SIOBHAN O'CONNELL
Media & Marketing, page 21

Proof that advertising works is that Renault doubled its share of the new-car market to 9 per cent in January

Effective measures are needed to stop the rot from spreading

PAT McARDLE

ANALYSIS

The EU must be seen to be able to sort out its own problems

THEY DON'T like the term bailout in Europe, preferring to draw a distinction between bailouts and other forms of support.

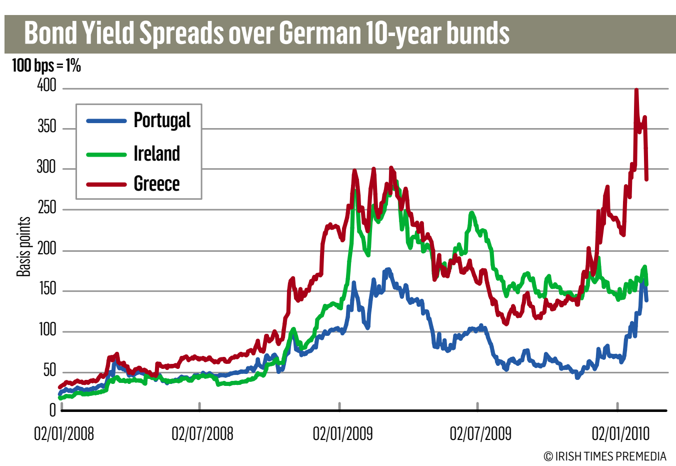
Whatever it's called, it all began with Ireland a year ago. Then, we were in extremis, with the markets reluctant to lend to us and interest rates spiralling. The additional interest paid by the Government, as represented by the spread over 10-year German bunds, widened from less than half a per cent to 3 per cent, giving a total cost of funds of about 6 per cent. At the time this was the highest in the euro zone, though Greece was not far behind (see chart).

Expressions of support from various EU spokespeople, not least the German ministry of finance and the president of the European Central Bank, started the ball rolling and Government action in the form of Nama and the April emergency budget did the rest. With hindsight, we were fortunate to have gone down the road we did. The alternative of job creation schemes or expansionary measures would have been disastrous. Had we attempted to "give the two-fingers to Brussels" as one critic memorably put it, our current situation would likely be similar to Greece.

Greece came under fire when the new government revealed that its predecessor had concealed a rapid deterioration in the fiscal deficit – there were two elections last year. The current government was elected on a populist manifesto and for a few months seemed unable to come to terms with the scale of the task it faced, reminiscent of the situation here in late 2008/early 2009.

Though the European Commission produced various plans, doubts remained about the ability and/or willingness of the Greek authorities to implement them. Market confidence continued to erode and the Greek spread over German bunds widened inexorably to 4 per cent late last month. However, by then the game was in the air and the news that the commission believed the Greek austerity plan was demanding but achievable got a positive reception.

Incidentally, this plan envisages lowering the budget deficit by 4 percentage points in one year.



This is more than twice the 1.8 percentage point cut in our deficit delivered in December's budget. The effect was an immediate alleviation of market pressure and Greek spreads fell back to 350 basis points.

However, the attention immediately shifted to other weak peripheral countries, notably Portugal. By now, we were into what Paul Krugman calls "contagion effects", the spread of crisis to economies with seemingly tenuous links to the original victims. Portugal suffered the most but Spain also came under attack. Stories about the possible break up of the Economic Monetary Union began to appear.

The great European experiment was under attack in a way never seen before and the risk was that the rot would eventually spread to the UK and even the US.

It has long been suspected the EU has a plan for this eventuality but was not prepared to unveil it until absolutely necessary. It seems that time has come.

Again, the Germans were first into the breach. On Tuesday, *FT Deutschland* cited officials as saying the German government was preparing an assistance package for Greece which could include bilateral aid as well as internationally agreed action at the EU level. At the same time, outgoing Commissioner Joaquín Almunia called on the EU heads of state to make a statement at the EU summit today offering support in exchange for a clear commitment from Greece to put its house in order.

Though nothing has yet been announced, the impact on the markets was dramatic. Both Greek and Portuguese spreads narrowed sharply and the euro regained some poise. The follow-through will be important.

While there are Greek strikes, these are similar to our current public sector action and are unlikely to have much impact.

Some of the measures proposed are dramatic – Greece is trying to do in two months what it should have done in the last 10 to 15 years.

