



The International Group  
of Treasury Associations

# IGTA eJournal

## SUMMER ISSUE 2015



**EU - WHERE DO WE GO FROM HERE?**

**Plus | Ireland: A lost decade | The EU's Capital Market Union**



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**Dear Treasurer,**

You receive the **IGTA e-Journal Issue Summer 2015.**

This is a First for IGTA. It is to be the electronic professional journal of IGTA, the International Group of Treasury Associations.

This journal, other than the IGTA Website, is intended to be the internal ongoing information platform for professional subjects, for the members of the National Treasurer Associations (NTAs) and for IGTA itself,

destined to reach the desk of each treasurer of an NTA,  
or reach him, her otherwise,  
at the discretion of the NTA Member Institutes of IGTA.

This issue contains a broad variety of articles on matters of concern to the treasurers, from 5 countries, respectively country groups, and from very diverse sources.

**All NTA member institutes of IGTA  
And all individual members of NTAs**

**we do herewith ask, to send to us, from time to time, articles, for inclusion in  
future IGTA e-Journals.**

That is, we wish to receive articles, which in your view are articles to be considered to be of general interest to the worldwide audience of IGTA members.

Also, we shall always be open to suggestions for improving format and style of this e-Journal.

For the time being, please send such articles in future to:  
[Helmut.Schnabel@asecuris-asset.com](mailto:Helmut.Schnabel@asecuris-asset.com)



IGTA is a voluntary association.

We have no financial means.

We collect no membership fees from NTA Members.

We employ no administrative staff.

As a consequence, do not expect miracles from this IGTA.

Everything, which each one in IGTA contributes, is a voluntary contribution of time, effort and professional know how, for the benefit of our association and of all of its members. Let us jointly continue on this path. Let us continue to contribute to its flourishing within the given parameters.

Every contribution from each NTA and from each of its members will be highly appreciated by all of us.

Already, we are also working on the Issue Autumn 2015 of the IGTA e-Journal.

With best personal regards



Helmut Schnabel

**European Union,**

**Presentation:**

**The European Union, the Euro, Greece, the ECB,  
Quantitative Easing: Challenges for the Treasurer.  
Where Do We Go From Here?**

**By Helmut Schnabel**, Managing Director Asecuris Asset  
Management Advisory GmbH, Chairman IGTA, International  
Group of Treasury Associations

Ladies and Gentlemen,

Seven years after the great financial crisis, the politicians, the European people, and the business community are still dealing with the following great challenges for the countries, for the economies, and for the corporations:

- how can the over-indebtedness of states be contained?
- how stable or unstable is the common currency, the Euro?
- how do the European States get out of recession, and regain stability and growth?
- will ultra-low interest rates be the cure for all financial problems and challenges?

Daily, we are confronted with comments to these issues and questions, from all involved parties, and more than ever we need a compass which guides us through this daily flood of such comments and opinions, as to what will be the best solutions for the ongoing challenges.

Let me start with touching upon the Euro. We are all aware, of what the foundations of the Euro are: It is to be a stable, strong and joint currency of the European countries, which participate in the Euro, it is a part of our European identity, which can be felt in our hands and pockets, daily, and, most of all, it symbolises the will and desire of all participating countries, after centuries of war, to live and work peacefully together for the joint common political and economic advantage and benefit. This mission and vision is also the ground layer of the European Union, constituted by 29 European Member countries.

But no instrument demonstrates this daily so intensely to everybody, as does the joint currency the Euro.

Why then, has the Euro become, as of today, a phenomenon of so much dispute between the Euroland member countries. What went wrong? The brief answer is this:

The creation of the common currency, the Euro, implies, that the participating countries have given away part of their sovereignty, meaning they stopped having their own currency and own central bank, and own monetary currency policy,

While, at the same time, maintaining sovereignty in other economic spheres, such as first of all the own fiscal policy of a sovereign state.

As all economic policies are interlinked, it was clear from the beginning, that the joint currency can only be successful, if there is also harmonisation of all other economic policies, at least to some degree.

And so the famous Maastricht Treaty was created, which not only defines the basics of the Euro, but which also defines criteria for economic stability, which itself then is the prerequisite of economic growth of the participating countries. The basics of this are in a nutshell:

- the yearly deficit of the government budget of a member state should not exceed 3 % of GDP

- the government indebtedness should not exceed 60 % of the GDP

- no member state should be held liable for the government debt of the other participating states, and thus there should not be any forced flow of money from one government to the other one in order to balance off government deficits. In short, Euroland should not be a Transfer Union.

- and last but not least, the European Central bank is not allowed, to finance the governments of states.

*In summary, and to put it differently:*

- the Euro is meant to be as stable and strong as the former DeutschMark.*

- the European Central Bank is meant to be as independent from politics, as is the German Bundesbank/ German Central Bank independent from politics.*

The history is known. By the nature of the Euro construction, the Euro can only function successfully, if the participating states have the discipline and the political will, to abide to the Maastricht Treaty criteria.

It took only 3 years until 2003, that 2 major states, Germany and France, broke the rule of not exceeding the 3 % annual government budget deficit, and since then, again and again this rule, and also other rules ( ! ), have been broken by the same 2 countries and by many other Euroland member countries. To the degree, that rule breaking has become common place.

Worse than that, from the beginning, 2 states were admitted to the Euro, Belgium (118%) and Italy ( 126%), which had government debt outstanding of over 100 % of GDP. Promises to bring this down considerably over time, have not been fulfilled, to the contrary, government debt was expanded in Italy towards 132 % of GDP, (Belgium now 107%).

And then came the great financial crisis 2008 to 2009, when many European countries had to bail out failed banks, and when governments did that by incurring huge additional debts, which had not been thought of before and budgeted before, and which led to the effect, that the governments of Euroland are now higher indebted and leveraged, than ever before since WorldWar 2<sup>nd</sup>, and way beyond the Maastricht Criteria.

Then in 2010 and in 2012 came the Greek Crises, and the tedious and painful effort of the other Euroland countries, to help out Greece from the brink of insolvency and bankruptcy, by installing a great bail out architecture which as of present looks like this:



-the total of Greek government debt is at **317** billion €

-of the **317** Billion € government debt, 82 %, or **260** billion €, is from the 2 bailout programs, from 2010 and from March 2012, from creditors who are Euroland countries, the ECB, and the IMF

-of the **260** billion €, three quarters, or **195** Billion €, is from the other Euroland countries and the Euro Bailout fund EFSF/ ESM, which has been set up by such Euroland countries

-the ECB holds **30** billion € of Greek debt

-the IMF holds **35** billion € of Greek debt.

There already has been a debt-hair-cut for Greek government debt, in November 2012, by the amount of **105** billion € from private creditors.

And there has been a second quasi debt-hair-cut in 2013 relating to the 142 billion € bailout loans from the ESM Bailout fund, which looks like this: Deferring most of the interest payments on such loans until 2022, and requesting no instalment repayments until 2022.

increasing the average maturity of such loans by 15 years to 30 years; with the last repayment instalment to be made after 45 years, in 2057.

lowering the interest rate on such loans by one full percentage point to now only libor plus 50 basispoints, which presently makes an interest rate of 60 basis points only.

