gross Govt. Finance Needs (€bn) (To Dec. 2014)**




**Sources – Bloomberg, Capital Economics**

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# ”Big bazooka” solutions?

1. **External devaluation**. *Euro-break up*. Large costs – pension capital and banks will be wiped out by the stroke of a pen. Severe recession that might turn into depression. *But*, no “lost generations” taking to the streets. Opens the option to “*Try again, but try harder*”

2. **Internal devaluation**. *Requires depression* and will lead to a large upward and perhaps (clearly!) unsustainable upward shifts in both deficit and debt ratios. Will, hence, necessitate a future restructuring of debt. Fattomable *iff combined with a fiscal union*, under strict and automatic penalties for sinners. Will also take time, even though the maxim ”*pacta sunt servanda*” might hold. Demand coordinated actions both within Euroland as well as globally. *Requires large scale ECB-purchases of government bonds*; Very large event risks, i.e. hyper inflation (fiat currency anchor is public finances)!



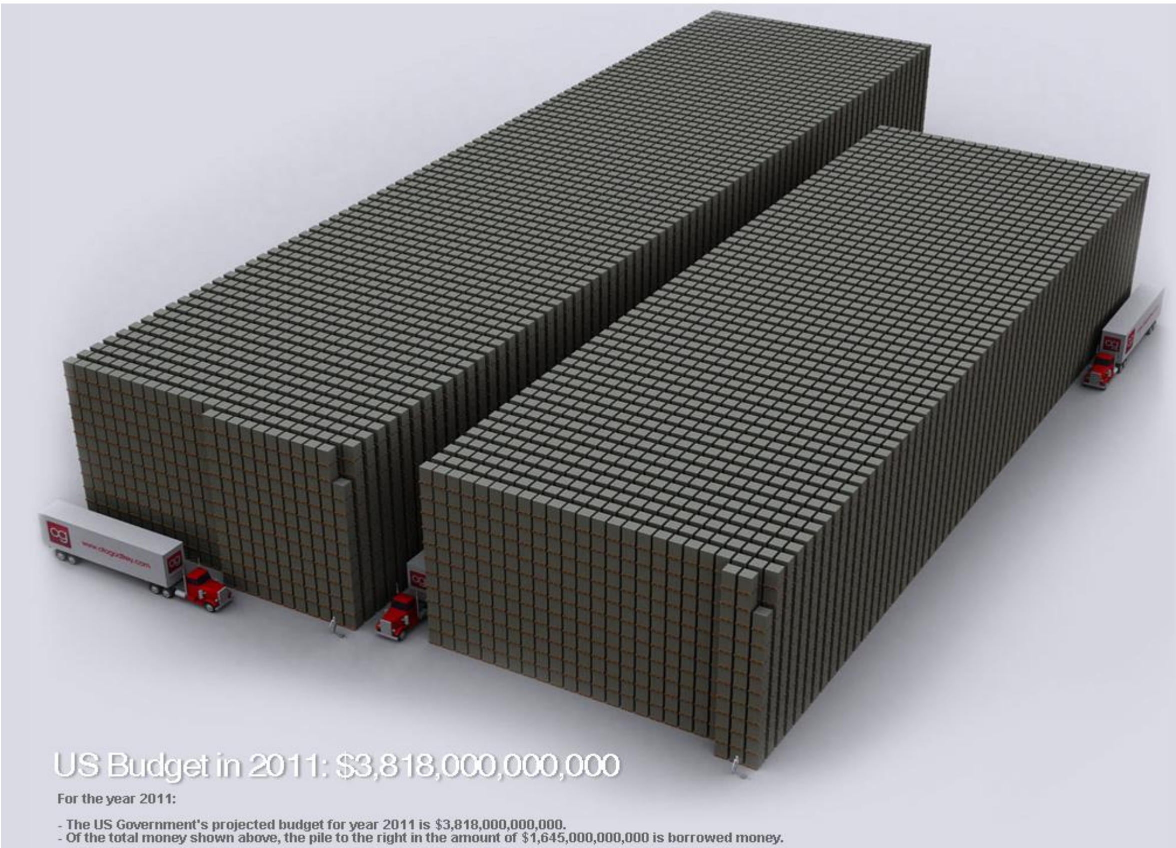
# Trading a crisis

- Don't speculate! – concentrate on operations (inventories, personnel). Hedge currency and interest rate exposures
- In an acute crisis the liqudity premium sky rockets rendering most asset classes illiquid and unsellable. The Krona and all Swedish assets will in an acute crisis suffer against USD, GBP, CHF (?) and JPY. EUR will be the epicentre of the early stages of a renewed crisis and chances are that EUR/SEK would fall. Currencies *en preference* is USD and JPY
- Under most circumstances, global interest rates *should* come down, but credit premias will rise and note that access to capital might, at best, be scarce. Event-risk of hyper-inflation (primarily) in Euroland
- Once through the acute stages of the crisis, the SEK (and NOK) will appreciate dramatically due to the fundamental strength of these two economies. (The new FIM and a realigned DKK should go the same way)



# Summary

## “*...speaks more than a thousand words*”


US Budget in 2011: $3,818,000,000,000
For the year 2011:
- The US Government's projected budget for year 2011 is $3,818,000,000,000.
- Of the total money shown above, the pile to the right in the amount of $1,645,000,000,000 is borrowed money.


114.5 Trillion Dollars


"Due to a change in its orbit, the giant asteroid destined to collide with earth today is not expected to hit until Monday. World stock markets rallied on the news."