The Year of the Sovereign Debt Crisis

***TIE* ASKED** a number of top thinkers to focus on the outlook for sovereign debt. How likely are countries in the eurozone's periphery (Greece, Ireland, Portugal, and Spain) to default outright or face significant "haircuts" on their sovereign debt over the next three to five years? What is the probability in the next three to five years that any of the major industrialized countries (the United States, Japan, Germany, France, and the United Kingdom) lose their top ratings*? And how might the increased prospect of default in the eurozone periphery and the loss of triple-A ratings in the major industrialized countries affect the global economy?

***Note: on January 27, the Standard & Poor's rating agency downgraded Japan to AA-minus. Other rating agencies have left Japan's credit rating untouched.**

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DESMOND LACHMAN
Resident Fellow, American Enterprise Institute

The seriousness of any intensification of the eurozone debt crisis for the global economic recovery should not be underestimated. This crisis has the potential to deliver a major blow to the European banking system, which is the main holder of the European periphery's US$2 trillion in sovereign debt obligations.

Over the next twelve to eighteen months, there is every prospect that Greece and Ireland will choose to restructure their sovereign debt. They will do so as their economies sink further into the deepest of recessions under the weight of the draconian fiscal adjustment being imposed on these countries by the International Monetary Fund and the European Union within the straightjacket of their euro membership.

A Greek or Irish sovereign debt restructuring would constitute the largest such restructuring in history. It would also more than likely result in an escalation in contagion to Portugal and Spain, since both of these countries have extraordinarily large external financing needs in 2011.

A banking crisis in Europe, coupled with a renewed European economic downturn, will have serious implications for the global economic recovery. In particular, it would heighten the risks of a petering-out in the U.S. economic recovery, since it would come at precisely a time when U.S. unemployment remains unusually high, the foreclosure crisis continues unabated, and international oil prices are again at high levels.

Likelihood of default or "haircuts" on the periphery?

Greece:	✔ Certain
Ireland:	✔ Certain
Portugal:	✔ Certain
Spain:	✔ Probable

Major industrial countries losing their top rating?

United States:	✔ Probable
Japan:	✔ Certain
Germany:	✔ Won't happen
France:	✔ Probable
United Kingdom:	✔ Probable

A deepening in the European crisis must be expected to result in a further weakening in the euro, which would put U.S. exporters at a competitive disadvantage, since it would heighten existential questions about the euro. It must also be expected to result in an increased degree of global risk aversion given the great degree of interconnectedness of the world's financial system.

Praise the Lord and pass the ammunition.

The check-marks tell the story, or at least my view of the story. Too many words have already been written as to the whys and wherefores. Praise the Lord and pass the ammunition.

BARTON M. BIGGS
Managing Partner, Traxis Partners

Likelihood of default or "haircuts" on the periphery?

Greece:	✔ Certain
Ireland:	✔ Certain
Portugal:	✔ Certain
Spain:	✔ Unlikely

Major industrial countries losing their top rating?

United States:	✔ Won't happen
Japan:	✔ Probable
Germany:	✔ Won't happen
France:	✔ Unlikely
United Kingdom:	✔ Unlikely

LOUIS BACON
Founder, Chairman, Chief Executive Officer, and Principal Investment Manager, Moore Capital Management

Likelihood of default or "haircuts" on the periphery?

Greece:	✔ Certain
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Major industrial countries losing their top rating?

United States:	✔ Won't happen
Japan:	✔ Probable
Germany:	✔ Unlikely
France:	✔ Probable
United Kingdom:	✔ Unlikely

SAMUEL BRITTAN
Columnist, Financial Times

Obstinate refusal to write down debt is the greater threat.

Alas, I don't rate rating agencies. The most important policy aim should be to free market economies from bondage to financial market prejudices.

Likelihood of default or "haircuts" on the periphery?

Greece:	✔ Probable
Ireland:	✔ Unlikely
Portugal:	✔ Probable
Spain:	✔ Probable

Major industrial countries losing their top rating?

United States:	✔ Won't happen
Japan:	✔ Won't happen
Germany:	✔ Won't happen
France:	✔ Unlikely
United Kingdom:	✔ Unlikely

ROBERT K. STEEL
Deputy Mayor for Economic Development, New York City, and former Undersecretary for Domestic Finance, U.S. Treasury

Likelihood of default or "haircuts" on the periphery?

