The PREYMA Report

The G20 and Global Capital Markets
Critical Issues and Analysis

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Introduction

On October 14-15, at a time of heightened tensions and significant downside risks for the global economy, the G20 finance ministers and central bank governors met to take decisive action to restore confidence, financial stability and growth. They welcomed the ambitious reform of European economic governance and actions taken by euro-area countries to implement the decisions taken by their leaders on July 21, 2011, to increase the capacity and the flexibility of the European Financial Stability Facility (EFSF). They made progress on their action plan of coordinated policies for consideration by their leaders at the Cannes Summit a few weeks later. This action plan will encompass a set of measures to address immediate vulnerabilities and strengthen the foundations for a strong, sustainable and balanced growth.[1]

The European Union agreed to ban "naked" credit default swaps (CDS) on sovereign debt. It added conditions and reporting requirements to short selling, which will take effect November 1, 2012. Countries that previously opposed the initiative were appeased by a clause that any country could opt out if the ban was seen to be damaging their government debt market.

After meeting frequently throughout the month, European leaders and finance ministers announced market-stabilizing measures at a summit in Brussels on October 26-27. They finalized the leveraging of the EFSF up to €1 trillion from €440 billion (with the exact terms to be worked out by eurozone finance ministers by the end of November). Holders of Greek sovereign debt would take a nominal discount of 50% on notional debt (deemed as a voluntary bond exchange so as not to trigger CDS). The European Union's largest banks would have to recapitalize to hold Core Tier 1 (CT1) capital equal to 9% after the sovereign debt writedown by June 2012 (which the European Banking Authority estimates would cost €106 billion). China said it would consider contributing up to €100 billion to the EFSF (with conditions) and, for the first time, another emerging economy — Brazil — looked into how to aid Europe.

1 G20 Finance Ministers and Central Bank Governors (2011), "Communiqué of Finance Ministers and Central Bank Governors of the G20," October 15. <www.g20.utoronto.ca/2011/2011-finance-111015-en.html>.

After all the negotiating over a rescue package by his European counterparts, Greek prime minister George Papandreou surprised the world by announcing a referendum on whether Greece would agree to the austerity measures called for at the Brussels summit. Markets went into a tailspin. Even the Greek finance minister was unaware of the decision until Papandreou announced it in Parliament on October 31. With only a two-seat majority after a defection in his own caucus, Papandreou will face a confidence vote on November 4 — which he is unlikely to pass.

As corporate default concerns rose after the bailout of the Franco-Belgian bank Dexia, credit rating agencies continued to downgrade Spain, Italy, France, as well as banks in the United Kingdom and even two banks in Canada. The U.S. economy grew at a rate of 2.5% compared to 1.3% in the second quarter. The Organisation for Economic Co-operation and Development (OECD) reported a continued slowdown in private consumption. China reported its growth had decelerated to 9.1% — the lowest in two years. CDSs on banks around the world rose to a level not seen since the financial crisis began in 2008. The Occupy Wall Street protest continued, with solidarity protests in other cities around the world joining the movement. Amidst this backdrop, U.S. president Obama's job bill stalled in the Senate when the Republican caucus and two Democrats voted against its procession to full consideration.

The U.S. Securities Exchange Commission and the Commodity Futures Trading Commission (CFTC) issued a joint statement on October 31 that they, along with other regulators, had been closely monitoring MF Global, Inc., a jointly registered futures commission merchant and broker-dealer. MF Global had reported to them that an anticipated transfer of customer accounts to another firm had not been agreed to and there were possible deficiencies in customer futures segregated accounts held at the firm. The SEC and CFTC determined that bankruptcy proceedings would be "the safest and most prudent course of action to protect customer accounts and assets."[2] The U.S. Securities Investor Protection Corporation (SIPC) initiated the liquidation of MF Global under the *Securities Investor Protection Act*.

After 42 years in power, Libya's ex-leader Colonel Muammar Gaddafi was killed on October 20 after an assault on his birthplace of Sirte.

2 Securities and Exchange Commission (2011), "SEC-CFTC Statement on MF Global," October 31. <www.sec.gov/news/press/2011/2011-230.htm>.