EUROZONE: RUNNING IN CIRCLES
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"Fix me now I wish you would (fix me now)
Bring me back to life (fix me now)". Garbage's song, "Fix Me Now"

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EURO AREA ECONOMY: RUNNING IN PLACE

Conjure up the dark days of the worldwide economic crisis that emerged in 2007 and accelerated in 2008. Recall the gloomy times when the European sovereign debt and banking crisis (not just in the European "periphery" nations such as Greece, Portugal, and Ireland) scared central bankers, politicians, and marketplace players. Nowadays, not only the international stage, but also its European scene in general and the Eurozone setting in particular (and therefore media headlines) appear somewhat sunnier. The Euro Area (Eurozone) did not break into pieces; Euro Area members firmly embrace the Euro FX currency. Ongoing massive deficit spending and very accommodative European Central Bank monetary policy fixes helped stop Europe from falling further backwards and helped it to climb to higher ground. Of course, generous deficit spending and easy money policies in key countries such as the United States, the United Kingdom, Japan, and China have intertwined with financial rescue and repair schemes within the Euro Area.

Nevertheless, although the Euro Area "in general" is not entirely out of gas and running on empty, it is running in place. Its economic performance for the next few years probably will be sluggish. There will be little or no economic growth, general government debt will remain quite high, and unemployment will stay very lofty.

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The International Monetary Fund's "Global Financial Stability Report" (October 2013, chapter 1, p31) states: "Policy actions at the euro area and national levels have reinforced a collective commitment to the euro. This renewed commitment has helped ease the severe market stresses that had been weighing on sovereigns and banks." Yet the Euro Area problems revealed during the global financial crisis in general (and its Eurozone chapter in particular) are by no means close to being fully repaired. The IMF underlines that "financial fragmentation" still exists. Moreover, it warns that the adverse "feedback loop" persists between banks, corporates, and sovereigns in "stressed economies" (not just Greece and Portugal, but also nations such as Italy and Spain). Private balance sheets (weak banks, weak corporates) need repair ("corporate debt overhang"; note the "problem of debt overhang in the nonfinancial sector".

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The Eurozone economy is going nowhere fast on the road to recovery. Of course differences between individual nations exist; Germany is not Greece. In any event, review the International Monetary Fund's "World Economic Outlook" ("WEO", October 2013, Table 1, "Statistical Appendix", Table A1). The Euro Area went into reverse in 2012 and 2013. Euro Area real GDP slides -.4 percent during 2013. This downturn follows 2012's -.6pc decline. The WEO predicts paltry 1.0pc growth in 2014, speeding up only to 1.6pc in 2018. Compare the 1995-2004 average of 2.2pc expansion. The European Union's predictions are close to those of the IMF. It forecasts 2014 Euro Area growth of 1.1pc (1.4pc in the European Union) and 1.7pc in 2015 (EU 1.9pc) (European Commission, "Autumn 2013 economic forecast", 11/5/13).

The IMF believes the Euro Area output gap as a percent of potential GDP was -2.9pc in 2009 (US was -6.4pc). Although it fell to -.8pc in 2011, it rose to -2.7pc in 2013 (US -4.5pc in 2013), with it still significant at -2.5pc in 2014 (US -4.0pc). IMF optimism reflects a dive in the Euro Area's output gap to -.4pc in 2018 (US merely -.2pc). (WEO, Table A8).

Sustained high unemployment underscores the Euro Area's current economic weakness and mediocre prospects. Euro Area unemployment as a percent of the total labor force was 7.6pc in 2007. (IMF, WEO database). It ballooned to about 11.4pc in 2012 (the US level was 8.1pc that year, up from 4.6pc in 2007). Euro Area unemployment reached 12.3pc in 2013 (US 7.6pc). The IMF forecasts Eurozone unemployment will remain high in 2014 at 12.2pc (US 7.4pc); 2018's 10.7pc still well above that of 2007. The European Commission (11/5/13) predicts Euro Area unemployment at 12.2pc in 2013, remaining unchanged at 12.2pc in 2014 and 11.8pc in 2015 (10.7pc in the European Union). A NYTimes article headlines: "Young and Skilled, a Generation Stagnates in Europe's Job Crisis" (11/16/13, pp A1, A8).