Greece:	✔ Probable
Ireland:	✔ Probable
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Major industrial countries losing their top rating?

United States:	✔ Won't happen
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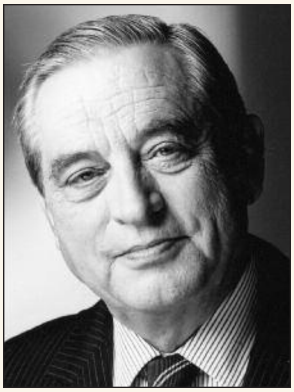
Germany:	✔ Unlikely
France:	✔ Unlikely
United Kingdom:	✔ Unlikely



KARL OTTO PÖHL
Former President, German Bundesbank

Likelihood of default or "haircuts" on the periphery?

Greece:	✔ Unlikely
Ireland:	✔ Unlikely
Portugal:	✔ Unlikely
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Major industrial countries losing their top rating?

United States:	✔ Won't happen
Japan:	✔ Won't happen
Germany:	✔ Won't happen
France:	✔ Won't happen
United Kingdom:	✔ Unlikely

Likelihood of default or "haircuts" on the periphery?

Greece:	✔ Unlikely
Ireland:	✔ Unlikely
Portugal:	✔ Unlikely
Spain:	✔ Won't happen

Major industrial countries losing their top rating?

United States:	✔ Unlikely
Japan:	Already AA-
Germany:	✔ Won't happen
France:	✔ Probable
United Kingdom:	✔ Unlikely

The risk of government defaults threatening the recovery is a somewhat exaggerated fear.

JIM O'NEILL
Chairman, Asset Management, Goldman Sachs International

There is growing evidence of accelerating global recovery, and if there is a surprise this year, it might be that the developed countries, led by the United States, will positively surprise. We may see a number of quarters of 3 percent to 4 percent or more real GDP growth in the United States. If this is correct, the size of some fiscal deficits will come down as government revenues grow and spending becomes less pressured. In this context, I personally believe that the risk of government defaults threatening the recovery is a somewhat exaggerated fear. By the way, unless I missed something, Japan lost its AAA status many years ago! If there were to be problems, then the country that concerns me most is actually Japan, not the United States.

TADASHI NAKAMAE
President, Nakamae International Economic Research

Japan's fiscal woes are no secret, but its currency is the strongest and its government bonds are the most secure, as witnessed by the fact that its yields are the lowest in the world. Moreover, unlike the United States, Britain, France, and Germany, Japan's government bonds are mostly held by domestic rather than foreign investors, who as stakeholders are unlikely to cause their country to default on its debt.

Thus, if credit ratings truly reflect default risk, it is ridiculous that Japanese government bonds (JGBs) are rated AA-minus, while the other G4 countries are still rated AAA. Over the past decade or so, investment banks and hedge funds have constantly tried to make money by short-selling JGBs (on the assumption that Japan's fiscal troubles would cause yields to rise), neatly enabled by credit rating agencies, whose reports backed up their beliefs. Yet these short sales rarely, if ever, turned out to be profitable as JGB yields sunk to ever-lower record-breaking levels.

If credit rating agencies were to lower the ratings of the remaining G4 countries equal to that of Japan—or lower—they might regain some credibility and legitimacy.

As fiscal deficits balloon, countries become increasingly incapable of funding their debt. This then shatters the myth that free-spending Keynesian demand-side policies are the answer to today's problems. For countries that can shift to supply-side policies that enable the private sector to become more efficient and grow, this poses few problems. For countries in the eurozone periphery, this means immense and painful economic upheaval.

This turmoil will be reflected in the global economy. Europe's economy and balance sheet is likely to deteriorate first. The United States will probably be next. Japan's decline is likely to be the slowest because it has already seen twenty years of recession and has slowly started to implement structural reform—something Europe and the United States have yet to do.

Likelihood of default or "haircuts" on the periphery?

Greece:	✔ Certain
Ireland:	✔ Probable
Portugal:	✔ Certain
Spain:	✔ Certain

Major industrial countries losing their top rating?

