The PREYMA Report

The G20 and Global Capital Markets: Critical Issues and Analysis

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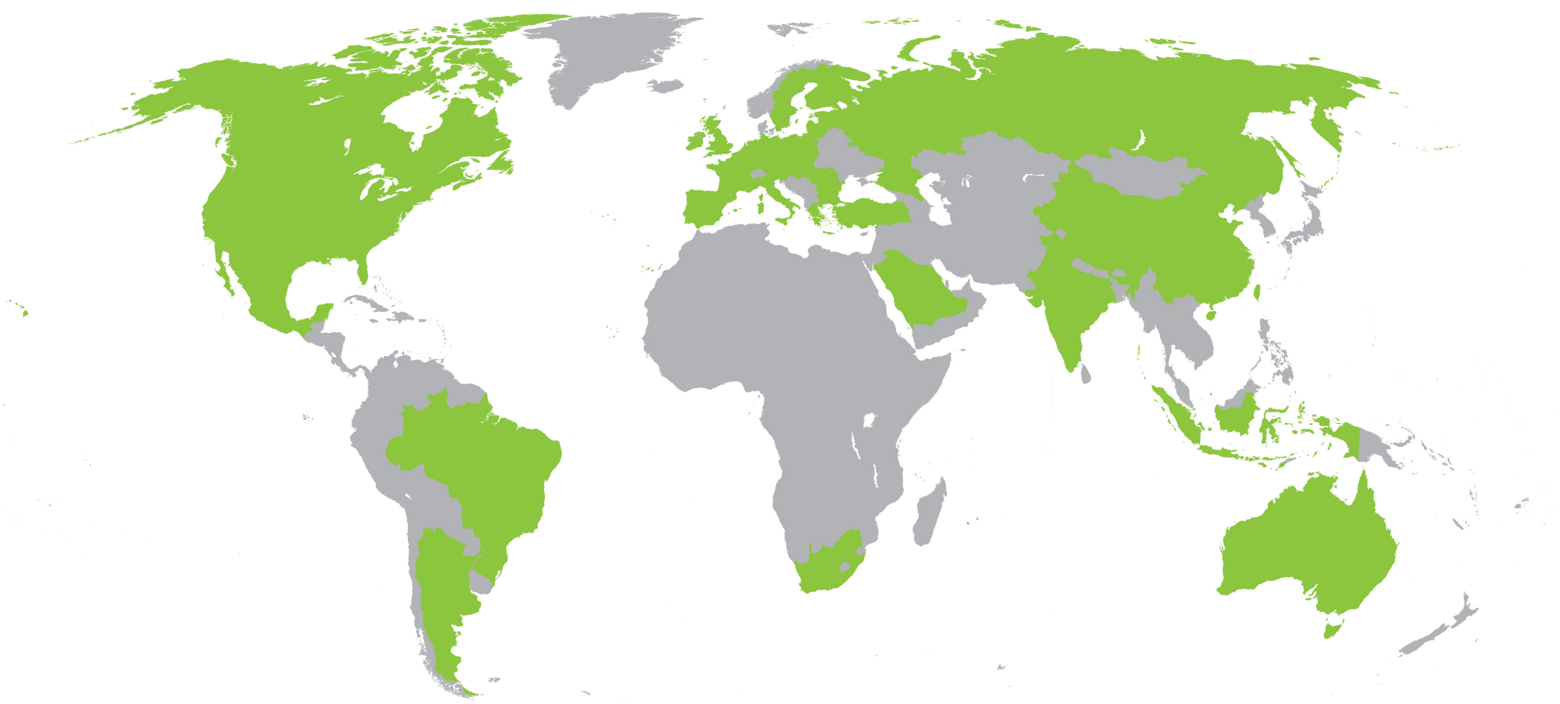

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Introduction

Most people would like to say goodbye to 2011 forever. The year was tumultuous and brought increased uncertainty to the capital markets. It seems 2012 is starting out in much the same way. Greece continues to repel confidence and the euro area is likely to face a recession this year. All the major global organizations have downgraded their forecasts for economic growth. The Financial Stability Board (FSB) has said that although market conditions have improved, downside risks remain substantial because the European sovereign debt crisis continues to weigh on the global financial system. The leading indicator readings issued by the Organisation for Economic Co-operation and Development (OECD) point to a slowdown in economic activity in most OECD countries and major non-OECD countries, with Japan, Russia and the United States showing some positive signs. The World Bank cut its forecast by the most in the last three years, saying that the impending recession in Europe will threaten global growth and that emerging markets have to brace for an exacerbated slowdown. It says world economic growth will only be 2.5% in 2012 and even achieving this number is uncertain. Foreign direct investment in China has decreased by the most since July 2009, which indicates a national focus on internalizing investment. The International Monetary Fund (IMF) lowered its global growth forecast to 3.25% and noted that downside risks are increasing. It expects economic growth to decrease in emerging markets due to the weakened external environment and reduced internal demand. Moody's announced that the credit ratings of banks and securities firms will be reviewed in the first quarter of 2012 to assess the impact of deteriorating sovereign creditworthiness, heightened economic uncertainty, elevated funding spreads and reduced market access in the face of large amounts of debt maturing.

