

A Whirlwind of a Week

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Last week, members of the 17 nation euro zone unanimously approved an agreement on the European Financial Stability Facility (EFSF). This action was aimed at safeguarding the stability of the euro currency by preventing the debt crisis in Greece from engulfing larger economies, such as Italy and Spain.

European leaders agreed to a 3-part deal to attempt to stem the sovereign debt crisis. First, they got a consortium of private banks to agree to accept a 50% write-down in the value of their Greek debt holdings. Second, they agreed to significantly expand the size of the European Financial Stability Fund (EFSF) to €1 trillion. Finally, the leaders committed to shore up the capital of banks that are having trouble accessing the private market. Terms of the rescue package call for €100 billion of bailout funds for Greece that will be backed by EU nations and the International Monetary Fund. Including the €30 billion contribution to the deal from bondholders, the total cost of the bailout for Greece comes to €130 billion.

The agreement on the EFSF was initially greeted positively by markets. On the day of the announcement, the Dow Jones climbed 340 points. This optimism, however, was short-lived.

Late Monday evening, Greek Prime Minister George Papandreou stunned investors, as well as his own citizens and his partners in the euro zone. He announced that a referendum would be held in what he called "a supreme act of democracy and of patriotism for the people to make their own decision."

Papandreou hoped to use the referendum both to improve the terms of the bailout and to win buy-in from voters, who up to now have shown strong aversion to further austerity measures.

After Prime Minister Papandreou's referendum announcement, the markets experienced a sharp decline. In the two days following the announcement, the Dow Jones declined by 2.26% and 2.48%, respectively.

In yet another twist, earlier today, the Associated Press reported that Greece has canceled plans to hold a referendum. They are now willing to accept the EFSF terms. During his speech, the Prime Minister also ignored widespread calls for his resignation and instead invited the opposition to join negotiations on the bailout. He told an emergency Cabinet meeting that early elections would force Greece into leaving the 17-nation euro currency. This could prove disastrous for both Greece and other European economies.

In domestic news, the Federal Reserve completed its two-day policy meeting. The Fed issued a slightly better outlook on the economy, but made no additional moves to stimulate growth. In fact, the central bank voted 9-to-1 to make no changes to the Fed's ongoing stimulus program, and maintain its pledge to keep interest rates at record lows "at least through mid-2013."

On the positive side, the Fed indicated "economic growth strengthened somewhat in the third quarter, reflecting in part a reversal of the temporary factors that had weighed on growth earlier in the year." Additionally, the Fed also noted household spending has increased at a faster pace recently, with business investment also expanding.

However, the Fed noted that the housing market continues to be a drag. Other risks to economic growth, including strains in global financial markets, still persist. The Fed expects the unemployment rate to stay at its current level (9.1%) through the end of the year; they do not foresee the rate falling below 8% until 2013 at the earliest. The Fed also cut its expectation for GDP, as gross domestic product is now forecast to grow between 1.6% and 1.7% for the year, down from its earlier estimates of 2.7% to 2.9%.

TPI will continue to monitor both the European crisis and U.S. economy very closely. We are also following U.S. debt ceiling discussions taking place in Washington D.C. Decisions regarding long-term deficit reduction plans need to be finalized by November 23, 2011 to avoid the prospect of congressionally mandated spending cuts. If you have any questions, please do not hesitate to contact me at TPI.