Sovereign debt outlook grim: analysts

Jonathan Chevreau, Financial Post · Monday, Oct. 25, 2010

TORONTO -- The global economy "isn't even close" to being out of the woods on sovereign debt, two speakers told an investment conference Monday at the Toronto Board of Trade.

Alex Jurshevski, founder of Recovery Partners, and Beat Guldimann, founder of Tribeca Consulting Group and former head of UBS Canada, distributed a co-written paper titled Sovereign Debt – Reality Finally Hits. A version presented recently by Guldimann to clients of Weigh House Investor Services reportedly "scared" attendees who heard it. Interest was similarly high Monday at the ExchangeTradedForum2010 conference otherwise focused on ETFs.

In recent decades, only two of 140 attempts at fiscal consolidation were successful, Mr. Jurshevski said, defining success as reducing the debt/GDP ratio by 10%. The two successes were New Zealand in the mid 1990s and Canada shortly after that.

Every major sovereign state was hugely indebted after the Second World War but the current situation after the 2008 financial crisis is "very different," the paper says.

"The prospects of growth in the major global economies are dim and the structural issues that need to be dealt with are so immense that overcoming them appears to be close to impossible."

The current crisis is global but both speakers are particularly concerned about the United States (and relatively upbeat about Canada and its banking system). Solving these problems will take more time than most electoral cycles permit, making it tough to maintain public support to keep needed austerity programs going. A canary in the coal mine may be the reaction of French workers asked to delay retirement until age 62.

Too many nations are trying to do the same thing at the same time, Mr. Jurshevski said: using currency devaluation to make exports competitive, while trying to drive economies with soft currencies and strong current account balances. "Everyone can't devalue at once but the problem is the U.S. government's policy of quantitative easing is based on exactly that."

Five developed economies are dealing with aging populations, shrinking workforces, more retirees and an eroding tax base that makes it hard to dig out of the hole, Mr. Guldimann said. By contrast, emerging nations have much lower debt/GDP ratios and are almost absent of structural deficits. "They have already emerged and are in better shape demographically and fiscally."

Mr. Jurshevski said it's arguable the United States is technically insolvent but no one is talking about changing how they do business. He believes there will be "several defaults by sovereign countries" in the next decade: perhaps Greece, other PIGS countries, Iceland or former members of the Soviet Union. Some German towns don't have the money to fix potholes because of the obligation to bail out Greece, so there are growing calls to leave the euro and return to the Deutschmark, Mr. Guildimann said. Crossborder flows of European sovereign debt are “absolutely staggering,” Mr. Jurshevski said, pointing to $1.4-trillion flowing between Italy and the rest of Europe.

Europe enjoyed 50 years of rich pensions and benefits because it didn’t have to worry about security supplied by the United States, Mr. Jurshevski said. But U.S debt has skyrocketed in the past three years and the Fed’s attempts to solve the problem by printing more money are failing. The official list of insolvent U.S. banks is just 775 out of a total 7,900, but the real number is closer to 2,300, he said. “There’s a sovereign debt problem in the U.S. as well because of this but the tonic the Fed is applying isn’t working this time.”

Because more people don’t trust paper money, many Americans are stocking up on silver coins and firearms, Mr. Guldimann said. In a Q&A, it was suggested Fed chairman Ben Bernanke has clearly chosen inflation over deflation but time didn’t permit any investment recommendations.