Volcanoes and Greeks cause havoc

Global economic update: May 2010

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Major events, whether man-made or forces of nature, remind us of how vulnerable this fragile recovery remains. Such events damage confidence levels and investor sentiment.

During the last month, offshore markets and economies have been dominated by Greek developments and more recently the havoc caused by ash spewing from a volcano in Iceland.

The cost of Eyjafjallajokull

It is impossible to work out the impact of all the flight cancellations on the European economy due to the eruption of Eyjafjallajokull, one of Iceland's many volcanoes. Costs will only be counted once the ash has dissipated and flights return to normal. It is currently estimated that 0.05% of European GDP is lost each week the disturbance continues – this excludes the millions of dollars airlines are losing each day.

South African exporters, especially those exporting perishables such as flowers and fruit, are feeling the pinch and there is a concern about the arrival of tourists for the FIFA World Cup™ in less than 40 days.

What is also of concern is that Eyjafjallajokull is only a dress rehearsal for the eruption of Iceland's most dangerous volcano: Katla. This volcano erupts once every 100 years and the last eruption was in 1918. Volcanologists believe Katla is due for a spectacular show. European authorities need to use this experience to prepare for what will undoubtedly be a far greater disruption to global travel when, not if, Katla erupts.

Debt burdens drag down Europe

A lot of attention has been placed on the so-called "PIIGS" referring to the **sovereign (government) debt concerns** in Portugal, Ireland, Italy, Greece and Spain. Governments have built up a lot of debt in maneuvering their economies out of recession. Quite a few of them had high levels of debt before the global recession began, so the crisis only made their debt dilemma worse.

Although funding has been made available for some of the struggling economies, it will take many years for the debt positions to be brought fully under-control. During that time, onerous debt payments will need to be made, and strict cuts in spending will have to be enforced.

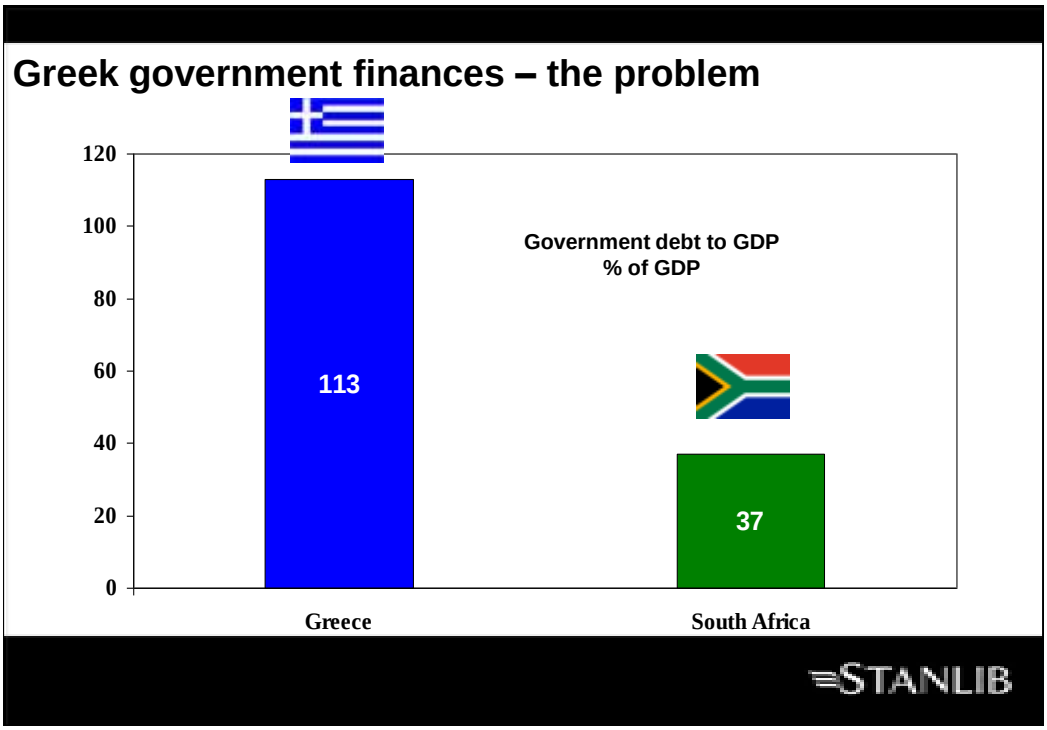
The trouble with Greece

The Greek economy is roughly the same size as South Africa's, although we have a lot more people. Total Greek government debt is over 113% of GDP (gross domestic product) – in other words, even if the Greeks used every cent generated in their economy to pay their debt, it would take over a year to pay it back. In comparison, South Africa's debt levels are at 37% (see graph below.)

The international guideline is that government debt should not exceed 60% of GDP.

Due to their large debt, Greece needed to raise over 11 billion Euros just to fund repayments during April and May, and another 20 billion Euros by the end of the year. There has recently been a substantial sale of Greek government bonds and, because people are only prepared to buy these bonds if the yield (interest rate) paid by government is much higher, it will cost the government a lot more to raise the necessary funding.

Thankfully, the EU (European Union) has indicated that they will provide additional funding, should it be required, and together with the IMF (International Monetary Fund) a total of 45 billion Euros has been made available to Greece. The markets are still quite jittery and speculation has increased, as perhaps there is now more recognition of how poor the underlying Greek financial position is.



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