



Markets React to Debt Outlook in the United States and Greece

Jacob Funk Kirkegaard assesses the prospects for debt restructuring by Greece and the market reaction to Standard & Poor's downgrading the US debt outlook.

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Steve Weisman: The budget and financial troubles of both Greece and the United States are back in the news. This is Steve Weisman at the Peterson Institute for International Economics with Jacob Kirkegaard, Research Fellow here at the Institute, to talk about the situation with both. Jacob, there are a lot of news stories today that Greece may have to restructure its debts to get out of the hole it's in. Is there anything new here?

Jacob Kirkegaard: No, I basically think [this comes from] a lot of the speculation that we saw over the weekend, where apparently there was a news story that cited some sources in the IMF, that the IMF was now pushing for Greece to restructure its debt, which was very quickly denied by senior IMF management. And then there was another quote by the German Finance Minister Wolfgang Schauble in which he talked about further measures needed to be taken in the event that Greece could not access the markets in 2012. And it was quite quickly clarified then by his spokesman that that did not necessarily mean debt restructuring. So I basically regard this as sort of a media created rumor storm with very little new facts on the agenda actually.

Steve Weisman: But these storms do have an effect on markets sometimes.

Jacob Kirkegaard: Oh yes, there is no doubt that we can see that particularly of course in the most volatile part which is the sovereign CDS [credit default swap] market, which really had a very large effect of these rumors. And Greece I believe widened by up to two to three hundred basis points on these very volatile measures. So if you are trying to cover a short, or you are trying to do other of these types of shenanigans, this would have a good leak to do so to speak.

Steve Weisman: Speaking of markets, the markets have reacted negatively to the news that Standard & Poor's has issued a kind of warning or a negative concern about the United States' debts and its ability to repay them. What is your analysis of the effect of that on the markets and the significance of the S&P downgrade?

Jacob Kirkegaard: I think, as you said, it's very clear that the markets have taken it quite negatively and this certainly also was in my opinion a negative surprise in many ways. I think that those of us who watch the budget fights in Congress have probably considered this to be inevitable. But it probably arrived somewhat sooner than what we would have expected—or certainly what I would have expected. And I think it is particularly interesting when you read through the justification given by S&P for the downgrade in which they basically say that while they maintain the current AAA rating, they say that given the fact that they basically doubt that Congress will get serious about budget deficit reduction before 2013, they feel that the outlook therefore needs to be put on negative.

Steve Weisman: Does this strengthen the hand then of the budget cutters and of the Republican and Democrats to try and reach a deal?

Jacob Kirkegaard: I think that that's quite hard to say. I mean it certainly raises the stakes quite a lot. And you would think that intuitively this ought to sort of sharpen minds and underline the fact that you need a deal. But given the fact that if you try to compare the Obama proposal from last week with the Ryan Budget, clearly both sides of the argument wants to cut spending. The question is whether or not you also need to raise revenues, which quite clearly is something that the Ryan Budget and the Republicans more broadly are not willing to do. And I think that as long as that's the case I don't think you can solve this sort of short-term threat to the U.S. sovereign AAA rating without raising more revenues in the short term.

Steve Weisman: Are the markets also reacting to the threat of a default and a refusal by Congress to raise the debt limit?

Jacob Kirkegaard: I don't know. There are obviously already a whole host of shenanigans, and political posturing going on where I think it seems to me like clearly the Administration has decided to basically do a dare for the Republicans, where you had [Treasury] Secretary Geithner over the weekend saying quite clearly that he believes that the Republican House leadership will "come to their senses and realize that this has to be done." And without necessarily having any major additional type of amendment attached to, or sort of budget, a balanced budget amendment or other long-term structural measures to address the budget deficit attached to the raising of the debt ceiling. So essentially it's sort of a game of chicken that is now being played out in Washington. And that of course was certainly further accentuated by today's downgrade as a cause of some concern. I think once we get past the deadline in mid-May, where we effectively run out of money and start running on these types of things that the Treasury can do to avoid a default in the immediate short term. That's what I think. If we still don't have the contours of a deal by then, meaning by mid-May, and we are running into the weeks until the default happens; yes, I certainly believe we will start to see a lot of market reaction.

Steve Weisman: Jacob, thank you.

Jacob Kirkegaard: My pleasure.

