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Market Strategy

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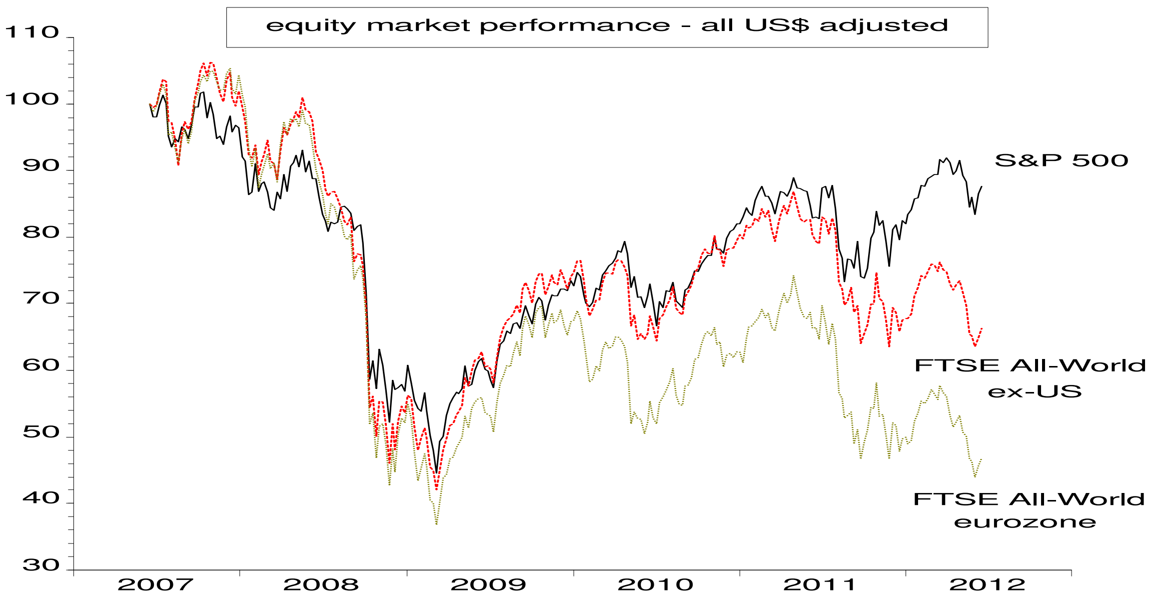
INVESTMENT RESEARCH
18 June 2012

A Greek moment, or a eurozone moment or a market moment?



Source: DATASTREAM

Financial markets were right not to welcome the result of Greece's election with elation but are they right in giving it the thumbs down? The initial and more cautious welcome seemed more appropriate. The election of New Democracy and what is set to be a pro-bailout government is a favourable outcome of sorts for the eurozone though the hardship is far from over.

Mr. Samaras and the government he will try to form intend to renegotiate the terms of Greece's bailout. Unlike SYRIZA though, the starting point is not a hostile rejection of them. A government led by New Democracy intends to work together with Greece's eurozone partners in the hope of easing the harshness and pace of fiscal adjustment that have left Greece in depression. You might have thought that the risk of a Grexit and contagion has diminished but, judging by their action, the markets are not for buying it – just yet.

Germany of course lost no time in welcoming the victor of Greece's election with a reminder of its hard line on fiscal austerity. That said, Mrs. Merkel's government recently indicated a readiness to make limited concessions on Greece's austerity programme, conditional, that is, on a new government's commitment to the substance of the bailout programme.

More importantly, Mrs. Merkel is to meet Messrs. Hollande, Monti and Rajoy, a troika themselves of 'pro-growthers', this coming Friday to consider what might constitute a 'credible package of growth measures' along with other issues for consideration at next week's EU summit (June 28 and 29). This Friday's meeting could be of far more significance for the markets than the two day meeting of the G20, which starts today in Mexico.

Germany, France, Italy and Spain represent more than three-quarters of the eurozone with France, Italy and Spain being half of it. Mrs Merkel will thus be facing off with her most powerful eurozone partners, meaning that she will be unable to ignore their unified pro-growth front. Germany has little choice but to show conciliation towards the uncompromising and counterproductive regime of fiscal austerity. It has little choice but to help spur the eurozone's policy makers into accelerating the action required to push back the 'large black cloud of uncertainty' to which the Governor of the Bank of England recently referred.

In fact it was ECB President Mario Draghi who said it all last week; '...no eurozone country faces an inflation risk, which is the bank's main concern.' Are the markets not saying this too? If it is fiscal austerity that is first and foremost and not growth, Greece alone will not be in depression.

Equity markets will see to this by their volatility and while the major central banks are still likely to remain on standby to help stabilise financial conditions, that black cloud of uncertainty will inhibit spending, employment and demand for credit, no matter how available the Bank of England makes 'Funding for Lending'. The pressure on Germany is mounting. This is where the finger will point if the stability of the global economy continues to be put at risk by austerity first.

As for this week's economic news, the focus will be mainly on the Bank of England and the Fed. Wednesday's release of the MPC Minutes is likely to confirm the view that further monetary easing will come sooner rather than later. As for Wednesday's FOMC meeting, this will also be accompanied by the release of the Committee's economic projections. As things stand, the members of the FOMC do not appear to be on side for more QE but an extension of Operation Twist is a likely prospect.

Until now, Germany's message has been that the Lady's not for turning but the likelihood is, that she is. The troika of pro-growthers will help see to that. Moreover, equity markets are likely to back them – and of course the Fed. The chart shows that the S&P 500 has the look of a market wanting to go only one way!

IMPORTANT NOTES

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