The total amount of this preferential treatment, expressed in present value, is **47** billion €, and a second quasi debt-hair-cut, at the expense of the European taxpayer.

In spite of this, the present Greek government debt level is again at **177** % of GDP, and way beyond the Maastricht criteria of 60 % of GDP.

Many believe, that Greece cannot shoulder and service this debt level, and that another 3 rd debt haircut will be necessary. In the case of Greece, 2 handicaps are coming together:

One, the government over-indebtedness.

Two, the lack of competitiveness of the Greek economy in the globalised world market.

Usually, the market reaction to this would be, that the domestic currency of Greece, formerly the Drachma, would be weakening, there would be a devaluation of the currency, which would then at least remedy part of the insufficient competitiveness in the world market.

As Greece is not having its own currency any more, therefore, what is called the external devaluation of the Greek currency, and of Greece, is not possible any more.

Therefore, the only way out of the dilemma for Greece, is the so-called internal devaluation, meaning the lowering of costs of production in Greece, among which the most important one is the lowering of wages in Greece.

This as everybody knows, and as everybody sees now, is tough to do. But with fairness, we should remember, that Greece, after joining the Euro, excessively increased its wages and other categories of costs, including the costs of an inefficient government and tax administration, and it is itself and alone responsible for having lost its international competitiveness.

So again, what remains to do, is the inner devaluation for Greece, as have successfully done the Baltic States, and to some degree as well Ireland and Portugal.

But the new Greek government refuses to do so, it refuses to do the reforms, which the donating countries are requesting from Greece, and which the preceding government was on the way to carry out.

The tragedy is, that the preceding Greek government had set the course for an economic recovery of Greece which was just about beginning at the end of last year. But then the new radical Greek government set an end to the reforms and we are now in a phase, where many have no confidence any more in a recovery of Greece, and where investments in Greece by local investors and international investors are stalling.

And the latest numbers tell the brutal truth: in the fourth quarter 2014 Greece had negative growth, and also in the first quarter of 2015. This, by definition, is recession.

So, what to expect as a solution:

What is different from 2011 and from 2012, is that there is a pretty high consensus, that with a Greece leaving the Euro, there would not be a contagion, or a domino effect, which would result in other southern European countries to having to leave the Euro as well. So, a Grexit, to many, is not any more a nightmare. And it would not have to be the end of the Euro.

Secondly, many do not think, that even a complete end of the Euro, to mention the worst case, would be the total failure of Europe and the European Union, as Merkel keeps saying and warning.

Thirdly, there is open mention now, that the Euroland countries, and of course also the corporations of the real economy, have a plan B, what to do in case of a Grexit. Before, nobody dared to mention, that there is a plan B.

But inspite of all this, there is great pressure from inside the governments of the donating Euroland countries to keep Greece in the Euro and to do everything, to keep Greece away from bankruptcy. Why?

The moneys cumulatively credited to Greece are so huge, that the governments of the crediting Euroland countries do not want to stand up before their voters and having to say, that all loans made to Greece are lost, at the expense of their taxpayers, and that the losses would have been a lot smaller, had all the bailout loans of the past four years not been made, and had a Grexit been made four years ago, when it had already been recognisable, that Greece had overextended itself.

Having to admit this, is the worst nightmare of the European politicians.  
And this is the negotiating power of the present Greek government.  
And this makes the outcome of the present situation unpredictable.

But how long can this dealing and wheeling continue? Is muddling through really the good strategy?

Is it imaginable, that the Greek government continues to make promises to its voters, for which the taxpayers of the other European countries have to pay, and that Greece at the same time does not accept the imposed conditions for reforms in Greece, imposed by the European creditor countries?

What can also be observed and said is this:

Countries like Ireland, Portugal and Spain have also received bailout money from the other Eurozone countries, and they successfully, and to a significant degree, have made the reforms requested by the creditors, as painful as these reforms have been. And all three countries by now are on the path for recovery.

If they would see, that Greece would get new money again and again, without having to carry out necessary and tolerable reforms requested by the creditor countries, they would get disincentivised to continue on their own reform path, which is not yet completed. And they would also request more bailout money, without having to pay for it by way of carrying out the requested necessary reforms. A new avalanche of bailout requests would then indeed be the end of what the giving countries can deliver.

For Spain, growth projections for this year have just been raised to 2,8 %, for Portugal raised to 1,6 %, and growth in Ireland is even booming by projected 3,6 %.

Some Eurozone politicians are praising, that Eurobonds would be the solution of all problems. But: Eurobonds are not a solid financing instrument. They represent socialism of indebtedness.

Eurobonds are not the solution. It would be, like you here in this room, giving your personal credit card to somebody else, who can then freely buy for himself, herself, at your expense. What nobody in this room would do, and could do, cannot do Eurozone member states either.

Let us again remind ourselves, of how the Euro is constituted in the Maastricht treaty:

-no member state should be held liable for the government debt of the other participating states, and thus there should not be any forced flow of money from one government to the other one in order to balance off government deficits. In short, Eurozone should not be a Transfer Union.

-and last but not least, The European Central bank is not allowed, to finance the governments of states.

Both contractual and legal prerequisites of the Euro are by now being broken by the participating Eurozone countries and the ECB, notwithstanding what is said to the contrary. And daily we must read about this great controversy, which is not going away by itself.

The view of many is: One cannot build a stable currency like the Euro, by permanently building it on the breaking of the agreement, of the contract and of the law. The end of the law, if it ever occurs, would then indeed lead to the end of the European Union.

As said the German Pope Benedikt the XVI th in his famous speech in the German Bundestag parliament in 2011: Take away the law - what else then is the state than a great gang of robbers.

Saying this is not popular, I know, but it is to be said.

Still, I will not make a too pessimistic statement to you today.

Probably a point will come soon, where the willingness will collapse, to give more new money, and to get no reforms for it in Greece, and no chance for a recovery from the inefficiencies in Greece.

The Euro is not Europe. The Euro is not the European Union.

Those countries, which do not have the Euro, are also Europe.

Those countries, which do not have the Euro, are also the European Union,  
9 out of the 28 European Union Countries.

The 28 European Union Countries are one of the greatest economic and political success stories in history of mankind, even without the Euro.

Since 1992, these now 28 European Union Member Countries have created this huge internal market of 507 million people without customs and tariffs.

This internal market has 4 constituents:

- The free flow of Goods

- The free flow of Services

- The free flow of Capital, including the right to freely establish businesses

- The free flow of Labour, meaning people can move freely to where they find work

This internal market is complemented by the governmental institutions of the European Union.

The European member states have given part of their sovereignty to such European Union governmental institutions, but not all.

The balance between the two is in a permanent state of flux, of discussion, and of even dispute. See the permanent criticism by the UK, saying, that too much and unnecessary responsibilities have been given to Brussels, thereby unnecessarily undermining the sovereignty of member states.

When suffering from the Euro crisis day in and day out, as is the case now, we must never forget this:

The internal market and its political framework is the biggest achievement of the European Union.

The internal market did function well from its inception in 1992 till 1999, without the

existence of the Euro, and it does function well for the 9 European Member states, which are not part of the Euro.

And it does function well between such 9 non-Euro member states with their 173 million people, and the 19 Euro member States with their 334 million people.