United States:	✔ Probable
Japan:	Already AA-
Germany:	✔ Probable
France:	✔ Certain
United Kingdom:	✔ Certain

HARALD DETTENBORN

HORST M. TELTSCHIK
Former President, Boeing Germany, and former National Security Advisor to Chancellor Helmut Kohl

Likelihood of default or "haircuts" on the periphery?

Greece:	✔ Probable
Ireland:	✔ Probable
Portugal:	✔ Unlikely
Spain:	✔ Won't happen

Major industrial countries losing their top rating?

United States:	✔ Unlikely
Japan:	✔ Unlikely
Germany:	✔ Unlikely
France:	✔ Probable
United Kingdom:	✔ Probable

RICHARD N. COOPER
Maurits C. Boas Professor of International Economics, Harvard University

If any of these events were to happen within the next five years, there would be black headlines in the financial press, but the world would move on. Any of these events would cause some consternation, but none would be devastating, and the global recovery would not be aborted on these grounds. If the recovery were aborted for some other reason, of course, the probability of these events would rise, since government revenues of all these countries would be adversely affected. Some "haircut" has already been priced into the public debt of the four eurozone countries, so debt holders could hardly argue that they were surprised or aggrieved. And the reputation of the rating agencies has been sufficiently compromised by their performance during 2006–09 that any changes in ratings they make will be viewed with greater skepticism than would have been the case several years ago.

Likelihood of default or "haircuts" on the periphery?

Greece:	✔ Probable
Ireland:	✔ Unlikely
Portugal:	✔ Unlikely
Spain:	✔ Won't happen

Major industrial countries losing their top rating?

United States:	✔ Unlikely
Japan:	✔ Unlikely
Germany:	✔ Unlikely
France:	✔ Unlikely
United Kingdom:	✔ Unlikely

MICHAEL J. BOSKIN
Tully M. Friedman Professor of Economics and Hoover Institution Senior Fellow, Stanford University, and former Chair, President's Council of Economic Advisors

Any increased prospect of some type of default on the eurozone periphery—Greece more likely than not, whereas Ireland, Portugal, and Spain are fifty-fifty—would temporarily send shockwaves through global financial markets. It would further strain especially Europe's undercapitalized banks, dampen European (and to a lesser extent, global) economic growth, and further stress monetary union.

Downgrades of sovereign debt of the major industrialized countries—Japan has recently earned this dubious distinction, the others remain possibilities unless budgets improve—would likewise raise interest costs, worsen budget balances, depress asset values, and slow growth.

Finally, these financial risks might just as well be the result as the cause of slower global recovery, as public debt dynamics typically worsen in sluggish economies.

Likelihood of default or "haircuts" on the periphery?

Greece:	✔ Probable
Ireland:	✔ Fifty-fifty
Portugal:	✔ Fifty-fifty
Spain:	✔ Fifty-fifty

Major industrial countries losing their top rating?

United States:	✔ Unlikely
Japan:	✔ Certain
Germany:	✔ Unlikely
France:	✔ Unlikely
United Kingdom:	✔ Unlikely

MAYA BHANDARI
Head of Emerging Markets Analysis, Lombard Street Research

Likelihood of default or "haircuts" on the periphery?

Greece:	✔ Probable
Ireland:	✔ Probable
Portugal:	✔ Probable
Spain:	✔ Probable

Major industrial countries losing their top rating?

United States:	✔ Unlikely
Japan:	✔ Probable
Germany:	✔ Unlikely
France:	✔ Unlikely
United Kingdom:	✔ Unlikely

The answers are not independent. Spain, Greece, Portugal and Ireland are insolvent within EMU, at any feasible euro exchange rate, absent permanent, ongoing unrequited transfers to deficit countries (that is, current account deficit countries). The only feasible candidate for making those transfers is Germany. The burden on Germany, were it to accept that role, could be something like 8 percent of German GDP—every year forever. Germany's credit rating, and possibly its political stability, would not survive that. France has an unsustainable current account deficit, but is almost certain to be bailed out by Germany; its default risk (though possibly not its first-move ratings risk) is thus probably smaller than Germany's.

The answers are not independent.

