

THE HUFFINGTON POST

THE INTERNET NEWSPAPER: NEWS BLOGS VIDEO COMMUNITY



Georges Ugeux

Chairman and CEO, Galileo Global Advisors

Posted: May 14, 2010 12:55 PM

Why it Is Not Smart to Short the Euro



As of today the Euro has fallen below \$1.25, its weakest level since November of 2008.

The fact that Greece saw its two year bond yield go from 2% to 18% in six months was probably one of the most dramatic sovereign bond events in recent years. Last Friday, things looked pretty desperate. But Greece is not the issue.

As the six months unfolded, it became conventional wisdom that the Europeans would not get their act together, so better short the Euro and the Euro sovereign bonds. Even the notion of a bankruptcy of Greece was broached, which is nonsense for countries: they restructure their debt but never go bankrupt. This is part of a common view prevailing in the United States, where European bashing is as widespread as it is uninformed. Even Paul Volcker does not exclude a breakup of the Eurozone. This, of course is all based on a misunderstanding of the Eurozone.

The first prediction was that Greece would leave the Euro. That idea ignores a very simple fact: the Euro does not have an exit mechanism. Once a country chooses to adopt the Euro it cannot go back to its national currency and the Eurozone has no power to exclude any European nation from said economic and monetary union.

If that is not enough, let's remember the facts: It took three years to execute the colossal task of changing currencies into Euros. A change of currency does not happen overnight. The Euro is essential, and the current decision reinforces the European common currency.

More importantly, the purpose of the Euro is not to become a reserve currency, but to facilitate the intra European trade which represents 80% of the EU's international transactions.

Granted, the European Union and the Eurozone leadership were hesitant and diverged on their assessment of the solidarity they had accepted by having a common currency. The German wakeup call was particularly striking. Chancellor Angela Merkel was torn

between winning a key regional election with the help of voters in Renania Westfalia (she lost for a number of reasons, including her acceptance of the Euro rescue plan) and the increased awareness that there was no other option than launching a support package to Greece. She courageously but belatedly decided for the latter, with President Sarkozy leading the initiative.

The European Union decided to put together a stabilization fund under the form of a Special Purpose Vehicle (SPV) and inject \$ 625 billion to support troubled economies. A mini-IMF for European countries in a sense, but a substitution for the IMF it is not.

As Dominique Strauss Kahn said on Thursday, "the Eurozone nations should establish a mechanism to allow for cross-border fiscal transfers between member nations in order to avoid a repeat of the recent crisis."

The stabilization is more than just a financing mechanism. It includes a budgetary system that will provide Europe with the ability to review country's budgets before being adopted by their national parliaments. As controversial as this measure is in Europe, it is an indispensable way to limit the exposure of fund to crisis.

The plan has its critics. Is the size sufficient? Comparing the size of the SPV to the needs of gross issuance and the needs of the countries is incorrect. The fund does not aim to be the only financing source. The countries in difficulty will be able to continue to borrow on the capital market.

Replacing debt with debt is not wrong: the issue is who is taking the risk. It is about risk sharing among partners who have the same central bank and the same currency. The SPV should command a AAA rating and borrow at better conditions than individual countries. . .with the possible exception of Germany. The loans they will receive from the SPV will decrease their borrowings on the public markets. Both movements will reduce the interest rates for the borrowing countries.

The devil is in the details, and we do not know them yet. Europe eventually did the right thing after having explored all other avenues. The Governance of Europe has to change, but this is a major step in the right direction. Beware of shorting the Euro. After all, the dollar is not in great shape and neither is the US budget deficit.