To preserve this 28 European Countries internal market and political framework, and the concomitant peacefully living together, is many more times important and beneficial for the people than the existence of the Euro.

Indeed, and thank God, the 28 European Countries internal market and political framework is not in danger, and it is the biggest economic and political achievement in the history of Europe.

And let me say, it is also the biggest economic and political experiment in the history of mankind. And let me add: It is admired for this in many parts of the world outside Europe.

Let me quote the Polish Donald Tusk, President of the European Union Council, who said this month:

Quote: I am profoundly convinced, that no country has a better life outside of the European Union.

Unquote.

And I do say: as Europeans we know: One of our biggest assets, among all others which are commonly mentioned, is our cultural richness and diversity. Out of this follows, that not everything must be harmonized by Brussels. To the contrary: Diversity must be maintained and cherished.

Again I quote the Polish Donald Tusk, President of the European Union Council, who said this month:

Quote:

Great Britain is playing a key role in the endeavour, to strengthen the competitiveness of Europe by way of a functioning internal market, and without an excess of regulations.

Unquote.

What advice can be given to the treasurers in this room, in the present economic and political environment:

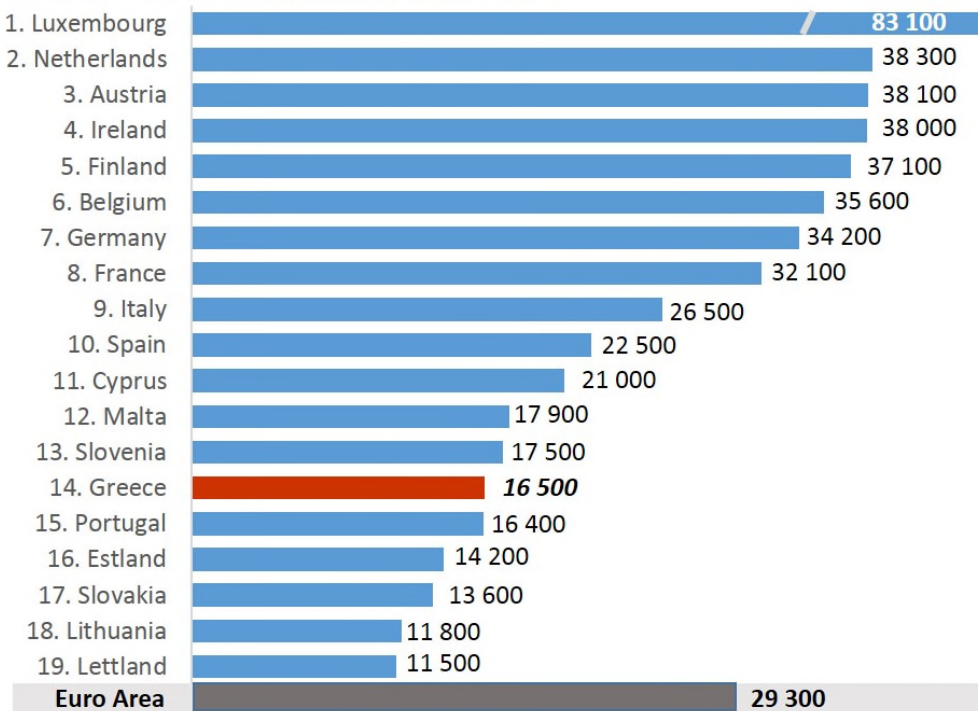
To those in this room, not from countries, who have the Euro as currency: Do not worry not to being part of the Euro. You have the benefits of the internal market, you do not have the burdens that go with the Euro. So wait and see.

And do not forget this statistics: Within the Euro, countries with lower per capita income must subsidise countries with a higher per capita income. Why get yourself into this. Wait until the Euro has become a fair institution.



## Many in the Euro Area are not richer than the Greeks

Gross Domestic Product per Capita, 2013, in Euro



Source: Eurostat

The situation is similar, when comparing the monthly minimum wages installed in selected countries:

Latvia     360 Euro  
Slovakia   380 Euro  
Greece     684 Euro

Says Robert Fico, Prime Minister of Slovakia: There is no reason for Slovakia, to make money gifts to others.

As to the interest rates presently prevailing: lowest interest rates in history of mankind. Even negative interest rates on government debt, never seen in history of mankind. Already some big corporates getting close to enjoying negative interest rates on their debt.

And as to the day in and day out news flow about the quantitative easing of the ECB, as to the talk of Europe falling into deflation, like the sinking ship, and as to the talk of banks not making sufficient new loans to the real economy in the Southern European States.

My advice: Do not expect, that this scenario will last for long. Negative interest rates for the broad real economy will not happen. And sustained deflation is not to happen either. Ultra low, but still positive interest rates may be around for some more time, but also they can be over quickly.

Treasurers, whose corporations have long term financial debt, should refinance and, or renegotiate such debt, in order to make use to the maximum possible of the presently ultra-low long-term interest rates.

The corporate bond market is testimony, that capital market oriented corporations do make maximum use, now, of such ultra-low long-term interest rates. BMW, as an example, issued a 1 billion Euro 10 year bond with an interest rate coupon of 1 % only.

Another advice to the treasurers: Learn, from what the treasurers of the best of the best corporations are doing:

In Europe, and in the USA, the best of the best corporations have deleveraged, before the great financial crisis in 2008 and 2009 started, and they have deleveraged more since then. In fact, they are less leveraged and better financed, meaning more conservatively financed than at any time since World War 2<sup>nd</sup>.

In fact, it is fair to say, that during the great financial crisis 2008 and 2009, the real economy was the rock of stability in the sea of turmoil in the financial industry, and thanks to this solid real economy the entire system was not on the brink of collapse.

Complementing the solidity of financing of the real economy is this:

Many corporations have learned the lesson, that it is good to have financing reserves. And not just in the form of uncommitted or committed undrawn credit lines from banks, which may fall into trouble and which banks may not honour the credit lines commitments.

Many corporations have learned, that the best precaution against the risk of refinancing in a financial crisis situation, is to have sufficient unused cash on the shelf.

To give you an idea: The companies of the US S & P 500 index, excluding the 87 financials companies, at the end of January 2015, collectively have cash on their balance sheets of 1430 billion US Dollar, tendency rising.

With interest rates ultra low, for loans taken up, and for cash invested, the negative spread between costs of loans taken up and return on cash invested, the so-called cost of carry, is so small nowadays, that it is almost irresponsible, not to have a reasonable box of idle cash on hold as an insurance against difficult financing times.

Let me give you an example for this: The rating agencies, in order to maintain the ratings on the Daimler Group, are requesting from the Daimler Group, that it can overcome twelve months without going to the capital market and raising new funds. Daimler responded positively to this request and is now holding roundabout 18 billion Euros of cash on its balance sheet for this safety purpose, on a volume of annual group sales of 94 billion Euros. That is, they have 20 % of annual turnover as cash, for safety purposes.

See this chart.

.

Another example: The Audi Group, another premium car producer, has 16 billion Euros net cash, on a volume of annual group sales of 54 billion Euros.

That is, they have even 30 % of annual turnover as cash, for safety purposes.

A recent survey by Deloitte, among 150 German CFOs of major German corporations, shows this conclusion: Financing conditions are at their best in history, meaning the ultralow interest rates, and credit availability is at a maximum. Ladies and Gentlemen, how much better than this can life be for us, the treasurers.