Globally higher sovereign credit-risk premiums would just mean a need for even lower "risk-free" real yields to sustain the continuing global Ponzi game, in which China is increasingly uncomfortably aware that it will be called upon to play a role *vis-à-vis* the United States similar to the one EMU countries want Germany to play. The underlying problem is a real-side one—dynamic inefficiency. The financial bubble which is re-forming is one particular channel through which dynamic inefficiency operates. Even complete default/debt forgiveness throughout the world would not resolve the problem of dynamic inefficiency.

Likelihood of default or "haircuts" on the periphery?

Greece:	✔ Certain
Ireland:	✔ Certain
Portugal:	✔ Certain
Spain:	✔ Certain

Major industrial countries losing their top rating?

United States:	✔ Unlikely
Japan:	✔ Certain
Germany:	✔ Unlikely
France:	✔ Unlikely
United Kingdom:	✔ Won't happen

BERNARD CONNOLLY
CEO, Connolly Insight, LP

WENDY DOBSON
Former Associate Deputy Minister of Finance, Canada, and Co-Director, Institute of International Business, Rotman School of Management, University of Toronto

Uncertainty about defaults in the eurozone periphery is already a drag on economic recovery. Since Greece and Ireland have defaulted in everything but name, let them get on with it—but not just yet. Within the next year, their investors should have had sufficient time to strengthen their balance sheets. That is when both governments should reduce principal and extend repayment terms to sustainable levels and get on with their lives. Eurozone institutional arrangements are inching towards dealing with future fiscal crises, but faster movement is desirable to ensure fiscal discipline in the first place. Voters in the two countries have already experienced painful austerity and now see public services displaced by debt servicing costs as far as the eye can see. The longer the delay, the more investor uncertainty and reluctance to acquire troubled country bonds which, in turn, shrink the investor pool and concentrate future risk.

Uncertainty about defaults in the eurozone periphery is already a drag on economic recovery.

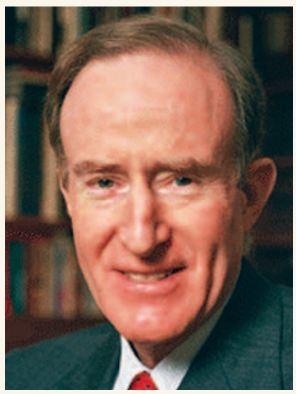
Prospects in major countries are brighter because of strong government action (United Kingdom), strong fundamentals (Germany), and domestic debt holders (Japan). In the United States, the noisy, often-surreal debate about how to cut debt and deficits may require a wakeup call from the markets in order to concentrate legislators' minds on agreeing to a credible medium-term plan for fiscal consolidation.

Likelihood of default or "haircuts" on the periphery?

Greece:	✔ Certain
Ireland:	✔ Certain
Portugal:	✔ Probable
Spain:	✔ Unlikely

Major industrial countries losing their top rating?

United States:	✔ Unlikely
Japan:	✔ Won't happen
Germany:	✔ Won't happen
France:	✔ Won't happen
United Kingdom:	✔ Unlikely



BENJAMIN M. FRIEDMAN
William Joseph Maier Professor of Political Economy, Harvard University

Likelihood of default or "haircuts" on the periphery?

Greece:	✔ Unlikely
Ireland:	✔ Probable
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Major industrial countries losing their top rating?

United States:	✔ Probable
Japan:	✔ Unlikely
Germany:	✔ Won't happen
France:	✔ Won't happen
United Kingdom:	✔ Probable

MAKOTO UTSUMI
President and CEO, Japan Credit Rating Agency, Ltd., and former Vice Minister of Finance for International Affairs, Japan

Economists, especially in Anglo-Saxon countries, have the persistent tendency to overlook the determination of the eurozone policymakers and the European Central Bank to defend the euro and its member countries. Regardless of the unproductive statements sometimes uttered by politicians in the core euro countries who are motivated by domestic politics, the euro's defenders would never choose the suicide of the euro and the eurozone.

Confusion in Japanese politics will not allow a reliable plan for the budget reduction.

In the United States, the higher savings rate of the household sector and the budget reductions likely by the Republican-dominated Congress will improve that country's current account balance.

For Japan, confusion in Japanese politics will not allow a reliable plan for budget reduction in the medium term.