In reality, the EU measures need to focus on stopping the rot and it would be a mistake to introduce measures that are specific to Greece alone.

Article 122.2 of the Treaty provides "Where a member state is in difficulties or is seriously threatened with severe difficulties caused by natural disasters or exceptional occurrences beyond its control, the Council . . . may grant, under certain conditions, Union financial assistance to the member state concerned".

It is critical that whatever is done be both effective and be seen to be effective. Otherwise, we shall be back to square one before long. This argues for the creation of a standby facility, funded by one or more member states, and made available to any member facing exceptional funding problems. The conditions attached to any such facility will be as strict as anything the IMF would dream of but it is extremely unlikely that the IMF will have any formal role. It is important that the EU shows it is capable of solving its own problems.

CANTILLON

INSIDE THE WORLD OF BUSINESS

Athens account-keeping exposes euro faultlines

WHEN THE euro zone was formed, Greece was not considered sufficiently economically fit to take part. With a long history of economic volatility, it was felt that Greece's inclusion would unnecessarily weaken the new European single currency, a step that would not be tolerated by the German Bundesbank, then the strong member of European central banks.

Two years later, however, Greece's socialist government was boasting some of the best economic figures in the EU, more than enough for it to be assured entry in time for the physical appearance of euro notes and coins at the start of 2001. The EU accepted Greece's evidence of its economic stability at face value.

In 2004, the incoming conservative government let it be known that the figures had been fudged to ensure they produced the required result for euro entry.

Ten years on from that original decision, the socialists are once again in power and revealing that the conservatives had gravely underestimated the scale of the country's deficit in 2008 and 2009.

The EU is again talking about disciplinary action and closer monitoring of how Greece compiles its figures. However, the fiasco has already exposed the faultlines in the euro experiment.

Clear manipulation of the rules for political and economic expediency and a failure to consolidate its position has been a recurring theme as the EU has rushed to expand its border and those of its euro zone.

As EU heads of state and European Central Bank president Jean Claude Trichet gather in Brussels today, they would do well to consider the wider problem inherent in expansion.

Dithering while bank shuts down

THE DECISION by Lloyds to close its Halifax business in the Republic highlights the lack of progress on the mooted third banking force to rival the State's big two banks.

The notion of knocking the second-tier banks together has been circulating for well over a year and was first raised in the context of the rescue of Irish Nationwide and the EBS building society. The initial proposal, of combining the societies with Permanent TSB to form some sort of supermutual, withered on the vine. The main drawback seemed to be a lack of scale, and the idea of combining them with Bank of Scotland (Ireland)/Halifax as a possible alternative surfaced last autumn.

The proposal had its attractions, not least the ongoing involvement of Lloyds in the Irish market, which would have helped to maintain some competition. But that proposal also seems to have fallen of deaf ears and this week's announcement can be interpreted as Lloyds running out of patience.

The Government's failure to engage on the third force in any serious or formal fashion is disappointing. There seemed little to lose and much to gain from exploring consolidation involving Lloyds' Irish operations.

The decision to step back from the issue of consolidation would appear to be the result of a number of factors. One is a reluctance to further antagonise the European Commission by interfering in the banking industry any more than is necessary. But given that inaction has lead to the exit of a significant player, this reluctance was misguided and has backfired.

A more worrying explanation for the lack of progress is that encouraging competition is not necessarily compatible with helping AIB and Bank of Ireland rebuild their balance sheets. More competition could reduce the amount of capital that the Government would have to inject into the two banks later this year.

In the first instance, the Government is focused on restoring the domestic banks to full health, not on creating a competitive long-term landscape in Irish banking.

The question of a €103bn tab

THE VALUE of State-guaranteed Irish bank debt owed to bondholders has been the subject of much debate since the Government guaranteed the banks in September 2008.

Internal Department of Finance documents – released to *The Irish Times* – show the breakdown of debts across the banks at December 31st, 2008. The department provided the figures to the International Monetary Fund last April to set it straight on the State's exposure.

At the end of 2008, the Government was guaranteeing a total of €351 billion of liabilities across the domestic financial institutions.

This figure excludes intergroup debts or sums owing to the European Central Bank. It includes €168 billion of retail and corporate deposits, and €48 billion of interbank deposits.

