

Q&A: Emerging vs. Peripheral Europe: The Debt Question

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Investors have focused on Greece's debt sustainability problems as of late. What is the extent of the problem?

In 2007, before the global financial crisis struck, Greek and German 10-year government bonds traded at comparable levels of between 4% and 4.5%. Now, in early 2010, Greek government bonds are trading at 6.1%, while German government bonds are trading at 3.3%. The reason that the Greek government is being asked to compensate their investors with higher government yields is because the country is increasing debt issuance at a time when its debt-to-GDP ratio is already unsustainably high. This in turn makes their ability to service their existing 300 billion euro debt under question.

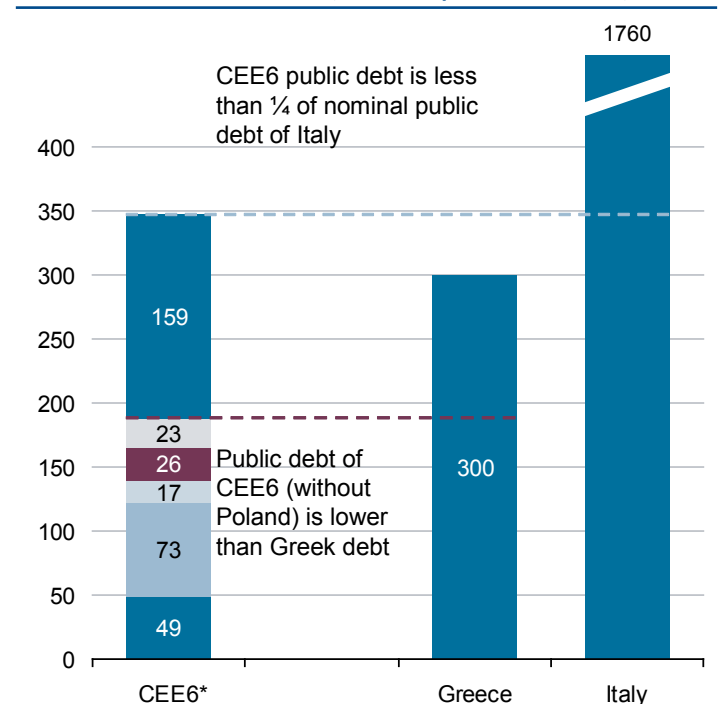
What other countries in Europe are facing difficulties?

A number of other European countries have been singled out as potential trouble spots, including Portugal, Ireland, Italy and Spain (which are, along with Greece, referred to as the so-called PIIGS countries). These countries either have high debt-to-GDP ratios (Italy's is at 115% of projected 2009 GDP) or are adding to their debt quickly by running large fiscal deficits (Ireland, Spain, and Portugal fall into that category).

What about Emerging Europe?

The debt situation in Emerging Europe stands in stark contrast with the troubled European periphery. In nominal terms, the size of public debt in the Czech Republic, Hungary, and Poland (~280 billion euro) combined is less than that of Greece (~300 billion euro) alone! As a percentage of GDP, the Czech Republic stands at a low 31%, Poland is at 51%, while Hungary is the only country which even reaches the euro area average, which currently stands at 80%.

Nominal Public (2009E, EUR billion)



Source: Erste Group

* CEE6: Poland, Hungary, Czech Republic, Slovakia, Romania, Croatia

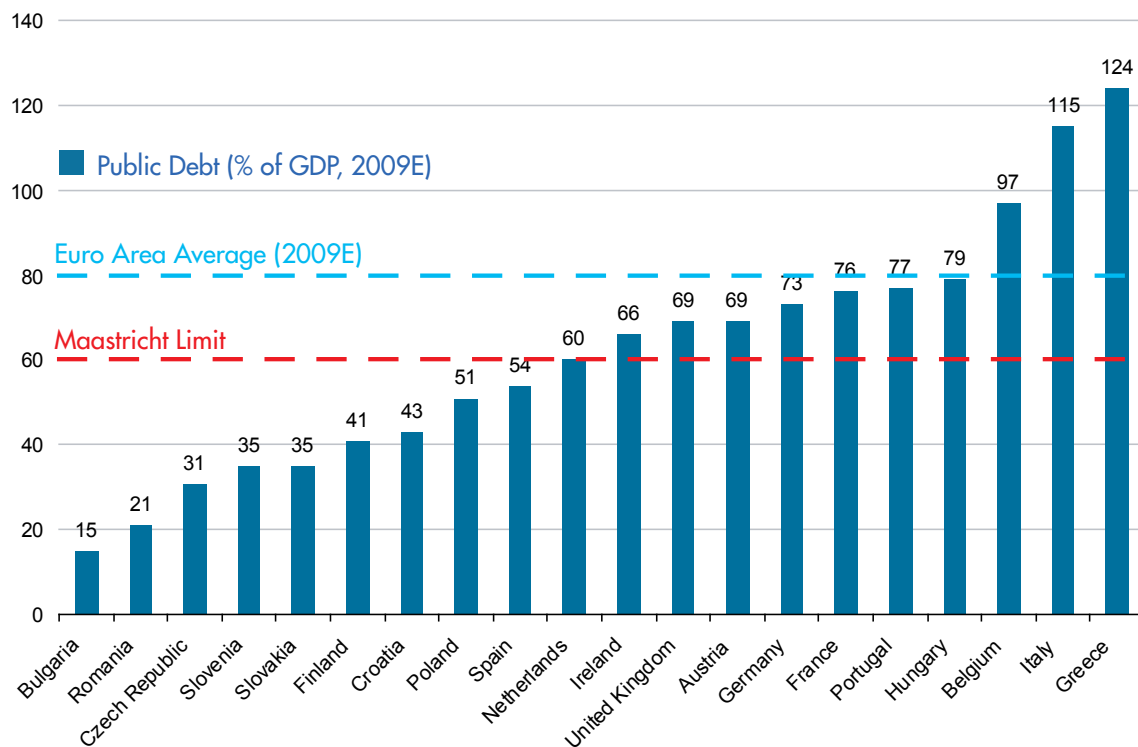
Are there any potential issues we can expect in Emerging Europe?

Much like economies elsewhere, budget deficits could be a potential future trouble spot, as consistent budgets in the red may lead to accumulation of unsustainable public debt and risk breaching the 60% limit of the Stability and Growth Pact (SGP)*. Prior to the crisis, the countries in the region were well within the 3% SGP upper limit required of euro zone members (Hungary was the notable exception). In the last couple of years, however, governments have been slow to adjust to new economic realities of lower revenues, and some are only now starting to raise taxes and reign in expenditures to avoid a second “Greek situation”.

Is Russian debt likely to become a problem? After all, the country defaulted on its debt in 1998...

Investors often associate Russia’s debt situation with its 1998 default, but the 2010 reality is vastly different. Russia public debt stands somewhere at around 10% of GDP, in stark contrast with the EU average of 80% and Greece/Italy’s at over 100%. During the “boom years”, when oil revenues were at a record-high, Russia diligently paid down much of its outstanding debt. At this time, the country is in fact planning its first debt issue in over a decade.

Public Debt (% of GDP, 2009E)



Source: Erste Group

*The Stability and Growth Pact (SGP) is intended to ensure that European Union states that use the euro as their currency maintain budgetary discipline, including: budget deficit of up to 3%, public debt/GDP ratio of up to 60%, price stability, nominal interest rates in line with other members’ and reasonable currency exchange rate fluctuation.

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