Stock trading in January was down close to 18% year over year, affected by investors' wait-and-see attitude, continued uncertainty over the European debt crisis and staff layoffs at brokerage houses. Citigroup is shutting its equity principal strategies desk, which uses the firm's own capital for trading. The Royal Bank of Scotland announced that with the restructuring of its investment banking arm it will eliminate approximately 3,500 jobs over the next three years. At now bankrupt MF Global Holdings Inc., investigators do not expect to find $1.2 billion of missing customer money. Customers, whose accounts were frozen after the company filed for Chapter 11 bankruptcy in October, cannot trade without access to their accounts. Worse still, some will have to rebuild their accounts and now will likely be skittish about using a trading account — especially if the money is not recovered. Kweku Adoboli, the former UBS trader responsible for the company's $2.3 billion loss due to unauthorized trading, pled not guilty to all charges in a London

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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.

court. His trial date is set for September 3, 2012.

At the annual World Economic Forum in Davos at the end of January, topics for discussion included finding solutions to global sustainable growth and job creation, the economic situation in Europe, the role of emerging markets in solving the financial crisis and the state of affairs in the Middle East. For the first time in 30 years, high-level Chinese officials were absent, as the forum took place during Chinese New Year festivities. Several chief executives of banks also did not attend. Many participants felt that although the discussions were relevant, they were short on ideas for solutions to global problems.

The election year kicked off in the United States with primaries for the Republican leadership candidate bringing Mitt Romney to the forefront as the leading contender. In the State of the Union address, President Barack Obama proposed a 30% minimum tax on anyone making over $1 million, a lower tax for companies that open factories in the U.S. and bring jobs home, and a tax increase for companies that export jobs outside of the United States. He proposed a $200 billion, six-year infrastructure plan and the creation of a financial crimes unit to investigate and prosecute financial fraud. Treasury secretary Timothy Geithner told reporters that he did not think the president would ask him to stay on for another term. Geithner had previously stated he would resign in August after the debt ceiling issue was solved and then agreed to stay on until the presidential election was over.

Investors need to understand how to navigate through the coming year for it will not be an easy one. They will need to consider more than just economic factors. Politics and personalities will also affect the decisions that are made. Stock market performance not only will be dictated by stock picking but, more importantly, will also be driven by the debt markets both in Europe and in North America. Investors are nationally internalizing their capital all over the world to decrease risk. If the Volcker rule remains unchanged in the United States, it will have an impact on the liquidity of sovereign securities and will therefore increase spreads and affect saleability. The coming recession in Europe will have spillover effects not only in developed economies but also in emerging markets, which are already dealing with decreased internal demand, lower external inflows and continued inflation. The

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>.

slowdown in China will also create a global decrease in demand. The deleveraging in the banking sector, as firms continue to prepare for pending regulation and increased capital requirements, will ensure that cost cutting continues. As a main driver of tax receipts for government, the financial industry continues to see a political response in the regulation of compensation and activities that will affect earnings — which will in turn decrease taxable income, consumer spending and government revenue. Revenue will be needed to generate job growth, stimulus and debt repayment. These factors will lead to more credit rating downgrades for sovereigns and banks alike, which will make it harder and more expensive to borrow. Investors in the European bond markets will become more fatigued and demand will soon dry up. Those traditionally in the business of stock picking will move toward alternative assets such as exchange-traded funds (ETFs) in order to participate in sectors but not try to pick individual winners. ETF regulation will be a hot topic for regulators in 2012 so this area will also come under scrutiny, as will shadow banking and alternative asset management. Elections in many countries will see economic decisions fast tracked, as in the case of French president Nicolas Sarkozy implementing a financial transaction tax (FTT) in France. Russia, China and the U.S. will face similar economic decision making in efforts to sway the popular vote. A tough year ahead, to be sure.

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