Some €3 billion was guaranteed on financial instruments and €15 billion on asset-backed securities. A further €103 billion is owing to bondholders who invested in the banks' senior unsecured debt and a further €12 billion of subordinated debt was being guaranteed at this stage. This is the debt which many have argued should have been left out in the cold by the Government given the high rates of interest investors were paid for the risk.

Some of the €12 billion has been swapped for higher-quality debt or bought back since then, but the €103 billion is a chunk of change many Government critics believe should not be repaid to help restore the banks' capital.

PODCAST

Listen to the *The Irish Times* business podcast at www.irishtimes.com/business/podcast

TODAY

EU leaders will discuss the Greek economic crisis at a special Brussels summit, Greencore holds its agm and the CSO will issue January inflation figures.

TRADE UNION MARCHES

Concern that protests in Athens could be taste of worse to come

KERIN HOPE and HUGH WILLIAMSON in Athens

ANGER WAS in the air yesterday morning in central Athens. With flags and banners flapping in the wind, tens of thousands of public-sector trade unionists marched past the country's neoclassical parliament building chanting their bitterness at government moves to target them with higher taxes to curb the state's spiralling debts.

"After 20 years on the job I only earn €1,300 [a month] and now the government wants to steal from me," said Maria Ioakimidou, a middle-aged social worker at an Athens hospital.

"The big guys who stole in the past [through corruption] should be paying," she added, referring to Greece's rich elite.

Union leaders hailed the protests, which closed airports and disrupted schools, hospitals and local transport, as a show of strength. By evening, as news filtered through to Athens of the likely EU emergency measures to support Greece, there were fears that the demonstrations could be just a taste of much worse to come.

Athens argues that it has already tabled a package of painful austerity measures for Brussels's approval, so there are worries that any tough new strings attached to emergency measures could spark social unrest.

Protesters hold a banner which reads, in Greek, "we are struggling to live", during a demonstration in central Athens yesterday. Photograph: Petros Giannakouris/AP

Constantine Michalos, chairman of the Athens chamber of commerce, which represents more than 100,000 medium-sized businesses, said tax measures announced on Tuesday, which include a big tax rise on distributed dividends, "will take time to implement and that will add to the problems business and households already face. If they have to be tightened further you have the potential for social upheaval."

Violent protests are not uncommon in Greece, as seen in 2008 when two weeks of riots erupted over the police shooting of a teenager.

Even ahead of the moves by the EU, trade unions had scheduled further strikes for later this month. These, they said, could easily be escalated amid increasing fears that incomes would be further squeezed following a 4 per cent across-the-board pay cut for all public-sector workers.

For Greek prime minister George Papandreou, the fragile mood in Athens underlines the challenge of maintaining public support as he tries to implement what is already the most ambitious reform schedule yet attempted by a Greek government. – (Copyright The Financial Times Limited 2010)

EXPERT OPINION

Ireland distances itself from hardest hit

SIMON CARSWELL
Finance Correspondent

IRELAND HAS distanced itself from the high debt problems of Greece, Portugal and Spain out of "sheer bloody-mindedness" by taking hard measures to correct its fiscal deficit, according to a UK author and expert on the euro.

David Marsh, author of *The Euro: The Politics of the New Global Currency*, said the recent stability of Irish sovereign debt spreads showed that the markets believed Ireland's recovery plan was "credible, will be maintained and will be ultimately successful".

Mr Marsh, a former *Financial Times* journalist, said the plan had distanced Ireland from the heavily indebted southern euro-zone states and aligned it with the more prudent northern euro-zone states such as the Netherlands.

"This will be the third time over the last 25 years that the Irish have tightened their belts – the country has shown that it is willing to take the medicine and the necessary pain," he told *The Irish Times* on a visit to Dublin.

"Ireland has a much better chance of succeeding than Greece, Portugal or, dare I say, Spain."

As a member of the 16-country currency bloc, Ireland cannot devalue to correct the public deficit but has taken the difficult task of reducing wages directly "in a very swingeing way", he said.

All countries must continue to take corrective action to prevent fiscal deficits ballooning, he added.

There is a permanent sword of Damocles hanging over every country, he said. "The markets can be a careful source of discipline and unfortunately you have to show permanent progress."

Mr Marsh warned that Ireland would need to maintain high taxes to stay within EU deficit limits under the stability pact following a recovery in the economy.

