The PREYMA Report

The G20 and Global Capital Markets
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Introduction

May began with news of the death of Osama bin Laden in a U.S. military operation. Markets did not react right away to the news.

On May 2, Canada's Conservative Party won the first majority government in six years after successive minority governments held by the party. Jim Flaherty became the longest serving finance minister in the G8.

The G8 leaders met on May 26-27 in Deauville, France. With most financial topics now being discussed at the G20 summit, over a day and a half they discussed topics such as solidarity with Japan, the internet, innovation and the knowledge economy, green growth, nuclear safety, climate change and biodiversity, accountability on development, and peace and security.[1]

Just before the G8 Deauville Summit, several countries imposed sanctions on Syria in response to the government's violent crackdown on peaceful protestors. With continued unrest in Libya and the rest of the Middle East and North Africa, the G8 leaders pledged support for the aspirations of the "Arab spring." They launched the Deauville Partnership with the people of the region and the countries engaging in a transition to free, democratic and tolerant societies, beginning with Egypt and Tunisia. This partnership is based on two pillars: a political process to support the democratic transition and foster governance reforms, notably the fight against corruption and the strengthening of the institutions needed to ensure transparency and accountable government; and an economic framework for sustainable and inclusive growth. The partnership is designed to support members in economic and social reforms, particularly in creating jobs and enshrining the fair rule of law, while ensuring that economic stability underpins the transition to stable democracies.[2]

On May 16, the United States hit its debt limit as the debate continued in Congress over raising the debt ceiling from $14.3 trillion or reducing the deficit by initiating spending cuts. That same day, the Treasury suspended new investments in federal retirement and disability funds, which provided $147 billion in room under the ceiling, and which treasury secretary Tim Geithner said would allow the government to function until August 2. The government currently borrows $125 billion every month and Geithner has said that an increase of $2 trillion would last beyond the presidential election in 2012. On May 31, Ways and Means chair Dave Camp presented the House of Representatives with legislation intended to be voted down because it focused solely on raising the debt ceiling without any deficit reduction or spending cuts. Only 97 representatives voted in favour.

The European Commission has opened a second antitrust investigation, this time into whether bank dealers colluded in the credit default swap (CDS) market by giving market information to Markit. This investigation immediately follows an examination of whether 16 banks colluded to manipulate the LIBOR (London interbank offered rate) during the financial crisis.

A year after Greece received its first emergency loans, it faces a funding gap of more than €60 billion in 2012 and 2013. EU leaders and finance ministers have met to discuss what they feel are limited options: restructure the debt by extending the maturities of current bonds, decrease interest rates charged on the debt, ask current bondholders to roll over the bonds after they mature and continue to hold the new bonds, or infuse additional funding. The EU, the European Central Bank (ECB) and the International Monetary Fund (IMF) are auditing Greece's progress in executing the reforms that were a condition of the emergency loans it received last fall. At the end of May, EU leaders will decide on the best aid package when the audit is completed in early June. The ECB warned against any form of restructuring, which it would consider a default. Fitch and Standard & Poor's, which both downgraded Greece significantly in May, would also consider restructuring to be a default.

Portugal, the third country in the eurozone to require a bailout, received an aid package of €78 billion over three years on condition that it ask private bondholders to maintain their exposure to

1 The G8 communiqué and other documents from the Deauville Summit can be found at <www.g8.utoronto.ca/summit/2011deauville>.

2 G8 (2011), "Declaration of the G8 on the Arab Spring," May 27. <www.g8.utoronto.ca/summit/2011deauville/2011-arabsprings-en.html>.

its debt rather than selling it off. Europe will provide €52 billion at 5.5% and the IMF €26 billion at 3.25%. This plan includes €12 billion for Portugal's banks and requires Portugal to address its deficit by 2013 and reform its healthcare and public administrations. Fitch raised its outlook for Iceland from negative to stable — the first such move since the country's collapse in 2008. Fitch also said that the Icesave dispute over debts owed to Britain and the Netherlands, which gave money to citizens who lost deposits when Iceland's Landsbanki collapsed, is not likely to delay Iceland's economic recovery.

Fitch also downgraded Japan to a negative rating because of rising government debt levels. Because the country's gross government debt reached 210% of gross domestic product (GDP) by the end of 2010, any prolonged delays of reconstruction after the March 2011 tsunami and nuclear disaster could drive corporate relocation abroad and therefore bring a permanent loss of output. A strong and credible consolidation plan that has strong political support could reverse the negative outlook.

In their annual strategic and economic dialogue, China and the U.S. agreed to increase business ties but, not surprisingly, did not agree on the strength of the yuan or on letting it float freely. Among other things, U.S. officials pledged greater business opportunities for Chinese firms and China pledged that foreign insurers will be able to sell auto insurance. China will also strengthen its inspection mechanism to prevent the use of pirated software in state-owned enterprises.