Eurozone crisis - bust to boom in 2013?

BR RESEARCH (January 07, 2013) : As Europe enters the fourth year of its sovereign debt crisis, the fundamentals underpinning the euro appear weaker than ever. Despite the actions of the European Central Bank (ECB) and the few steps forward taken by political leaders in CY12, the political will to address the crisis meaningfully still does not exist. The World Bank has gone so far as to say that the EU would be lucky to register any GDP growth at all in CY13. Leaders hesitancy and the deep differences between them is only one of many deteriorating fundamentals that bode badly for the single currencys future. The EU Leaders Summit in Berlin in mid-December illustrated the shambles of political will in the region where backsliding characterised discussions and outcomes. Investors perceive this as a severe threat along with severe ongoing recession in the peripheral economies. Cyprus, Italy, Portugal, Spain and Ireland all stand at risk of following Greece into sovereign default. After a turbulent CY12, it is difficult to predict where the next flashpoint for euro-crisis will emanate from. One of the primary suspects is Irelands ability to exit its EU-IMF bailout on schedule. Paying down personal and corporate debt will likely grind on even beyond CY13, thus dampening consumer spending and corporate investments. The course of evolution taken on by public finances - the weakening trend in tax revenue growth and the need to arrest overruns in health spending - will be a key determinant of Irelands ability to meet the scheduled completion of the three-year bailout in December this year. Cyprus is another potential threat to stability of the Eurozone with its collapsing banking system and exploding public debt. After six months of discussions, a bailout is expected to be formally agreed once a new president takes office in February. European authorities have shown strong resolve against "moral hazard" by allowing the possibility of letting one or more financial institutions fail - the first case since Lehman Brothers. Though correct in principle, panic could be triggered in Europes highly fragile financial system. In Italy, it is amazing to note that the potential return of Berlusconi is not the worst that could happen. The six percent increase in the debt-to-GDP ratio in the first six months of CY12 are indicative of the lack of willingness and ability of Italian politicians to cure the chronic malaise that has afflicted the economy since the 1990s. On the Iberian Peninsula, the crisis is marked with dropping property prices, sharp contractions in the Spanish and Portuguese economies, increasing unemployment rates, and ever-growing banking losses. Forward-looking indicators do not point to stabilisation, never mind an immediate return to growth. Questions to the solvency of the state will not take long to come back to the table if drastic changes to not hinder the persistence of these issues. European leaders quelled the fever pitch on the Grexit in mid-2012 with a significant deal on loans given to Greece. However, lack of political will in the country points to talks returning to the forefront in 2013 - a contraction in the economy, or a lack of compliance with tax and spending commitments could easily turn the clock back for the euro-crisis agenda. On a Euro-wide scale, expectations of a deal entailing the complete severance of the link between the sovereign and future additional bank losses are overplayed - the biggest drag on the economy (i.e. paying down private debt) would still continue. Investor sentiment has turned quickly and dramatically over the last three years, and governments will not find it easy to raise necessary funds. The future of the single currency seems as uncertain as ever. The ECB may broker short-term saving grace deals, but in the medium- and long-term, political legitimacy must come from political decisions of historic proportions. Based on what was seen in 2012, don hold your breath for any of that happening in 2013.