The PREYMA Report

The G20 and Global Capital Markets: Critical Issues and Analysis

VOL. 3, NO. 2 • DECEMBER 2011

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Introduction

Much of December focused on Europe and the summit that took place in Brussels on December 8-9, 2011. As political manoeuvring and concessions abounded, not much was accomplished to relieve the sovereign debt crisis in the short term. With a new fiscal compact in sight, the European Union began to address the inherent problem underlying the sovereign debt crisis — the lack of fiscal discipline. Just as the United States will not be able to recover fully until the housing market recovers, which was the root of the initial financial crisis in 2008, the sovereign debt crisis will not be solved until the root cause of fiscal irresponsibility is solved. It took years to get into this mess and so it will take many painful years to get out of it for the sovereigns.

The Organisation for Economic Co-operation and Development (OECD) has warned that raising large volumes of funding in the private markets for governments across the globe will be a great challenge for the foreseeable future, with rollover risk causing big problems for the stability of those governments. This challenge will be even greater as the investment and banking communities divest assets and employees and hold more capital to comply with increased regulation. Crédit Agricole, France's second largest bank, announced that it will eliminate 2,350 jobs in investment banking and consumer finance units due to huge losses for 2011. Continuous downgrading of banks and sovereigns by the credit rating agencies is also exacerbating the problem, as fewer sovereign and corporate debt qualify for the Core Tier 1 (CT1) capital that banks will have to hold as of 2013 when the Basel III rules take effect. The scarcity of high-grade investments may lead banks to hold more cash to meet the requirements, thereby leaving no excess cash to lend to governments through bond purchases.

Retail investors are also keeping their money in cash and for good reason. In the U.S., the Federal Bureau of Investigation (FBI) says that securities fraud is up by 47% since 2008. It currently has 2,500 active investigations into corporate and securities fraud. This is one fewer than before: Enrica Cotellessa-Pitz, who was the comptroller for Bernard L. Madoff Investment Securities, pleaded guilty to falsifying records. She is cooperating with the ongoing investigation into the Madoff case and could face a maximum of 50 years in prison. Sentencing takes place on June 22, 2012. Jon Corzine, who was the chief executive officer (CEO) of the now bankrupt MF Global, testified before a financial services subcommittee and the agriculture committee of the House of Representatives that he does not know where the missing $1.2 billion of client money is and that he was unaware that client segregated accounts were used to cover liquidity shortfalls at the brokerage. The Commodity Futures Trading Commission (CFTC), the Securities and Exchange Commission (SEC) and the Justice Department

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Never before has it been so important for all those involved in the global capital markets to pay attention to the discussions and decisions of world leaders. The decisions and commitments made by leaders directly affect the interconnected global economy.

Financial institutions, identified by many as a cause of the recent financial crisis, have received much attention by the G20, a group of the world's leading advanced and ascending powers. Consequently, there have been unprecedented changes in financial institution and market regulation. Leaders have taken action in the areas of market integrity, bank supervision, capital requirements and leverage ratios, bank stress tests and executive compensation. Issues that caused or were affected by the crisis have been addressed.

Why is it important for the financial industry, and those related to it, to pay attention to what is happening on the international political stage? National regulators are directly tied to international bodies and the global guidelines that they must establish. At the G20 summits, leaders commit to implementing the recommendations put forward by these international bodies. Whatever is accepted by the G20 has the full support of the most powerful leaders of the most systemically significant countries in the world. The commitments they make at the global level are later put into action at the national level. These decisions affect not only the markets but also the industries and sectors that operate within them.

The Preyma Report discusses the commitments made by the G20 leaders and their finance ministers and central bank governors, with an emphasis on the issues most relevant to the global capital markets. Each summit serves as a starting point for tracking these issues at the national level and monitoring the landscape as it changes on a monthly basis.

continue to investigate what happened and where the missing funds are.

On December 17, 2011, Kim Jong-il, North Korea's ruler, died of a heart attack. His heir apparent and successor, son Kim Jong-un, has been named "supreme leader of the party, state and army." Stocks in Asia dropped sharply in response but later stabilized. Uncertainty about North Korea's intentions has risen as Kim Jong-un is not well known and his rise to power was not expected to be this soon. Although the National Defence Commission issued a statement that the international community should not expect any change, with a ruler who is not yet 30 years of age (there are conflicting reports about his age being 28 or 29) it remains to be seen if he will take this opportunity to prove himself on the world stage.

World markets did not fare well in 2011 with an overall decrease in value. Venezuela proved to be an outlier with a 79% gain in its stock market. Not surprisingly, two eurozone markets were the worst performers: Cyprus lost 72% and Greece lost 52% over the year. Most analysts now recommend investing in high-dividend stocks of corporations with strong balance sheets.

The outlook for 2012 does not appear to be overly optimistic. Europe will continue to muddle through its sovereign debt crisis with piecemeal solutions. The liquidity injected by the European Central Bank (ECB) in December and the upcoming infusion in February may just be enough to begin to turn things around and to help avoid a full-blown recession that would spread to other parts of the globe. The U.S. begins an election year with slow growth, which will continue at a lacklustre pace. The inability of the U.S. to get its fiscal house in order, along with political stalemate, will not yield performance-enhancing results. Regulation in all sectors of the financial industry will continue to hamper corporate ability to innovate and perform as everyone waits for the rules to be finalized before making any decisions.

To end with some optimism: one should remember that it is always better to be tepid than burning.

About the G20

In 1999, in response to the Asian-turned-global financial crisis, the G7 established the G20 forum of finance ministers and central bank governors. In addition to the G7 members of Canada, France, Germany, Italy, Japan, the United Kingdom, the United States and the European Union, the G20 included countries considered systemically significant at that time: Argentina, Australia, Brazil, China, India, Indonesia, Korea, Mexico, Russia, Saudi Arabia, South Africa and Turkey. From 1999 to 2008, the G20 finance ministers and central bank governors met annually, usually in the fall.

Today, the group represents 85% of the global economy, 80% of global trade and two thirds of the world's population.

In late 2008, during another global financial crisis, the G20 was considered sufficiently inclusive to be elevated to the leader level to consider the options for managing the situation and mitigating its effects.

In November 2008, in Washington DC, U.S. president George W. Bush hosted the "Summit on Financial Markets and the World Economy," the first time the G20 met at the leaders' level.

Since November 2008, the G20 leaders have met six times and have made many commitments to try to mitigate the crisis — with varying degrees of success. There have also been more frequent G20 finance ministerial meetings to carry on the work of the leaders and to prepare for the summits.

The second summit, hosted by British prime minister Gordon Brown, was in London in April 2009. The leaders committed $1.1 trillion to increase the capital available to the International Monetary Fund.

The third summit in September 2009 was hosted by U.S. president Barack Obama in Pittsburgh, Pennsylvania. The leaders declared that the G20 was their "premier forum for international economic cooperation." They also created the Framework for Strong, Sustainable and Balanced Growth, and committed to continue their coordinated efforts to get the global economy back on track.

Subsequent summits have been held in Toronto (June 2010), Seoul (November 2010) and Cannes (November 2011).

The G20 finance ministerials developed a tradition of rotating the hosting responsibilities among the membership in such a way as to allow responsibility to be shared among the advanced and emerging powers, with a "troika" of the present chair supported by the immediate past chair and the following year's chair. Mexico will chair the G20 in 2012, followed by Russia, Australia and Turkey.

More information about the G20 is available from the G20 Information Centre website at <www.g20.utoronto.ca>.