The stability pact "should have been exerted with far greater intensity", he said, as the euro zone's "one-size-fits-all by definition encouraged recessions in some countries and asset-inflated bubbles in others".

"I don't think the euro will survive in its present form unless there is more of a political union."

Mr Marsh is co-chairman of the Official Monetary and Financial Institutions Forum, a group which links central bankers and sovereign wealth funds in private discussions with company executives. He is also a senior adviser to London-based corporate finance firm Soditic.

SOVEREIGN RISK

French and German banks heavily exposed to default

FRANCE AND Germany, likely to have the biggest say in the politics of a bailout for Greece, are also the countries whose financial institutions would be among the most exposed to a default.

Weighing the sovereign risk borne by banks is difficult but figures from the Bank for International Settlements – sometimes referred to as the central bank for the world's central banks – show that European exposure to Greece is concentrated in French and Swiss banks, each with almost $79 billion (€58 billion).

German banks have about $43 billion of exposure, about half through holding Greek debt to provide backing for issuance of so-called covered bonds.

Kian Abouhossein, banks analyst at JP Morgan, said it was "not unreasonable" to see banks in France, the UK and Italy as the most exposed to sovereign risk, though he said it was impossible to establish definitively which sovereign risk banks held. "Some big banks might have €50 billion of sovereign bonds, others might have €150 billion, but there is no disclosure of which bonds they might be."

Some of the biggest French exposure comes through direct ownership of local banks in Greece. Crédit Agricole controls Emporiki, Greece's fourth-largest bank, with a €30 billion balance sheet; Société Générale, France's second-largest bank, owns Geniki, the Greek bank with a €5 billion balance sheet.

In November, Agricole was forced to take a €485 million hit on its investment in Emporiki through an impairment write-down. – (Copyright The Financial Times Limited 2010)

ECONOMIC SUMMIT

Van Rompuy set to seek mandate for economic plan

ARTHUR BEESLEY
European Correspondent

EUROPEAN COUNCIL president Herman Van Rompuy will today urge EU leaders to back deeper policy co-ordination at a special economic summit that is set to be overshadowed by the financial emergency in Greece.

Mr Van Rompuy is seeking a mandate from the 27 EU leaders to develop a tight set of priorities for the EU's new medium-term economic plan, known as Europe 2020.

Each of these priorities would be backed up by a small number of headline targets for each member state. Such targets, to be agreed by June, would be policed by the European Commission in the same way as it oversees public finances under the EU's stability and growth pact.

While any breaches of the targets would not be punishable by financial sanction, Mr Van Rompuy wants to deploy powers already enshrined in European law to issue "early warnings" and policy recommendations to member states.

In addition, Mr Van Rompuy will also ask each leader to come forward with proposals to eliminate economic "bottlenecks" such as infrastructure deficits or labour laws that inhibit economic activity.

He has been backed in the drive to deepen policy co-ordination by José Manuel Barroso, president of the European Commission.

Irish European commissioner Máire Geoghegan-Quinn, who has charge of the research and innovation portfolio, said she took heart from the fact that "innovation-based growth" had been identified as a core theme for the 2020 plan.

SPRING/SUMMER 2010
BUSINESS BREAKFAST BRIEFINGS

William Fry's 2010 Spring/Summer Breakfast Briefings cover key issues of interest to the business community. Each briefing will run from 7.30 am to 9.00 am in our Dublin office. The topics to be discussed are:

TUESDAY 23 FEBRUARY **BANKING & PROPERTY**
Banking on NAMA: The future of the Irish property market
Guest Speaker: Bill Nowlan, Chairman, W.K. Nowlan & Associates - Property Asset Managers

WEDNESDAY 24 FEBRUARY **TAX**
New Transfer Pricing Regulations and their implications for Ireland Inc.
Guest Speakers: Shiv Mahalingham, MD and Head of Transfer Pricing, Taxand UK; Justin Smith, Senior Director Transfer Pricing, Taxand US

THURSDAY 25 MARCH **PENSIONS**
Rising from the ashes: Investment outlook and strategy for pension schemes
Guest Speaker: Jim Power, Chief Economist, Friends First

THURSDAY 15 APRIL **CORPORATE**
Companies Acts: Recent & proposed changes

WEDNESDAY 19 MAY **FINANCIAL SERVICES**
The Financial Regulator's administrative sanctions procedure: Tips and traps

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