The PREYMA Report

The G20 and Global Capital Markets
Critical Issues and Analysis

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Introduction

The G20 finance ministers and central bank governors gathered in Mexico City on February 25-26 at what can only be described as a non-event. They met to address the ongoing economic and financial challenges and to agree on a way forward. They welcomed the progress made by Europe in recent months in strengthening its fiscal position but recognized that growth expectations for 2012 are moderate and downside risks continue to be high. The international economic environment continues to be characterized by uneven performance, with weak growth in advanced economies and a stronger, albeit slowing, expansion in emerging markets. Structural problems, insufficient global rebalancing, a persistent development gap, and high levels of public and private indebtedness and uncertainty continue to weigh on medium-term global growth prospects. In their communiqué, the finance ministers and bank governors applauded the deal made with Greece, but behind closed doors they sparred over the eurozone's commitment to put in place a proper firewall to mitigate contagion and investor lack of confidence.[1]

The New York Federal Reserve completed its sale of the mortgage-backed securities it bought from AIG and turned a profit of \$2.8 billion on its \$19.5 billion portfolio. Separate sales to Credit Suisse and Goldman Sachs were completed. AIG then bought some of the portfolio's contents from the broker-dealers citing that their crisis was over. The New York Federal Reserve still holds AIG's credit default swaps (CDSs), which it purchased during the AIG bailout.

Although trading volume has fallen for the third straight year, the Dow Jones Industrial Average (DJIA) crossed the 13,000 mark in February for the first time since the start of the financial crisis in 2008. In a move that was more emotionally invigorating than technically significant, the DJIA replaced AIG, Citigroup and General Motors with Kraft, Cisco Systems and Travelers. The Dow's highest day was when it hit 14,164 on October 9, 2007. The lack of volume has forced more U.S. brokerage firms to close, because raising capital and obtaining adequate loans to offset the decline in trading revenue have become tougher. Membership in the U.S. Financial Industry Regulatory Authority (FINRA), which regulates broker-dealers, has decreased by 11% since 2007. Burdensome regulatory costs are another reason some firms cannot stay afloat. The European sovereign debt crisis is also claiming victims. French bank Crédit Agricole posted a €3.07 billion loss due to losses on Greek debt and its shrinking balance sheet. Franco-Belgian Dexia posted a 2011 net loss of €11.6 billion. Natixis, Deutsche Bank, Credit Suisse and Barclay's are among other industry giants that posted losses.

1 G20 (2012), "Communiqué: Meeting of Finance Ministers and Central Bank Governors," February 26. <www.g20.utoronto.ca/2012/2012-120226-finance-en.html>.

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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.

The U.S. Federal Bureau of Investigation (FBI) released a report on its open cases and the types of fraud under investigation in the financial markets. It noted that insider trading was widespread. The FBI has increased the use of wiretaps and undercover operations in its 2,572 open cases.

The International Monetary Fund (IMF) warned China that it would have to prepare to add stimulus if the situation worsened in Europe as it could cut its projected 8.2% growth in half. China's internal demand for imports is slowing, and its exports contracted by 0.5% and declined by 5.5% to Europe alone. This trend may lead to a more gradual rise in the renminbi than first planned by Chinese policymakers. The low loan-to-deposit ratio also suggests that the People's Bank of China may have to include open-market operations and not simply decrease the reserve requirement ratio to spur growth and lending. China is nonetheless maintaining its strong investment policy.

A $1 billion partnership between Canaccord Financial and the Import-Export Bank of China is a prime example of business relationships that are growing in importance. The two entities are creating a "Canada-China Natural Resource Fund" to improve technology in Canada in the energy sector in order to increase available resources for import to China.

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>.