Ladies and Gentlemen, on another note:

I have not yet addressed the subject of over-indebtedness of states and governments which is particularly worrying to many people and in many member countries of the European Union.

Two numbers demonstrate the phenomenon: In 2008, shortly before the financial crisis, the government indebtedness of the 19 member states of Euroland was at 69 % of GDP. At the end of 2014 this number had increased to 92 %.

The strong increase is mainly due to governments bailing out banks from the huge losses of the financial crisis, but it is also due to general deficit spending by governments for general and all kinds of political purposes.

Ever since the financial crisis in 2008 and 2009, there is an ongoing worldwide debate on the question which government indebtedness is acceptable and which government indebtedness is not acceptable and tolerable for the longer run. The keyword in this connection is the notion of debt sustainability of a state meaning how much that state can bear and service over time, without getting to the brink of insolvency.

We – as treasurers in our corporations – have a pretty clear view what the debt sustainability of our corporation is. And we are not left alone asking ourselves when / what such debt sustainability of our corporation is. If we have doubts about what it really is, then we will talk to the banks which make loans to us. That will help us quickly to learn where our debt limits are.

And if we do not believe what banks are saying and if we want to issue debt securities in the capital market, then we will always be able to go to the rating agencies, and they also will clearly tell us what our debt sustainability is, and by which margin it may vary to the upside and downside. Further than that, the rating agencies will clearly tell us at which indebtedness ratio our rating would be AAA, and at which indebtedness ratio our rating would be subinvestment grade, meaning below BBB-.

And of course – as we all know – the acceptable debt ratio is not only this static number. It has to be complemented by the EBITDA earnings to fixed financial charges ratio.

And the laws in our countries also tell us, when we have overextended the corporate debt and have to declare insolvency. The two alternative reasons for insolvency, given in the law are:

-One, so called over-indebtedness, meaning a corporation has more debts than assets.

-and Two, illiquidity.

Even if the corporation is not over-indebted, there may be the possibility that it may become illiquid. This will happen when a company has depleted all its available cash and when – at the same time – nobody is willing to credit new money to the corporation.

Why do I speak out this, what is known to all of you?

I speak it out, because when it comes to government and state financing, there are no such guidelines / regulations / laws.

There is no regulation and law in the world which regulates the situation, when a country or a government is bankrupt and which procedures will then have to be taken.

With countries like Greece, presently on the brink of financial collapse, there is the desire in the European Union by many member countries, since a long time, that it would be wishful to have regulations that clearly define what a bankruptcy of a state government is, and which would give clear rules and guidelines, as to how to proceed in such a case.

There are also requests by many politicians at the European level, that such regulations should be put in place. But as no individual country has such regulations for its own country and government, it is so much more difficult, to establish such regulations within an association of states like the European Union.

So, clear rules for state government bankruptcies, remain wishful thinking.

What guidance do we all have when we have to make an opinion about whether a country, a state and a government have a debt level which is sustainable over a longer term or not.

Here are some answers:

According to the Maastricht Treaty criteria a government debt level of 60 % of GDP is acceptable.

In the past few years much research and studies have been done by economic professors worldwide and there is a conclusion of all this research that a government indebtedness in the order of 100 % of GDP is just about tolerable though not desirable over the longer term. Any ratio in excess of 100 % is said to make the economic and financial situation problematical for a government and a country, and it will endanger the possibility for the country to further grow its economy.

Let us have a look at the government debt ratio of a few member countries of Euroland:

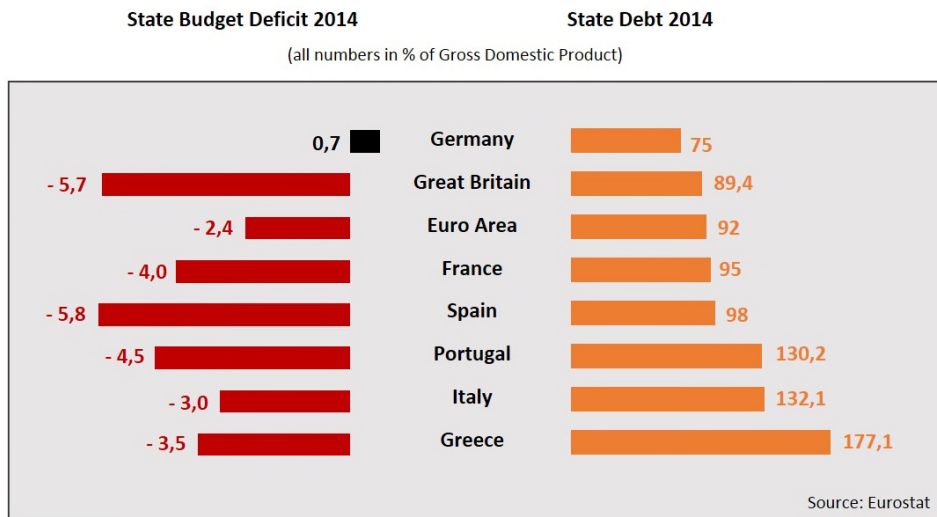
Greece has presently a government debt ratio of 177 % of GDP which – due to the orientation ratios which I have just mentioned – appears as not manageable over a longer term.

Italy with 132 % and Portugal with 130 % are already both in a problematic range.

France with 95 % is approaching the 100 % ratio which is regarded by many as just about tolerable.

Germany with 75 % is less indebted, but it is over and above the Maastricht criteria of 60 %, which, however, the German acting politicians want to reach again over the medium term and they are striving for it.

At the low end, you find Estonia with only 11 %. The low ratio is partly due to the fact that after the fall of the iron curtain, countries like Estonia made a new start.



We have a similar to Europe situation in the United States of America, where the government debt ratio is presently 110 % of GDP. And we have the most extreme situation in Japan, where for country-specific reasons the government indebtedness is at around 250 % of GDP.

You see also on this chart the annual 2014 government budget deficit in % of GDP, and with the exception of Germany, they all on this chart are above the Maastricht criterion of an annual government budget deficit of 3 % of GDP.

However, this chart does not show all 19 member countries of the Euro.

The good news is, that out of the 19 member countries of the Euro, still 7 countries in 2014 are meeting this budget deficit criterion and are below the 3 % ratio.

And as you see from this chart, the annual budget deficit of all 19 Euro Area Countries is at minus 2.4 % in 2014, down from the minus 2.9 % of 2013. So there is some improvement.

There is a kind of consensus among many representatives of the Western World countries, that from here on the government indebtedness should not be increased further.

What acts as a brake against a further significant increase of government indebtedness, is the fact, that with such an excessive indebtedness goes an interest expense burden, which takes an ever increasing bite out of the government budgets and which leaves such budgets with a sinking portion of their government tax and other available income available for all typical other political purposes.

Raising taxes further to higher levels is not a remedy to this situation, because in many of such countries, the existing tax level is already considered as a very high, if not too high burden for the people, and to the degree that there is even disincentive to people for doing business and paying taxes.



In the European countries and in the USA, there is wide spread opinion, that given the present debt levels of countries and governments, that such governments should not stimulate their economies, which are in recession, with huge deficit spending programs.