In the United Kingdom, Prime Minister David Cameron is making respectable efforts to tackle the budget deficits and the people are showing the endurance to accept higher taxes and lower public services, so far. However, the inflation and the interest rate hikes on the horizon, together with severe budget cuts, might cause serious shrinkage of the UK economy.

Likelihood of default or "haircuts" on the periphery?

Greece:	✔ Won't happen
Ireland:	✔ Won't happen
Portugal:	✔ Won't happen
Spain:	✔ Won't happen

Major industrial countries losing their top rating?

United States:	✔ Won't happen
Japan:	✔ Unlikely
Germany:	✔ Won't happen
France:	✔ Won't happen
United Kingdom:	✔ Unlikely

Likelihood of default or "haircuts" on the periphery?

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Portugal:	✔ Unlikely
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Major industrial countries losing their top rating?

United States:	✔ Unlikely
Japan:	✔ Probable
Germany:	✔ Won't happen
France:	✔ Unlikely
United Kingdom:	✔ Unlikely

EDWARD YARDENI
President, Yardeni Research

CATHERINE L. MANN
Barbara '54 and Richard M. Rosenberg Professor of Global Finance, Brandeis International Business School, Brandeis University

Under this scenario—Greece and Ireland restructure, Portugal maybe, but everyone else muddles along—the global economy actually does better than if Greece, Ireland, and Portugal keep on rolling over debt that won't be repaid. The experience of Latin America in the 1980s is instructive. Giving up on the Baker liquidity plan and restructuring the debt according to the Brady Plan created the foundation for renewed lending and growth in Latin America. Like the Brady Plan, the European Financial Stability Facility should use guarantees, not outright purchases of sovereign obligations. Guarantees are a much more efficient use of limited funds.

Likelihood of default or "haircuts" on the periphery?

Greece:	✔ Certain
Ireland:	✔ Certain
Portugal:	✔ Unlikely
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Major industrial countries losing their top rating?

United States:	✔ Won't happen
Japan:	Already AA-
Germany:	✔ Won't happen
France:	✔ Won't happen
United Kingdom:	✔ Won't happen

RONALD MCKINNON
Professor Emeritus of International Economics, Stanford University

As long as the United States, Japan, and the United Kingdom own their own central banks, they won't default on their respective Treasury bonds outstanding—which are denominated in dollars, yen, and pounds respectively. Each central bank can buy back its own Treasury bonds by just "printing" money. Hence there is long-run inflation risk but not default risk.

For Germany and France, the situation is more complex because their national central banks cannot directly print euros. But Germany is a major international creditor and France is probably, on net balance, a creditor also. So I would not expect either to default on Treasury bonds outstanding.

Defaults could restart a banking crisis.

The big threat to European recovery is that defaults on its periphery could restart a banking crisis. German banks in particular have lent heavily to governments and firms in southern and Eastern Europe.

The United States has a similar problem should there be substantial defaults by its state and local governments—particularly on their unsustainable defined-benefit pension plans. But municipal bonds are owned mainly by wealthy individuals, and pensioners might be out of pocket. So defaults are much less likely to directly impact U.S. banks.

Likelihood of default or "haircuts" on the periphery?

Greece:	✔ Probable
Ireland:	✔ Probable
Portugal:	✔ Probably
Spain:	✔ Unlikely

Major industrial countries losing their top rating?

United States:	✔ Won't happen
Japan:	✔ Won't happen
Germany:	✔ Won't happen
France:	✔ Won't happen
United Kingdom:	✔ Won't happen

Likelihood of default or "haircuts" on the periphery?

Greece:	✔ Probable
Ireland:	✔ Unlikely
Portugal:	✔ Unlikely
Spain:	✔ Unlikely

Major industrial countries losing their top rating?

United States:	✔ Won't happen
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Germany:	✔ Won't happen
France:	✔ Unlikely
United Kingdom:	✔ Unlikely

JEAN-PIERRE PATAT
Advisor, Centre d'Etudes Prospectives et d'Informations Internationales, and Thierry Apoteker Consulting

Greece will probably be downgraded, considering the heavy burden of its debt and poor prospects for economic growth. At the moment, Greek debt is protected by the European Financial Stability Facility with a deadline of 2013. After this, the fund will be replaced by a permanent new organization. But efforts by creditors to make settlements cannot be ruled out. Ireland and Portugal have better growth prospects. The existence and apparently the brilliant start of the EFSF lend it high credibility. Ireland and Portugal have two years during which they can benefit from this credibility and prove that they can manage sound economic and fiscal policy.

