The PREYMA Report

The G20 and Global Capital Markets
Critical Issues and Analysis

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Introduction

Typically a slow trading month due to vacations, August turned out to be tumultuous for the global capital markets. Although the U.S. debt ceiling issue was solved at the final hour by Congress and passed by the Senate, renewed economic fears soon took over. Concerns grew that the slowdown at the beginning of the year was not temporary and that the continuing debt crisis in Europe would spread; they peaked when Standard & Poor's downgraded the rating of the United States from AAA to AA+, citing the shortfall of the fiscal plan of Congress and the Administration would not be enough to stabilize the government's medium-term debt dynamics. A week of 400-point swings in the market ensued, but things calmed down in the second half of the month. Moody's and Fitch affirmed their highest credit ratings for the U.S. despite the S&P downgrade.

The market swings prompted emergency phone calls over the weekend of August 6-7 to quell the crises in Europe and the United States. The finance ministers of the G7 and the G20 and the officials of the European Central Bank (ECB) sought a plan to restore stability to the financial markets. The G7 finance ministers and central bank governors issued a statement on August 8 that said they are committed to taking coordinated action where needed, to ensuring liquidity and to supporting financial market functioning, financial stability and economic growth.[1] The ECB signalled that it would buy Spanish and Italian bonds to soothe nervous investors. Fear soon infected France, where bank stocks lost double-digit percentages due to rumours that France's rating may be downgraded next. At one point Société Générale was down more than 20% amid rumours of financial trouble. President Nicolas Sarkozy returned from his holiday early to reassure investors that he would cut France's huge debt and that a ratings downgrade was not forthcoming. All three rating agencies affirmed their top ratings for the country.

France, Italy, Belgium and Spain imposed a ban on short selling on some banks and large financial institutions for various lengths of time in order to contain the Eurozone debt crisis, calm markets and to restrict the benefits from spreading false rumours. Korea and Greece also completely banned short selling for three months and two months respectively after their markets lost significant value. By month's end, in European countries that had banned short selling, regulators extended the timelines promising a review by the end of September.

German chancellor Angela Merkel met with French president Nicolas Sarkozy mid month to discuss the financial crisis in Europe. They agreed to proceed with closer euro-area cooperation, harmonization of corporate tax rates, debt limits to be written into national law and the creation of a European council. They rebuffed an expansion of the European Financial Stability Facility (EFSF) rescue fund beyond its current €440 billion and prioritized the levying of a financial transaction tax.

With the U.S. and Europe in turmoil, investors flocked to buying the Swiss franc. The Swiss central bank unexpectedly cut interest rates in response, because an overinflated currency has a direct negative effect on economies like Switzerland's, which relies heavily on export and tourism.

U.S. treasury secretary Tim Geithner, who took office in January 2009, suggested he might step down after the crisis over the debt ceiling was solved. He agreed to stay on after being asked by President Barack Obama.

Warren Buffet, through Berkshire Hathaway Inc., has purchased $5 billion of Bank of America preferred shares. The 50,000 perpetual preferred shares have a liquidation value of $100,000 each, pay a dividend of 6% per year and are redeemable at any time. Warrants to buy 700 million common shares at $7.14 each and good for 10 years were also part of the deal. Bank of America stock, which has dropped by almost 50% this year, surged by almost 26% the day the deal was announced.

The Organisation for Economic Co-operation and Development (OECD) has reported a growth slowdown in its members, led by Europe, this past quarter. Moody's Analytics also reported that the economic outlook was significantly weaker than in June due to a series of economic shocks in the spring and summer that eroded overall confidence.

Turmoil continued in Japan as Naoto Kan resigned as prime minister on August 26. The Japa-

1 G7 (2011), "Statement of G7 Finance Ministers and Central Bank Governors," August 8. <www.g8.utoronto.ca/finance/fm110808-en.html>.

nese parliament elected finance minister Yoshihiko Noda as his replacement on August 30. Jun Azumi was appointed the new minister of finance.

After six months of fighting by NATO forces in Libya, rebels entered the city of Tripoli on August 21 and took control of the city on August 23. Muammar Gaddafi's second wife and children fled to Algeria, but the whereabouts of Gaddafi and his sons remain unknown.

Dominique Strauss-Kahn is a free man after a New York judge dismissed the sexual assault case against the former managing director of the International Monetary Fund (IMF). Prosecutors cited doubts about the credibility of the accuser, who filed a civil suit against him on August 8. French prosecutors are also considering whether to lay charges against him after a French writer claimed he sexually assaulted her.