

La Tercera Newspaper, Business Column, Saturday May 9, 2010 (Page 59)

Robert Merton, Nobel price in Economy 1997:

“Greece makes EUR be no competition against USD”

In the middle of 2008 the fact that the USD value had fallen so much made some experts to see the possibility the EUR could become the most important currency in the world.

But today, two years later, the flight to quality from Greece, the threat the crisis spreads over Europe, the EUR drop as a consequence of higher risk of Greek default illustrate what in finance is called self-fulfilling prophecy.

Robert Merton not only believes in the self-fulfilling prophecy for Greece, but also agrees that the EUR weakness reveals its true value.

What should be considered in order to understand what is happening in Europe and Greece?

“I’m not an expert in sovereign defaults, but I do not believe that there are magic solutions. Either Greece finds ways to pay its debts, what seems improbable, or the only alternative is that Germany and the rest the strongest countries give massive guarantees. It’s an economic and politic problem because if those guarantees are given, that rises precedents for any other country. I’m not a politic scientist but given Germany’s attitude until now, that ’s difficult to occur.”

But what is involved? Is it about a continent?

“The problem goes further Greece or Europe, even further the crisis spreads over other countries. One issue is whether Greece falls in default. Is it possible to maintain its economy without leaving the EUR? I think that it is not legally possible to leave the Euro Zone, but people will find any way to do it. If that happens at least in the near future it would rise doubts about whether the EUR could be a reserve currency. The idea of having a smaller group of countries such as Holland, Germany and France does not have sense. This creates the ghost that EUR is not a competitor against USD.”

Is there any risk that makes a systemic collaps as there was in 2008?

“Nobody can discard anything. I do not know enough about this case in order to say what the possibility of spread is, but just a dump would say that it is impossible. We have seen in the last two years that anything is possible. I’m sure that all central banks and governments involved are conscious of this.”

Due to the new volatility, has it changed the manner of how assets should be allocated in a portfolio?

“A portfolio manager always has to be aware about what is happening in the market and what are the risks, but for all investments one has to see the long term, has a strategy well defined and stay there. It is extremely difficult to move with the market. When one

tries to do trade, the market has already adjusted the prices. Believe that one can sell a position before the price falls is not that realistic. I'm not saying that that does not happen but it's not a base for a strategy."

Your work in Economy is based on the use of derivatives. What's your opinion about critics against the of default insurance market?

"When I talk of derivatives I mean the Chicago Board Options Exchange, or those that are traded out of Exchange, such as interest rate swaps, cross currency swaps, stock swaps, CDS. The majority of them helped to deal with the problem, they did not produce it. What's more, the all central banks use derivatives, they can not work without them. CDS in the beginning are a great idea but it is a very new market. The problem was that the institutions that used to sell those instruments, such as AIG, did not have collateral. I did not even know that there were entities that were allowed to work without collateral."

Do you agree to regulate more the financial market?

"There has been a bad use of CDS. It is not the contract that has to be fixed. There is a bad use in automobiles and medical drugs. Should we deal with that? Absolutely yes. Should we have a good regulation? Absolutely yes. Should we ban those things? Absolutely no. I'm concerned about the consequences of such legislation, including the larger difficulty that can affect the risk transfer that has existed legitimate before, during and after the crisis."