Spain is unfairly put in the disagreeable PIGS category. Spanish sovereign debt is less important than most other advanced economies' debts. Of course, private debt is high and the current account largely umbalanced, but Spain's economy can benefit from an improvement in the real estate market. Its international banks are solid and well-managed and the government has begun a severe program for reducing deficits.

The United States has a very bad fiscal situation.

The United States has a very bad fiscal situation and the government has failed to take measures to improve it. But rating agencies will never take the risk of downgrading the country which issues the major international reserve currency—and with which they do so large a part of their business.

Japan was just downgraded to AA-minus. Is further downgrading possible? This country has by far the heaviest sovereign debt among big industrialized economies. Even if domestic saving is important, Japan's economic growth is hesitant and its policy situation sometimes blurred.

For Germany, everything is possible, including the worst (that is the secret motto of central bankers!). But a spectacular policy and/or economic reversal in this country is, obviously, unlikely for the next three and even five years.

France's sovereign debt is average for an industrialized country and even lower if one takes into account the retail pension burden (France's demographic situation is better than that of other countries). But its policy for reducing deficits is much too timid and political consensus on public finances, globalization, and markets is not evident.

The United Kingdom has been suffering from spectacular deterioration of its economic and fiscal situation which could justify questions about its rating. But the government has engaged in a very severe and credible plan for reducing deficits. In addition, playing host to the largest financial and money markets in the world is strategic protection.

An increased prospect of default in the eurozone periphery would not have a significant impact on recovery, considering the weak share of Greece, Portugal, and Ireland in the global GDP, and if the successor in 2013 to the EFSF is credible.

The loss of triple-A ratings for major industrialized countries could encourage new fiscal cutbacks and, theoretically, have some impact on economic growth, especially if the United States is concerned, but in my opinion this country will not be downgraded. If other counties lose their rating, the exact reasons are important, otherwise rating agency credibility could be questioned. Nevertheless, it is uncertain such an issue could have significant impact on fiscal policies if economic growth remains weak.

JAMES E. GLASSMAN
Managing Director and Senior Economist, JPMorgan Chase

When it comes to assessing the creditworthiness of the large industrial economies, the global bond market is the only "rating agency" that matters. Bond investors must weigh all manner of risks, political and economic. For that reason, the historically low level of real interest rates on the sovereign debt of the large industrial economies implies that bond investors must be assuming that the fiscal picture for many will improve as the global economy recovers.

It is very unlikely that any of the periphery countries will default on their outstanding debt. The Europeans eventually will transform the European Financial Stability Facility into a more effective mechanism for dealing with liquidity strains. Economic recovery will restore some fiscal balance in the region, as it will in the United States. The alternatives would be less disruptive, such as developing a fiscal transfer mechanism or subsidizing the interest rates a sovereign must pay.

The global bond market is the only "rating agency" that matters.

The long-term consequences of default are more punishing than the alternatives. There is a deep historical and political commitment to the monetary union and the euro, which has brought many benefits to the eurozone, and a default by one of the members, and inability of the members to prevent it, would call into question the euro's survivability. A default could easily trigger a wider financial crisis across the region, harming even the strong economies. And these countries will take sufficient action to address their structural fiscal deficits, enough so to be credible to financial markets.

Likelihood of default or "haircuts" on the periphery?

Greece:	✔ Unlikely
Ireland:	✔ Unlikely
Portugal:	✔ Unlikely
Spain:	✔ Unlikely

Major industrial countries losing their top rating?

United States:	✔ Unlikely
Japan:	✔ Unlikely
Germany:	✔ Unlikely
France:	✔ Unlikely
United Kingdom:	✔ Unlikely

On the probability that the rating agencies will lose their top ratings—oops, that the major industrial economies lose theirs—highly unlikely, because the fiscal erosion is largely the result of deep economic recessions (cyclical factors) and the global recovery now in place will begin to restore fiscal balance. This will be seen as a positive development by the rating agencies. (I am not sure if a downgrade of industrial country debt would carry much meaning for financial markets, because default by these countries is assumed to be negligible.) The recent downgrade of Japan's debt (and possible downgrades of other large countries), given the breadth and depth of the investor appetite for sovereign debt of the big players, is likely to create more noise in the media than in the financial market.