Around the world, enormous deficit spending helped to promote recovery. Will substantial deficit spending (or a cut in current deficit outlays) help to keep the recovery moving forward?

Statistics unveil the fiscal deficit spending programs and resulting general government debt burdens weighing on the Euro Area in general at present and probably for 2014. Will these challenges persist for the next several years? Again, notable differences exist between Eurozone nations.

Scan the International Monetary Fund's "Fiscal Monitor" (October 2013, Table 1 and Statistical Table 1). This points out that the Euro Area's general government overall fiscal balance (the general category includes states/localities, not just the federal level) as a percent of GDP was -3.1 percent (a deficit) in 2013. This far exceeds compare 2007's -.7pc, although it shows progress relative to 2009's -6.4pc hole. What is its probable track? The 2014 budget deficit will be -2.5pc, a sign of progress. The European Central Bank (11/7/13) notes the European Commission's forecasts, which are similar to IMF Fiscal Monitor ones for 2013 and 2014. The IMF is optimistic regarding the more distant future; note 2018's -.8pc. Compare the US's overall general government budget deficits of 12.9pc in 2009 (-2.7pc in 2007), -8.3pc in 2012, -5.8pc in 2013, -4.6pc in 2014, and -3.8pc in 2018.

Gross general government debt for the Euro Area as a percent of GDP (Fiscal Monitor, Table 2, Statistical Table 4) raced from 66.5 percent in 2007 and 70.3pc in 2008 to 80.1pc in 2009 to the very large totals of 93.0pc in 2012 and 95.7pc in 2013. Moreover, 2014 offers no improvement in this variable, inching up slightly to 96.1pc. The ever-hopeful IMF guru predicts it will erode to 89.9pc in 2018. This still hovers above that of 2008 and preceding years. The European Commission's near term outlook is about the same as the IMF's. What about America? According to the IMF, US general government debt was 64.4pc of GDP in 2007. It spiked up to 102.7pc in 2012 and 106.7pc in 2013. As for 2014, it does not decline, edging up to 107.3pc; 2018 stays elevated, at 105.7pc. Japan's huge 243.5pc in 2013 remains a monumental 241.1pc in 2018.

Keep in mind European Union "rules" (fairly loose guidelines, in practice) seeking national budget deficits of no more than three percent of GDP and government debt at 60pc or less of GDP. The NYTimes headlines that "In Economic Review, Italy and Spain Get Warnings on Debt and Deficit" since they risk missing important 2014 targets (11/16/13, pB7). European Commission ("Europe's budgetary surveillance moves into full gear", "Press Release", 11/15/13).

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"I don't know where I'm running now, I'm just running on
Running on running on empty
Running on running blind
Running on running into the sun
But I'm running behind". The Jackson Browne song, "Running on Empty"

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The Eurozone and its members of course are not islands separated from the rest of Europe and other domains. Looking forward, one should ask if the European Central Bank and Europe's nimble politicians are running out of ideas (or opportunities) which will generate even a modest sustained pace of real economic growth for the region. As in the United States and many other regions, deficit spending and very easy money policies promote near term GDP growth. But what about over the long run span? The US Federal Reserve is rather long on rhetoric regarding its exit strategy but rather short on substantial details regarding the exit method and its implementation despite its declaration of principles and forward guidance speeches. Do the ECB, the Bank of England, the Bank of Japan, or China have any more of an exit strategy than the Fed?

The ECB has long confined its policy interest rates to very low levels. Its Long Term Refinancing Operation ("LTRO" announced 12/8/11; two large rounds, 12/21/11 and 2/29/12) and its overview for its Outright Monetary Transactions ("OMT") program (declared 8/2/12, framework 9/6/12) have been around for many months. Yet these assorted easy money policies, including some forward guidance pronouncements, have not engineered much of a recovery, even if they have helped to stop a disaster and mended some financial damage. The ECB president says the institution is ready to conduct another round of LTRO (cheap three year loans of 2011 and 2012) "if needed" (Financial Times, 9/24/13). Keep in mind the ECB President's speech of doing "whatever it takes" (7/26/12) to preserve the Euro FX. The highly accommodative ECB again recently (11/7/13) slashed its key policy refinancing rate; the 25 basis points cut left the rate near the ground, at .25pc. Yet even with rates at such depressed levels, the guardian continually declares: "The risks surrounding the economic outlook for the euro area continue to be on the downside."

