

In this period of relative calm – notwithstanding yet incomplete negotiations on Greek debt and growing concerns about Portugal – we wonder if the European leaders are really using the respite achieved for them by the ECB to plan the steps needed to achieve what Merkel calls a “fiscal union” and we call a “federalised structure”. We can only wonder, as whatever negotiations are taking place are far from transparent, all part of what Nigel Farage (EuroMP from the UK Independence Party) calls the “anti-democratic” operation of the European Union. Merkel made a speech this week about the latest EU summit, but listening to it provides no concrete information.

Let us nevertheless suppose that our leaders are actually doing something. That allows us again to compare and contrast the current US and European politico-economic policies. Both are meant to restore growth and confidence, but in virtually opposite ways:

- the USA is enjoying a cyclical and short-term recovery, based on low interest rates and high money supply. The long-term issues of budget imbalance and future obligations for social security and health care remain largely unaddressed (although military spending is being cut back). There is no fundamental structural problem in the USA: the labour market is extremely flexible and entrepreneurship is encouraged and thrives
- the EU is, or close to, recession, mainly because of the austerity programmes imposed by virtually all national governments. Internal and external budgets are in reasonable balance for the EU as a whole, while the imbalances of greatest concern are between members of the euro zone. Europe has massive structural problems, ranging from the absurd labour laws in Spain with two-thirds of employees on inflexible permanent contracts and one third on temporary contracts, through to generalised tax avoidance in Greece and an anti-entrepreneurship bureaucracy in France

The USA is addressing short-term issues, while acting like the proverbial ostrich on the long term. Europe is (we hope!) dealing with the long term while allowing, even encouraging, short-term economic hardship. To ask which approach is the better is akin to choosing between the devil and the deep blue sea. Neither approach is attractive. Markets probably lean towards the short-term US approach, but are clearly worried about the absence of a long-term US solution to “entitlements” and all the rest. When Paul Volker, the saviour of the world from 1970s inflation, says that “there is no question that confidence in government is shaky”, he is stating in gentlemanly terms what everyone feels, viz. that our governments are not really up to facing the problems created on both sides of the Atlantic by lax budgetary and monetary control (albeit in different ways), together with poor regulation.

Our reticence over bank paper has to be softened, at least in the short term. The ECB’s intervention has not only given respite to politicians while they try to restructure Europe, but also returned confidence in the banking system. That has allowed banks to issue debt, not least to replace the earlier issues of government-guaranteed debt now reaching maturity. It solves a short-term problem, but in an echo of the USA’s leaving long-term issues unaddressed, does nothing to resolve the need for higher capital to asset ratios.

How interesting it will be to see how French banks react to Sarkozy’s “Tobin Tax”.

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- **USA:** at a 2.80% annual rate GDP grew less than expected in Q4 on weaker personal consumption, following a 1.80% gain in Q3. Consumer spending as per the Conference Board stalled in December and consumer confidence unexpectedly fell in January (from a revised 64.8 to 61.1). However consumer sentiment as measured by the UoM Index painted a more positive picture, rising from 69.9 in December to 75.0
- **Fed:** Bernanke set an inflation target for the first time (2%), achieving one of his main goals as Chairman of the Fed. Aiming at greater transparency, the FOMC committee released details of individual members' forecasts for the Fed funds rate, thus highlighting the differing opinions of members. The Fed fund rates are likely to remain at current levels at least through late 2014
- **Germany:** unemployment fell to a 20-year low in January, to a seasonally 2.85 million. Retail sales unexpectedly declined from November to December by 1.4%. Lawmakers re-opened the Soffin bank-rescue fund, while the lower-house voted in favour of legislation to revive the fund and arm it with €480 bln
- **Greece:** negotiations are continuing between the Greek government and private bond holders on a debt swap. The latest update suggests a GDP based sweetener could result in bondholders accepting a coupon as low as 3.60% on a new 30-year issue. Germany, with support from the IMF, has led demands for a bigger debt write-down by investors (holding €40 bln of Greek debt) and tighter budgets by the Greek government
- **Europe:** confidence in the economic outlook improved, but only slightly: from a revised 92.8 in December to 93.4. Services and factory output strengthened in January, rising to a five-month high of 50.4, led by strong German performance. Spanish unemployment rose to 22.90%, the highest level in 15 years. Data from the Bank for International Settlements show international banks cut their loans to fellow lenders and governments in Italy, France and Spain in Q3, hoarding German, Japanese and U.S. bonds instead
- **UK:** David Cameron suggested it would be madness to consider a Europe wide tax on financial institutions and called on EU leaders to focus on a fix for the debt crisis, not least because UK exports are handicapped so long as the UK's largest trading partners' debt woes remain unresolved. The IMF cut its 2012 UK growth forecast from 1.60% to 0.60%. Ernst & Young expect the UK economy will contract again in Q1, which would produce its first double-dip recession in more than three decades
- **Switzerland:** the KOF economic indicator fell to the lowest level in more than two years in January, to -0.17 from -0.01 in December