Many say that you cannot buy economic growth anymore by governments executing huge deficit spending programs. This would only increase the government indebtedness and would drive governments further into financial difficulty and immobility. As the governments have run out of tools to stimulate their economies, what is left? Well, we all see it:

In the USA at first, also in the United Kingdom, and in Japan, and now also in Euroland, the same is happening everywhere: The Central Banks are trying to help out and to stimulate the economies, with the limited tools they have: the buzzword is “quantitative easing”.

The result of this is, that the countries are flooded with money and as an intended consequence, the interest rates have fallen to the ultra-low levels, which mankind has never seen before. The question for many people is: Does the system get out of control and balance?

The critique against this worldwide quantitative easing and ultra-low interest rates is brief and simple:

1. Interest rates being ultra-low are losing their function to allocate the scarce capital in the economies to the points of highest return and efficiencies. The compass for economics and profitability is being lost. Investments are increasingly flowing into higher risky asset classes and new asset bubbles may arise which will burst sooner or later. So new financial crises will be created.
2. The main beneficiaries of the ultra-low interest rates are the governments, indeed, by making their interest expense burden lower than it would be with normal interest rates levels.
3. There are also many losers due to these ultra-low interest rates:

These are all the savers, in fact the broad mass of people and individuals, who are saving money, many of them with the purpose of having some financial reserves for the case that retirement pensions will not be sufficient.

Losers are also insurance companies, pension companies, pension funds, the business of which is, to increase over time the capital, they received as premiums from the insured, so that in future they can pay the pensions, which they have contracted with the insured people, and they build this capital by investing predominantly into bond securities, which now carry almost no interest any more.

This phenomenon, that the savers and the pension insurance industry are losers, due to the quantitative easing, has a name: It is called “financial repression”. It is described with clarity by economists and economic professors. And it is not a new phenomenon.

After the second world war, the then over-indebted United States used the instrument of financial repression to get itself out of the government over-indebtedness over a period of almost 20 years. Interest rates in this period were often lower than the inflation rate for a long time. Both, continued inflation, and good annual growth rates of GDP, then continuously decreased the relative indebtedness of the USA.

Ladies and Gentlemen, the day-in/day-out question to everybody is, how long will this financial repression last? There is no consensus opinion on it. Since a few years, financial repression is already existing – and it may last longer, than just a couple of more years.

In summary:    ultra-low interest rates,  
                     financial repression,  
                     and incentives to investors to move into riskier asset classes

all this is not a good situation, for the economy as a whole, to prevail for long, but let us hope and work for a better world !

At least, and to close with some optimism,

Growth is again returning to a number of Euro Area Countries, and here on this chart you have a selection of such countries. This makes us hope for an improved business cycle.  
Thank you very much.

Germany, Article:

**“It is the matter of pulse beat”**

**The financial crisis revalues the treasury in a company-group – counterparty risk is still a challenge for industrial corporations**

**Interview** with Mr. **Thomas Schröder**, PwC Germany, Head of Corporate Treasury Solutions,

**Interviewed** by **Sabine Wadewitz**, Börsen-Zeitung, Frankfurt am Main, Germany, March 24, 2015

*The capital market environment with low or negative interest rates and volatile currency exchange rates is a challenge to the treasuries of the industrial corporations. Since the breakout of the financial market crisis, the treasury has risen enormously in importance. Formerly regarded as a standard service provider in the corporation, it is increasingly moving into the focus of strategic decisions, explains Thomas Schröder, PwC, Germany, Head of Corporate Treasury Solutions.*



**Mr. Schröder, how are industrial corporations dealing with negative interest rates concerning treasury?**

The risk-free investment of cash continues to be the prime objective of the corporations. The cash has to be parked for capital expenditure or for dividend payments. For short-term risk-

free deposits – however – one receives presently no interest rate return or one must even accept a negative interest rate.

### **This is not about to change soon?**

No, in the financial markets things remain turbulent. Not only the European Central Bank is printing money, also the Chinese Central Bank is opening its floodgates. The national economies are trying to achieve advantages by way of devaluations, but this has negative consequences, among them negative interest rates.

### **Do you see that corporations are investing into higher risks with their hunt for return?**

Industrial corporations are shying away from negative interest rates as they are also shying away from high risks. Thus, the investment decision becomes a balancing act. But we cannot recognize a trend that corporations accept higher risks now, in order to improve the return on their investments. They live with the low interest rate scenario and they try to find other uses for their cash.

### **Which are?**

The possibilities can be found in the area of capital expenditure, but partly in alternative investment possibilities as well, for example in the support of start-up companies or venture capital. But we cannot deduce a trend, however.

### **But this would mean longer-term investments, however?**

Absolutely. Often, there remains a deposit in the cash-box, a strategic reserve which is used in another way with respect to the interest rate environment. In the short-term area the deposits and money-market funds are the customary way of investing.

### **In the world, there are still regions with higher interest rates. Do corporations move their cash for the short-term into these regions?**

This is often a naïve assumption. In countries with higher interest rates, one must also regard higher credit risks and eventually a currency risk, so one has to hedge against this. This is removing the interest rate advantage and is a zero-sum game. Higher returns go along with currency and credit risks. Naturally not everyone is looking for a solution by way of investing in central government bonds or in a single A bond. But I do not recognize a trend to enter into higher risks below an investment grade rating.

### **Does a corporation with its own banking licence have more leeway?**

This has been a short hype during the financial crisis 2011/2012. At that time, there was much discussion about this subject. In the foreground, there was the question to park ones money safely. Investments in the area of German Bundesbank or the European Central Bank were wanted which would have been done by a bank. Now, there is less excitement about that. The corporations do not see a banking licence as a necessity in order to park money outside the banking system.

### **Concerning bank licences, does especially the sales finance matter?**

For this advantages can be provided. The corporation can buy itself into better financing possibilities with an own bank. But also this is not a strategic component for the majority of the industrial corporations. It is a solution for single cases only.

### **Do industrial corporations have a more relaxed view with regard to counterparty-risk in the meantime?**

No, there has to be a differentiation. The financial crisis has increased the significance of counterparty-risks when it comes to dealing with banks. Since, the corporations are taking a precise look at their banking partners, not only with regard to service quality and price, but also strongly with regard to creditworthiness. The counterparty-risk still has an enormous weight as in the high time of the financial crisis. The decision parameters regarding this have not yet changed.

### **By which others subjects the treasurers are plagued?**

First of all, there is the risk management necessitated by the fluctuations in the currency market. Steering the currency risk is the main theme. As a matter of fact, the treasury is generally trying to hedge away the risk from the operative value added chain by way of use of the financial instruments, thereby increasing the capability to plan for the business operations. With this, the treasurer becomes increasingly the strategic partner for the board of management.

### **Strategic partner in what sense?**

This has been caused by the financial crisis. Before that, the treasury was a part of steering the corporation which simply had to function. It had to safeguard the ability to pay for each single corporation of the group and for the entire corporation group. It was about sufficient financing sources, the steering of risks and the execution of the payments. There was the attitude of expecting: this has to be done, so please ensure!

### **And today?**

Today, the treasury has moved closer to the steering of the corporation. Its advice is being sought when it comes to strategic decisions and thereby, the treasury has a greater influence.