Since the individual Euro Area nations have adopted the Euro FX as their common currency, individual nations such as Greece cannot depreciate their currency to help resolve their debt problems and spark economic growth. In addition, substantial renewed Euro FX weakness might coincide with a test on the Eurozone's ability to stay together (or at least may reflect the difficulty facing one or more nations to keep using the Euro FX). Judging from their responses during the crisis on the European periphery, most leading Euro Area politicians do not want the Eurozone to break apart. Besides, in the current global environment, many countries around the world would like a feeble (or at least relatively weak) home currency to bolster economic growth. Picture the United States, Japan, and many emerging marketplaces. Thus significant Euro FX depreciation relative to current levels probably is unlikely.

The European Stability Mechanism (ESM) provides support to Euro Area governments in financial trouble. Recall the European Financial Stability Facility and the European Financial Stabilization Mechanisms which preceded it. Yet despite the existence of these backstops, which have bolstered financial confidence (reduced fear) in the Euro Area, the Euro Area's real GDP turned negative in 2012 and 2013 and growth prospects remain mediocre.

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The European Central Bank and its mainstream politicians probably are scared of political conflict emerging from both the so-called far left and far right wings. This underlines their promotion of sustained easy money policies and still relatively substantial deficit spending programs.

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The United States currently is trapped in political quicksand, thus impeding significant solutions (or at least notable progress) on many important economic topics. Republicans and Democrats battle fiercely. Presidential leadership is rather weak. Note the deficit spending (and ceiling) quarrels, the recent government shutdown, and the Obamacare health plan uproar.

Europe also has its set of political (and economic) divisions and dramas. As does America, Europe has rich and poor people (the haves versus the have-nots) as well as a variety of conservatives, moderates, and liberals (however defined). In addition, however, the Eurozone and Europe in general divides into nations (not just states or cities) on the prosperity parameter. Compare Germany with countries on the European periphery. In the face of all these differences, the multiplicity of nations within the Euro Area (and the diversity between their national policies and economic situations) makes it cumbersome for the Eurozone as a whole to achieve major progress on the economic front.

THE EURO FX AND GERMAN BUND: ON THE MERRY-GO-ROUND

Chuck Berry sings in "Around and Around":
"They say the joint was rockin'
Goin' round and round,
Yeah reelin' and a rockin',
What a crazy sound,
Well they never stop a rockin'
'till the moon went down."

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What are the current trends and significant levels for the Euro Area currency and the German 10 year government note?

Central bankers, finance ministers, Wall Street, Main Street, and the financial media closely watch key cross rates for the Euro FX against currencies such as the US dollar, British Pound, and Japanese Yen. However, monitoring a broad real index for the Euro FX such as the Bank of England's Euro FX effective exchange rate index ("EER", monthly average, 1990=100) provides better insight into the Euro FX's level and overall (general) trend. Although the Euro FX began trading in January 1999, the Bank of England devised a synthetic Euro FX, which creates Euro FX EER data back to the mid-1970s.

On an effective exchange rate (trade-weighted) basis, although the Euro FX EER has been bouncing up and down quite a bit since the onset of the worldwide financial crisis (and before), it probably established a major low in July 2012 at 86.7. However, the Euro FX EER probably will remain stuck in a broad range between around that 86.7 level and the peak around 105.0 it established during the worldwide economic crisis (105.2 in April 2008) and the early stage of the global recovery (October 2009's 105.3). Its October 2013 average was 96.4.