A default in the eurozone would be punishing, not only for Europe but also for the global economy, which is a strong argument against taking such an action. It would require the defaulting party to implement austerity measures, with negative implications for growth.

NORBERT WALTER
Walter and Töchter Consult, and Chief Economist Emeritus, Deutsche Bank

The world is in for higher real rates of interest (financing costs) than over the last few years. And for good reason: There will be more differentiation of financing costs between governments and companies.

However, the present focus on some countries in deep trouble (due to mismanaged banks or inflated real estate/construction sectors) is misplaced. Some, like Ireland, have a strong constitution and can and will grow out of their problems. Others, who still do not understand that being on drugs may make you "high" but not "sound," will soon have to swallow bitter medicine and will thus fall below in trend growth for a number of years. This is not just true for Spain, but for the United States.

Goldilocks is over.

But misperceptions about rating countries go further. Quite a few countries today perceived to be natural candidates to act as donor countries in international rescue operations are heading toward unsustainable fiscal positions, particularly because of their imminent demographic decline.

Thus, Germany clearly is overrated. And by 2020—when China still is anything but rich—it will age aggressively. Today's sobering views about financial prospects foreshadow an unattractive future for more than just the short term. Goldilocks is over, for good.

Likelihood of default or "haircuts" on the periphery?

Greece:	✔ Probable
Ireland:	✔ Probable
Portugal:	✔ Unlikely
Spain:	✔ Unlikely

Major industrial countries losing their top rating?

United States:	✔ Probable
Japan:	✔ Probable
Germany:	✔ Unlikely
France:	✔ Unlikely
United Kingdom:	✔ Unlikely

Likelihood of default or "haircuts" on the periphery?

Greece:	✔ Certain
Ireland:	✔ Certain
Portugal:	✔ Probable
Spain:	✔ Unlikely

Major industrial countries losing their top rating?

United States:	✔ Won't happen
Japan:	✔ Unlikely
Germany:	✔ Won't happen
France:	✔ Unlikely
United Kingdom:	✔ Won't happen

BOWMAN CUTTER
Senior Fellow, Roosevelt Institute

Likelihood of default or "haircuts" on the periphery?	
Greece:	✔ Unlikely
Ireland:	✔ Unlikely
Portugal:	✔ Unlikely
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Major industrial countries losing their top rating?	
United States:	✔ Won't happen
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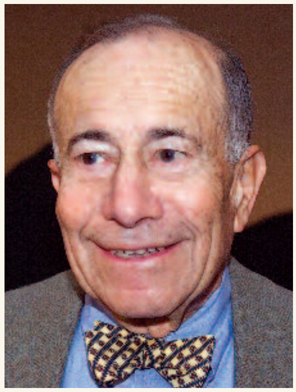
France:	✔ Unlikely
United Kingdom:	✔ Unlikely



CHARLES WOLF

Senior Economic Adviser and Distinguished Corporate Chair in International Economics and Professor, Pardee Rand Graduate School, RAND, and Senior Research Fellow, Hoover Institution

The increased precariousness of sovereign debt, coupled with the extensive EU inter-bank holdings of this debt, are likely to slow global economic recovery. Two other effects are no less important but with more ambiguous consequences for recovery.

First, the jeopardy to debt repayment and to bond ratings is likely to result in lower priority accorded in OECD countries' budgeting processes to "stimulus" spending than to so-called "austerity," that is, to curtailing government spending. A concomitant effect among economists and bankers will be diminished attention to the Keynesian legacy of the "multiplier," and increased attention to how to affect the crucial as well as more elusive state of confidence and expectations in global markets. While this change may dampen the pace of recovery, it's also likely to enhance the recovery's robustness.

Recovery is likely to be slowed.

Second, the worries that adhere to EU and U.S. Treasury bonds are likely to encourage and accelerate China's efforts to make the renminbi an international currency. A consequence of recent events in undermining the dollar's primacy as the world's favored reserve currency and its predominance as the invoicing currency of first recourse will be to boost receptivity among global bankers and traders to China's efforts on behalf of the renminbi.