### **For instance?**

Today, decisions concerning transactions are also considered by treasurer's eyes view. When business activities are shifted in the context of geography, then country risks have to be evaluated. There is the question whether the liquidity can be parked there, whether the corporation can freely use the cash-flow and which risks are arising in case of doing business with banking-partners. For these considerations the treasury is in the frontline. These themes are not seen as a just prevailing situation any longer. It is a matter of pulse beat of the corporation, because liquidity must flow at any time. As a consequence, also liquidity-based ratios are playing a major role.

## **The cash-flow as a measure of all things?**

The cash-flow as a steering parameter has increased in importance. Therefore, the treasury must deliver new kinds of information and must give strategic impulses. Thus, traditional ways of planning liquidity as well as of analysing and reporting about the financial situation are reviewed and adapted comprehensively.

## **Is the revaluation of the function connected with organizational changes in the corporations?**

One is trying to find forms of organization, which increases the access to the liquidity and the transparency of the risks – keyword: payment factory or inhouse bank. The treasury is positioned in that way that from the perspective of the subsidiary it is acting like an external bank. Thus, the payment traffic is not transacted via local banking partners or decentrally any longer, but by clearing accounts of the central internal banking leader. So, companies have a longer access to their liquidity, they are improving the steering of the liquidity and the risk management and they have more transparency about the cash flows.

## **How much the industrial corporations are affected by the regulations as a consequence of the financial market prices?**

The industrial corporations are affected directly and indirectly by subjects as Basel II, Emir, Remit, Mifid II as well as IFRS 9.

## **Which is the largest chunk?**

The EU-derivate directive Emir is representing a big challenge. Indeed, Emir is welcome by the corporations concerning the obligation for clearing and risk-management on the one hand. It is understandable from a macroeconomic point of view and also from a business point of view, that one only executes hedging businesses and that one exercises risk management activities. But what is creating non-understanding is the reporting to the transactions-register. Even the European securities and market supervisory agency ESMA has announced that it must itself learn first to deal with the quantity and complexity of the data.

The interview was made by Sabine Wadewitz.

## **About the person/ Thick boards**

Thomas Schröder has made it a profession for him, to drill thick boards, in order to solve problems for his clients. The 45-year-old consultant is employed at the consulting and auditing firm PwC since 1999 and since 2006 he has been partner. He is head of corporate treasury solution at PwC in Germany.

Responsible for translation: GEFIU, Association of Chief Financial Officers Germany,  
translator: Helmut Schnabel



## **India, Article:     **Modi – Nomics: The Optimistic Case for the World’s Third Largest Economy****

By **Payden & Rygel**, Los Angeles, California, USA, Spring 2015,  
Point of View, Our Perspective on Issues Affecting Global Financial Markets

Narendra Modi, the son of a tea merchant, has quickly become one of the world’s most talked-about leaders. But does he bring real change or is his election just another fanciful Bollywood love story for the 1.2 billion Indians living in the world’s third largest economy?

Nearing the end of his first year in office, Modi has cut bureaucratic inefficiency, made steps toward putting India’s fiscal house in order, and advanced India’s quest to become the next manufacturing hub of the world. While many of the benefits may arrive years down the road, we are optimistic that the reform momentum Modi personifies will thrust India forward and boost the country’s economic growth prospects.

### **The Personification of Hope**

Modi swept to victory with an election campaign analogous to American President Barack Obama’s in 2008. Modi used Twitter hashtags, 3D hologram appearances and catchy slogans to create the “Modi Wave,” which swept the nation. Modi’s calls for economic growth through “minimum government and maximum governance” resonated with young Indian voters.

Modi himself embodies the “Indian Dream.” He rose to fame during his ten years as the Chief Minister (Governor) of Gujarat, the fourth largest Indian state (India has 29 states) by gross domestic product (GDP). During his tenure he provided 24-hour electricity access—a rarity in India that made the state a darling for industrialists. As a result, Gujarat grew 10% per year between 2004 and 2012, well above the Indian average of 8.25%.<sup>1</sup>

Can he replicate his success in Gujarat for the rest of people of India?

### **Moving the Bureaucratic Behemoth**

For decades India has been plagued by politicians who made election promises to rein in bureaucracy and increase efficiency but failed to deliver.

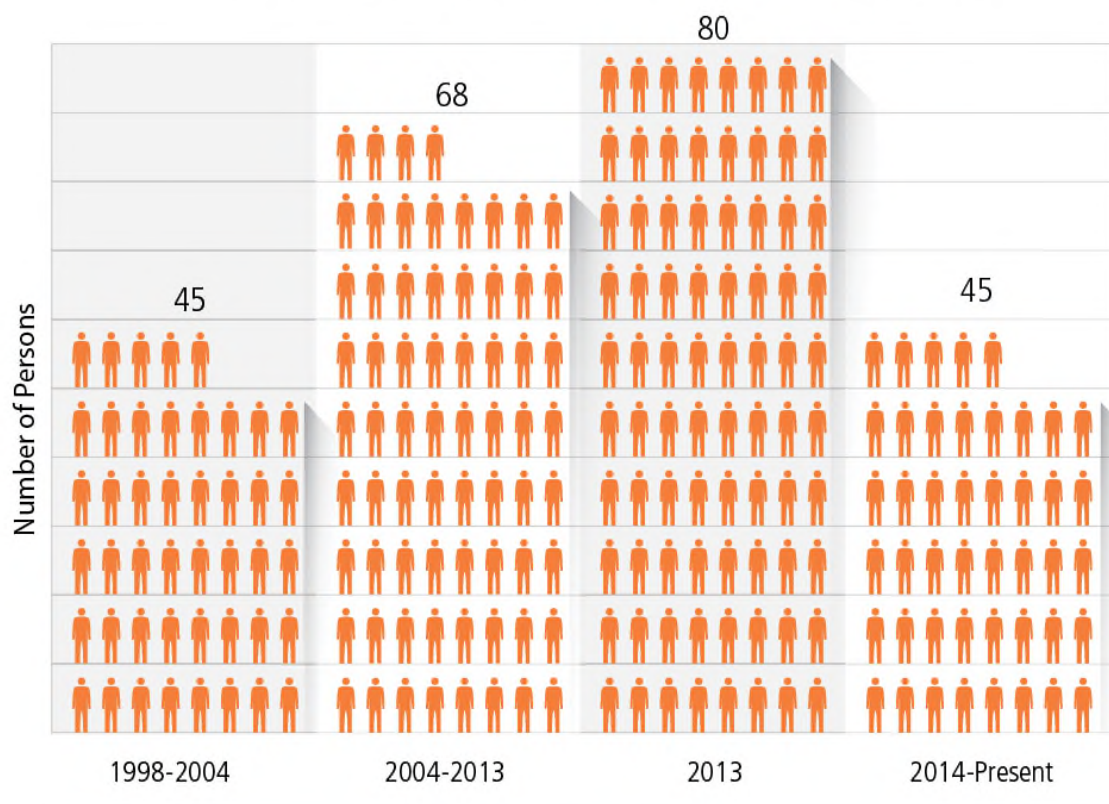
Using his political capital and reputation of “CEO-style” leadership from his days in Gujarat, Modi quickly inspired India’s notoriously inefficient bureaucrats to

work. As old files were thrown out and offices were cleaned, some agencies found files dating as far back as the time of British colonial rule.