Key resistance levels for the Euro FX EER:

**112.0 (December 1979 pinnacle; 50 percent rally from October 2000's record depth of 75.1 is 112.7).
**105.2 (April 2008 plateau)/105.3 (October 2009 peak) during recent worldwide economic crisis and its aftermath/104.0 (20pc rally from the July 2012 bottom at 86.7)/103.3 (October 1992 plateau).
**101.1 (January 1996 top)/100.0 (five pc fall from 105.3; 99.7 is a 15pc jump from the key bottom of July 2012 at 86.7; a 33pc rally from October 2000's 75.1 all-time low gives about 100.0).

**97.5/94.8: Recall the Euro FX EER interim highs during its tumble due to the European sovereign debt/periphery crisis: 97.2 in October 2010 and June 2011. The midpoint between the October 2009 high at 105.3 and July 2012's important low at 86.7 is 96.0. The average for the Euro FX EER (monthly data) since its April 2008 summit is about 96.6. Also, 94.8 is a 10pc slide from 105.3; 95.4 equals a 10pc rally from 86.7.

The Euro FX marketplace recently has cruised around the higher end of this 97.5/94.8 resistance range level. It reached 96.4 in October 2013, touching a high (daily basis) 10/29/13 at 97.3 (96.1 on the daily on 11/14/13).

Key support levels for the Euro FX include:

**91.0 (five percent rally from July 2012 low)/89.5 (15pc fall from 105.3).
**86.7 (important bottom July 2012, suggesting the worst of the European debt crisis was finished)/84.2 (20.0pc slump from 105.3). The Euro FX EER broke over 80.0 in June 2002. It ascended decisively over 90.0 in June 2005 on its runup to the 2008/2009 peak.
**79.0 (25.0pc collapse from 105.3).
**76.4 (March 1985 key trough)/75.1 (October 2000 major low).

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What are some factors influencing the Euro FX versus US dollar cross rate? The US recovery to date has been stronger than that of the Euro Area, and most forecasters believe America will have more GDP growth. However, unlike the United States, the Euro Area runs a current account surplus. The Euro Area surplus was 2.3pc of GDP in 2013. The IMF predicts it will be 2.5pc in 2014 and 2.7pc in 2018 (WEO, Statistical Appendix, Table A10). The European Central Bank's mandate makes it more of an inflation fighter than does the Federal Reserve's mandate, which focuses directly on unemployment as well. The Federal Reserve is far more of a quantitative easer (money printer) than the ECB (in any event, the ECB maintains it is not a money printer; note its sterilization talk). General government debt is significant in the Eurozone, and still dangerously high for several nations within it. Some nations continue to produce undesirable budget deficits. However, the overall Eurozone general fiscal balance (budget deficit) and general government debt situations arguably are less severe than that of the United States. Although the US dollar remains the key reserve currency, to what extent do many nations (and firms and individuals) wish to diversify away from the dollar?

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The German Bund is a signpost for top quality European sovereign (and high grade corporate) debt securities. To many, the Bund's relatively modest yield fluctuations over the couple of years may seem like that benchmark is running in place. However, the German 10 year government note established a major low on 7/23/12 (and 6/1/12) at 1.13 percent. Note its further march higher from the later low at 1.15pc on 5/2/13, reaching 2.09pc on 9/11/13.

The Euro FX EER likewise made a major low in July 2012. Recall the date of the ECB President's late July 2012 "whatever it takes" comments. Don't forget the peak of the Spain less Germany 10 year sovereign note yield spread was 7/24/12 at about 638 basis points.

Despite the Eurozone's mediocre growth prospects and the German 10 year note's flight to quality (safe haven) potential (whether inspired by European periphery nation problems or difficulties elsewhere around the world), German government yields are in a sideways to up trend. The United States 10 year Treasury note likewise made a major low in July 2012 (1.38pc on 7/25/12), advancing sharply from its later and higher bottom at 1.61pc on 5/1/13 to touch just over three pc on 9/6/13.

That mid-September 2013 yield ceiling for the German Bund probably will be broken despite the determination of the ECB (and the US Federal Reserve) to keep repressing yields. Even though the ECB's forward guidance wordplay says that it expects key ECB rates will be at "present or lower levels for an extended period of time", the ECB over the long run aims to maintain inflation rates below but close to two percent. The IMF states Euro Area 2013 consumer prices will be up 1.5 percent. They will climb 1.5pc in 2014 with 2018 up 1.6pc. (WEO, Table A5).