Likelihood of default or "haircuts" on the periphery?	
Greece:	✔ Probable
Ireland:	✔ Probable
Portugal:	✔ Unlikely
Spain:	✔ Unlikely

Major industrial countries losing their top rating?	
United States:	✔ Unlikely
Japan:	✔ Unlikely
Germany:	✔ Won't happen
France:	✔ Unlikely
United Kingdom:	✔ Unlikely

DAVID K.P. LI

Chairman and Chief Executive, Bank of East Asia, Limited

ROBERT J. SHAPIRO
Chairman, Sonecon, LLC, and former U.S. Under Secretary of Commerce for Economic Affairs

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Without the extraordinary interventions of the European Union and the International Monetary Fund, Greece already would be in default and Ireland would be on the edge of doing so. The irony here is that default has been staved off thus far by the political commitment of Germany and France to the euro—yet the rules of the eurozone prevented Greek and Irish policymakers from taking normal steps to avoid default and rebuild confidence through currency devaluations and interest rate adjustments.

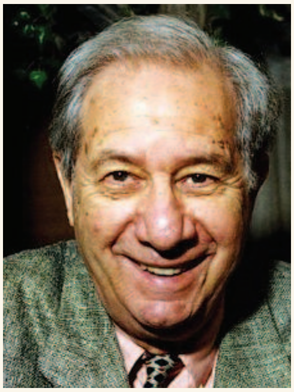
The differences between the two countries' predicaments, however, are also instructive. The seeds of Greece's problems lie in years of fiscal profligacy, which in itself was a political response in order to maintain employment while the eurozone precluded their using interest rate and currency policies to improve their competitiveness. Dublin, by contrast, has been a model of fiscal responsibility for years; but like the United States, lax oversight of the domestic financial system allowed the country's dominant financial institutions to pursue reckless overleveraging built helter-skelter on a huge housing bubble.

The rules of the eurozone prevented Greek and Irish policymakers from taking normal steps to avoid default.

When the U.S. financial crisis and subsequent deep recession reached Greece and Ireland, the Greeks found themselves with unmanageable public debt while Irish banks quickly turned insolvent. And in both cases, the fiscal austerity required to slow the two countries' fast-rising debt burdens has proved to be politically difficult, if not impossible. It's also economically counterproductive, since the cutbacks stall the growth needed to generate the revenues to stave off or at least limit the extent of a default.

There is no prospect of default by the United States, Germany, or France, and virtually no prospect of such a dire development in Japan or the United Kingdom. All have fundamentally sound economies, as financial markets recognize. Long-term interest rates remain historically low in all of these countries, signaling investors' confidence in their long-term solvency. All of these nations also have mature political systems capable of quickly addressing any impending debt crisis, as each has demonstrated in the past when deficits have expanded sharply.

However, a special caveat applies to the United States. As the only nation of the group without parliamentary arrangements, there is a theoretical possibility of a politically driven default if the political opposition were to block an increase in the legal debt limit. However, this almost certainly is an empty threat. Congressional opponents of sitting presidents have threatened such action many times in recent decades, and the president has won the debate and the fight every time.



MURRAY WEIDENBAUM
Mallinckrodt Distinguished University Professor, Washington University in St. Louis

Continued international conversation on weaknesses in sovereign debt is bound to have a depressing effect on the finances of marginal economies in southern Europe, if not elsewhere. This negative impact may be offset in part by the continued economic strength of Germany and also the United States.

Practical reasons will inhibit the rating agencies from seriously contemplating downgrading the Treasury issues of the United States These agencies may have escaped tough government oversight for the time being. However, substantial discussions of downgrading Treasuries could lead congressional committees and perhaps some regulators to initiate investigations and public hearings. Any sensible management would try to avoid opening itself to such potential problems.

Thus, for the major industrialized nations, muddling through is the most likely outcome. The United States will not lose its triple-A rating for sovereign debt and such an eventuality is unlikely for Germany, France, the United Kingdom, and Japan.

The peripheral countries will not all enjoy such luxury. Haircuts are initially certain for Greece and Portugal and, to a lesser degree, probably for Ireland and Spain.

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JAMES CAPRA
Capra Asset Management

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