Modi personally called ministers on their desk phones to ensure they were at work on time, and instituted a biometric “check in, check out” system for government employees that can be accessed by anyone in real time. The system has led to a morning rush of government employees at the Delhi Metro in a scramble to arrive at work on time.<sup>2</sup>

Modi also abolished around 30 committees that had been set up by the previous government to resolve disputes between ministries, a symbol of policy paralysis.<sup>3</sup> Instead, his office and cabinet, the smallest in 16 years (see Figure 1), will resolve disputes directly and leave decision-making to the ministries themselves, without the burden of overarching groups and panels. These small, but meaningful steps in the central government were only given lip service by politicians until now.

*fig. 1* “MINIMUM GOVERNMENT, MAXIMUM GOVERNANCE”:  
SIZE OF THE INDIAN “CABINET” OVER TIME



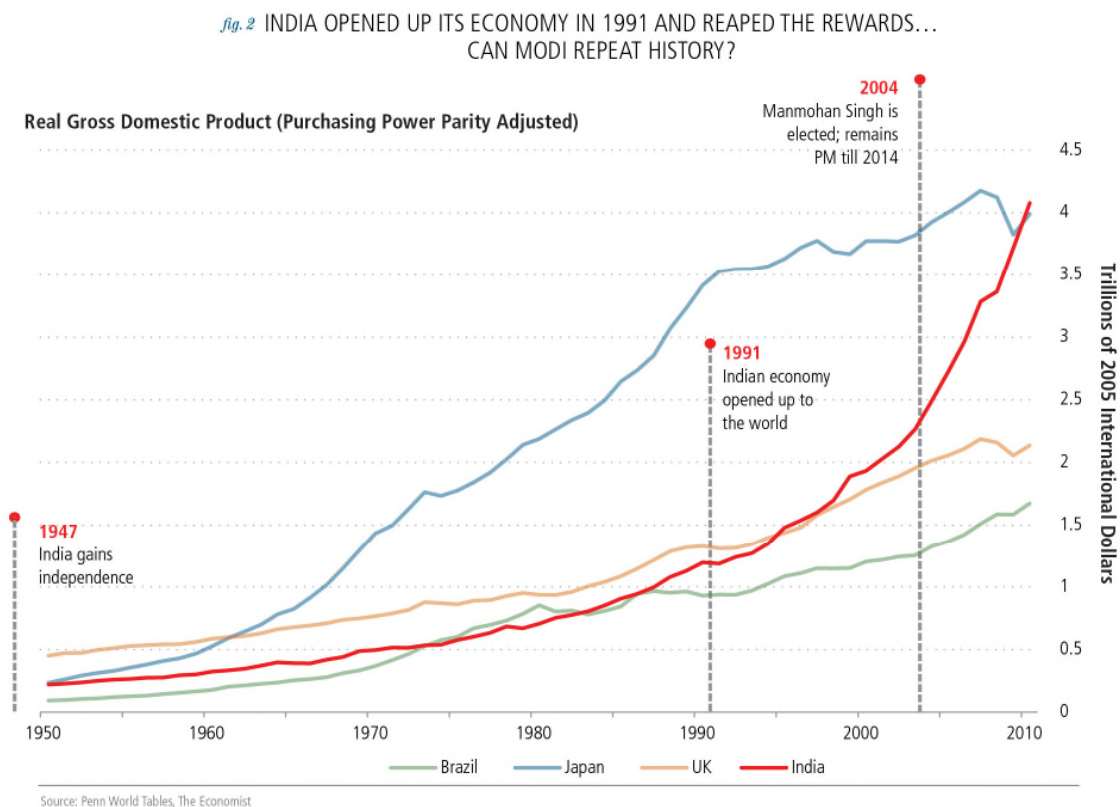
Source: India Today

## “Come...Make In India!”

In 1990, the average Indian citizen had slightly more income than the average Chinese citizen, as measured by GDP per capita. Today, China’s GDP per capita is more than double that of India’s. Manufacturing and export-led growth, which also made countries like Japan and South Korea prosperous, drove China’s economic miracle. Instead of reinventing the wheel, Modi has gone back to basics.

Modi’s economic reforms aim to make India the manufacturing hub of the world. However, half of Indian workers are still employed in low-paying agricultural jobs, and Modi knows that manufacturing jobs offer higher wages. A worker in manufacturing is 14 times more productive than one in agriculture, and higher productivity brings higher wages.<sup>4</sup> In order to bring these jobs to his nation, Modi aims to reform land and labor laws and increase inflow of capital via foreign direct investment to serve as the catalyst for his “Make in India” campaign.

Land acquisition problems have plagued producers and industrialists in India and is the primary hurdle in setting up new ventures. Under Modi, the government passed an executive order (an “ordinance” in India) to ease land acquisition in critical sectors, including power, housing, and defense, reinvigorating some of the \$300 billion in projects that had been held up due to the land acquisition laws.<sup>5</sup>



Furthermore, to signal seriousness in opening up the Indian economy further (see Figure 2), Modi passed two more ordinances increasing foreign firms' access to insurance ventures and commercial coal mining, which the country relies upon to provide a majority of their electricity. By opening up to foreign competition, Modi seeks to provide electricity to the millions of Indians who still live in the dark and to the industries that will need a consistent supply of energy if they are to "Make in India".

**In 1990, the average Indian citizen  
had slightly more income  
than the average Chinese citizen, as measured by GDP per capita.**

### **Getting the Fiscal House in Order**

India has balanced a budget at the federal level only once in the last 25 years. The previous government poured endless rupees into wasteful subsidies, and in one year, 2003, had a primary deficit of 5.5% of GDP. This fiscal deficit caused Standard & Poor's to give India a credit rating that is just one notch above "junk" status (India is Baa3/BBB-/BBB-, upgrade watch by S&P). Modi has the government on track to cut the deficit to 4.1% of GDP in 2015, but a budget surplus remains elusive. India has not posted a budget surplus since 2007.

How will the government control its spending problem? The answer lies in revenues and subsidies. In order to raise revenues, Modi promised to divest from state-owned enterprises. He started this with a 10% sale of the coal-mining giant, Coal India, raising funds to fill state coffers.

On the side of wasteful subsidies, Modi took advantage of the timing of falling oil prices to remove costly diesel fuel subsidies, which accounted for a quarter of the government's total subsidy bill. In order to be more efficient with the subsidies still being disbursed, the Indian government opened bank accounts for 18 million poor people (almost the population of the State of New York) in a week in order to make sure subsidies reach their destination. To date, they have opened 115 million bank accounts.<sup>6</sup>

### **What Next?**

We have here presented an optimistic case for India. But Modi's popularity and upstart presence alone are not enough to solve all of India's problems. For example, inflation, were it not for the decline in crude oil prices, might still be running too high.

Land acquisition problems, though worked on by Modi thus far, stand to face considerable opposition. And while a 4% budget deficit might be desirable compared to recent years, the central government still has a long way to go to balance the budget. Consider that the International Monetary Fund does not forecast a general government primary surplus over the next few years. The new government last month pushed out the date for a budget surplus to 2017, moving the budgetary goal posts once again.

