Tortoise QuickTake
Credit Podcast

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Welcome to the Tortoise QuickTake podcast. Thank you for joining us. Today, senior members of Tortoise provide a timely update on trending topics in the market.

Hi, I'm Graham Allen Senior Portfolio Manager with this week's credit podcast.

It has not been difficult for some to foresee the eventual failure of the European Union project. In fact, with hindsight some prescient human beings, including the late UK Prime Minister Margaret Thatcher forecast its demise before the European Union was officially formed in 1993 by the passing of the Maastrict treaty in the previous year. This agreement laid out the ground rules for membership of the Eurozone and formerly recognized European citizenship. Prior to that, the project grew out of a series of treaties that began with the Treaty of Rome in 1957.

Fast forward to today and of course, the jury is still out on whether the project will ultimately be successful. That said, there is no doubt that events of today are beginning to show the irreconcilable differences predicted by some in the past.

It doesn't matter which subject you pick: economics, migration, legal or philosophical, you quickly come across issues that cannot be solved without giving rise to another set of factors which are seemingly irreconcilable.

Let's look at BREXIT as an example. As the deadline for the UK leaving inexorably approaches, the ability of the UK government to come to an acceptable solution seems remote. This raises the prospect of a hard BREXIT which, in and of itself, will create huge market uncertainty both for the UK and the EU as the UK would leave the EU with no agreement on trade, budget contributions or borders and so on. In the short-term there are unlikely to be any winners should that occur.

Unfortunately, the media spotlight has justifiably been on the dysfunctionality of Theresa May's cabinet and its failure to reach an acceptable agreement with the EU. It ignores the fact that the problem lies as much with the EU's hardline stance in reaching any kind of agreement. For if any acceptable agreement is reached it will be held up as a model for other countries to follow, which is anathema to Brussels. So the seeming stalemate continues as the inevitable day of departure approaches.

Which brings us to the current problem de jour; Italy. Let's keep things simple and just look at the economic predicament the Eurozone's third largest economy faces. Comparisons are frequently made with Greece, which has experienced a 26% nominal GDP decline in the last eight years, despite a bailout program from the EU and the IMF(1). Italian GDP in the same period grew by 5.1% compared to Germany's, which grew by a significantly higher 27.4%. Therefore, it's easy to see, again with hindsight that the one-size-fits-all policies of the EU's budgetary process do not produce equitable results. This economic inequality is one of the major forces driving up anti-EU sentiment.

Italy however is no Greece, with a GDP almost ten times the size. Italy's debt level of €2.3 trillion is also the highest of any country in Europe. By any measure, Greece's debt of €317 billion is relatively insignificant. More importantly, Italy's debt is so large that it becomes almost as big of a problem for the EU, and by extension Germany, who would be on the hook for significant debt liabilities defined by the ECB's target2 balances. To compound the problem, Italy's growth rate has been among the lowest in the Eurozone creating chronically high unemployment. Many of these factors, along with other obvious ones such as immigration, have contributed to the present governing anti-EU being elected in March 2018.

So Italy's potential economic demise, or departure from the Eurozone will almost certainly lead to the end of the Eurozone itself and possibly the European Union as we know it. At $17.6 trillion in value, the collective GDP of the 28 countries of Europe is comparable to the U.S. so major economic disruption of the region will undoubtedly affect the global economy in a very negative manner.

The point of this podcast is not to predict that this will happen any time soon, but to point out that the fundamental irreconcilable differences in the original proposed structure are now beginning to show.

One justifiable criticism of the pro-Europe camp is that the Union itself has not done the necessary things to make the EU successful. In other words, provisions were never put in place to provide the impetus needed to complete the project and render it successful. This would include a European army that would control EU borders, which are presently controlled by member countries, and a unified fiscal policy. As the project now reveals itself to be increasingly unworkable, political opposition is growing across the EU against these final necessary steps, rendering ultimate failure difficult to avoid.

Although the end of the European Union may not be any time soon, the beginning of the end is likely to be triggered by a single event; possibly a hard Brexit, an Italian referendum on EU membership, the political defeat of European champion Chancellor Merkel or even a debt crisis that the ECB will not be able to contain. All are equally plausible reasons.

What is becoming increasingly clear is that Margaret Thatcher may have been right when she said of the European project 26 years ago that it was a “program whose inevitable destiny is failure; only the scale of the damage done is in doubt.”

We hope you have enjoyed this Tortoise podcast.

Thank you for joining us. And stay tuned for our next cast. Have topics you want covered or other feedback to share? Write us at info@tortoiseadvisors.com.

(1) Source: Eurostat

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