Suppose the Bund jumps over its 2.09pc hurdle of September 2013. Half the 4.70 peaks (6/13/07 and 7/23/08) equals 2.35pc (2.37pc was the 11/29/11 minor top).

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Even if German sovereign rates remain rather low, those of other Euro Area nations may have yield jumps if the European periphery (or a global debt) crisis returns.

EUROPEAN STOCKS: THE RUN UP

"It's Your Time to Worry", a blues song by Blind Willie McTell

"What—Me Worry?" asks Alfred E. Neuman of "Mad" magazine

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For the stock arena, take the SXXP index of 600 European stocks (though it includes United Kingdom and other non-Euro Area companies) as a benchmark (Bloomberg symbol is SXXP). This vehicle, like America's S+P 500, has not moved in a sideways pattern, but instead has (despite some sharp twists and turns) flown sky-high since its 3/9/09 major low at 155.4 (S+P 500 major trough 3/6/09 at 667). The bottom line is that the probable path of European equities probably is closely bound with that of American stocks.

Easy money policies by worldwide central banks (especially but not only the Federal Reserve; keep Japan, China, and the UK in mind) continue to play a key role in propelling US and European stocks upward. Given the absence of significant current and likely near term Euro Area growth, gurus should wonder how much longer European stocks will keep going up. Admittedly, the aphorism that timing is everything remains true. Besides, stock prices are in nominal terms and real returns from high-grade debt instruments are mediocre (negative across the first few years of the US government yield curve). And the ECB, Fed, and other central bankers do not look like they will tighten their lax policies significantly soon. American corporate earnings have been strong, and buyback programs have assisted the S+P 500's long-running bull charge.

However, central bankers and politicians have spent a lot of ammunition on their current yield repression and money printing and other accommodative policies, and these programs are old news. The central bankers probably do not have any notable significant new plans, and the Fed is likely (eventually) to tighten (even if slowly).

Leverage in US (and probably many other) stocks is significant (see NYSE margin debt). In addition, net foreign buying of American debt securities (and equities) has slipped dramatically (there even has been net selling in several months in calendar 2013). US federal deficit spending fights continue in Washington. The United States has achieved no progress on solving its long run federal fiscal problem. What if the US dollar depreciates from current levels, or if the US 10 year Treasury makes a new high yield in its bear trend? And after all, even apart from these US considerations, the Eurozone's economic growth prospects are at best fair.

Emerging marketplace stocks, unlike the S+P 500, generally have been in a bear trend since spring 2011. The same is true for commodities "in general".

The October 2013 Euro Area Economic Sentiment Indicator is at 97.8, right around the 1990-2012 average of 100. This index includes industry, services, retail trade, consumer, and other components. Thus European equities are much more buoyant than overall confidence. What about US consumer confidence? Its recent high since its February 2009 depth at 25.3, attained in June 2013, only reached 82.1. In October 2013, the Conference Board Index stood at 71.2. That June 2013 elevation lurks far beneath the confidence peaks of January 2000 (144.7) and June 2007 (111.9), which were achieved not long before major pinnacles in the S+P 500.

So like the S+P 500, European equities probably will have a noteworthy bear move within the next few months.

With the SXXP now around 325.0, what's the rundown on some SXXP levels to monitor? Recall 332.9, the 5/19/08 high. The final top in the S+P 500, after its 10/11/07 pinnacle at 1576, also occurred 5/19/08 (at 1440). If prices fall from current levels, note that twice the 3/9/09 bottom is 310.8; keep an eye on 2/18/11's 292.2 if prices stumble further. Unlike the S+P 500, the SXXP has not escaped above its 2007 peaks. Are prices for European equities circling back to their former record heights? In any event, if European stock prices venture even higher from current levels, watch 10/11/07's summit at 391.3 and the major pinnacle of 401.0 on 7/13/07.

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