As is the case with any democratic system, politicians do not win votes on nuance or plausibility. But, ultimately the history books will determine whether Modi's promises were substantive or just fanciful. Does he have the ability needed to execute on thorny issues like subsidies, land acquisition, and bureaucratic reforms? We will see.

After a great decade as Chief Minister of Gujarat, Modi hopes to replicate his efforts in New Delhi. With Modi at the helm, India has a renewed sense of hope for its economic future.

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## Ireland: A Lost Decade

The illness, the remedy, the recovery

By Jimmy Doyle, IACT

30<sup>th</sup> May 2015, Porec, Croatia



**I begin the story by quoting from the Minister for Finance Mr Michael Noonan in his presentation of the Spring Economic Statement to Dail Eireann (the Irish Parliament) on 28<sup>th</sup> April 2015. While not quite signalling the end of our economic woes, it certainly shows our progress.**

“Since taking office in 2011, the Government has been determined to fulfil the mandate given to us by the Irish people. To repair the economy and public finances, to create jobs and to give hope and confidence of a better future to our citizens. The scale of the economic crisis that we have gone through has been unprecedented in Ireland’s history. We have essentially lost a decade in terms of economic growth and job creation. Difficult decisions have been taken and huge sacrifices have been made by the Irish people. But this has not been in vain.

This Spring Economic Statement published today confirms that the path that has been taken was the right one. As we now plan for the remainder of this decade, our Citizens have every reason to be confident and hopeful about their future. A future of steady, stable economic growth and a future with more people working in secure and sustainable jobs than ever before in the history of the State. A future of stable public finances that will deliver money in people’s pockets, higher quality public services and strategic investment in essential infrastructure throughout the Country.

But I want to stress, such a bright future is not guaranteed and is contingent on a continuation of the policies and reforms introduced and being followed by this Government. There are external risks, no doubt, but the choices taken within this Parliament matter”.



## The illness

- During the 1990s the Irish Economy (The Celtic Tiger) was one of the most remarkable post war industrial phenomena
- Ireland, once relatively poor, became one of the richest countries in Europe
- Growth rates of almost 10% achieved primarily through massive inflow of Foreign Direct Investment
- Ireland's tradition of high emigration was reversed to net immigration
- However, around 2002, the Irish Banks went on a splurge of reckless lending to property purchasers and developers
- Government budget expenditure soared. Minister for Finance Charle McCreevy famously said "If I have it I'll spend it". This was financed by revenues from the artificially booming property sector
- House and land prices soared to levels among the highest in the world. People engaged in a frenzy of buying before prices went even higher. This was all facilitated by banks providing credit with little or no due diligence
- Economic commentators said there would be a "soft landing" of property prices
- In 2007 the tax revenues fell short of target and wiped out the expected budget surplus
- Ireland officially entered recession in 2008
- All of this coincided with the collapse of Lehman Brothers and the onset of the global financial crisis
- Timing is everything!!

## The remedy

- The Irish government announced on 28<sup>th</sup> November 2010 that it had agreed to the provision of €85 billion of financial support from Ireland by EU member states (EFSF), the IMF and bilateral loans from the UK, Sweden and Denmark.
- The state contributed €17.5bn from the National Pension Reserve Fund
- European Financial Stability Fund, UK, Sweden and Denmark contributed €22.5bn
- IMF contributed €22.5bn
- European Financial Stability Mechanism contributed €22.5bn
- Average interest rate across all loans 5.8% (later renegotiated downwards)
- The €85bn to be used as follows,
  - €35bn to support banking system, €10bn for immediate recapitalisation and €25bn on a contingency basis as required
  - €50bn to support financing of the state
- Bank Restructuring and Reform
  - Fundamental downsizing and reorganisation of banking sector to make it appropriate to the size of the economy
  - Banks to be capitalised to highest international standards
  - Bankers' salaries capped and bonuses eliminated

- Fiscal Policy and Reform
  - Govt agrees to budgetary adjustment plan of €15bn over next 4 years with €6bn of this frontloaded to 2011
  - Tax increases in Excise, Site valuations, Capital gains, Carbon, Personal income tax, lowering of tax reliefs
  - Public service employee numbers reduced, pensions reduced, programme of sale of state assets introduced

### The recovery

- Irish economy recovering steadily with some uncertainty around certain issues
- GDP growth in 2014 was 4.8%
- Exports have recovered well, helped by
  - Euro weakness vs Dollar and Sterling
- Domestic demand continues to improve
- Govt deficit remains below ceiling set by EU under the Excessive Deficit Procedure (unlike France!!)
- Unemployment, having peaked at 15% in 2011 is now below 10%
- Restructuring of domestic banks progressing slowly but surely
- Main Irish banks passed the recent severe stress tests
  - Govt expects to sell 25% of AIB this year

## The recovery – possible threats

### Internal

Property market – severe housing shortage leading to higher prices and increasing rents in both residential and commercial sectors

- Restructuring of mortgage arrears progressing very slowly leaving an overhang of personal debt in the market
- Banks still not providing sufficient credit to the market, particularly to SMEs

### External

- Interest rates need to remain low
- Euro need to remain weak vs £ and \$
- GREXIT – would make it difficult for Ireland to borrow
- BREXIT – would be a disaster for Ireland and might lead to us considering our own membership

## Timeline of significant events

The Economy	The Banks
<ul style="list-style-type: none"> <li>• <b>Sept '08</b> – Global financial crisis</li> <li>• <b>Oct '08</b> - Ireland officially in recession mainly due to overheated property &amp; construction markets</li> <li>• <b>Feb '09</b> – Unemployment reaches 11%, highest since 1996, it peaks at 15% in 2011</li> <li>• <b>Mar '09</b> – Sovereign downgraded from AAA</li> <li>• <b>April '09</b> – Govt introduces supplementary budget with severe cuts in public expenditure</li> </ul>	<ul style="list-style-type: none"> <li>• <b>Sept '08</b> -Govt. guarantees €440bn liabilities of Irish owned banks</li> <li>• <b>Oct '08</b> – Other Euro governments react to prevent capital flows to Ireland</li> <li>• <b>Dec '08</b> –Govt announces plan to inject €5.5bn into banks and underwrite capital raising of AIB and BOI</li> <li>• <b>Jan '09</b> – Govt abandons plan to inject €1.5bn in Anglo Irish Bank and instead nationalises it</li> <li>• <b>Feb '09</b> -Govt says it will inject €7bn into AIB and BOI</li> <li>• <b>Apr '09</b> – Govt creates “bad bank” to buy assets from Irish banks - NAMA</li> <li>• <b>May '09</b> – Govt injects €4bn into Anglo</li> <li>• The Banks</li> <li>• <b>Feb '10</b> – Govt swaps 25% Pref shares in BOI for 16% equity</li> <li>• <b>March '10</b> – NAMA buys first batch of assets at avg. 47% discount</li> </ul>

<ul style="list-style-type: none"> <li>• <b>Sept '10</b> – Budget deficit rises to 30% of GDP due to economic downturn and cost of bank rescue</li> <li>• <b>Nov '10</b> – Govt agrees to €85bn rescue package from EU/IMF and introduces severe austerity programme of 4 years tax increases and spending cuts equal to a fiscal adjustment of €5.4bn</li> <li>• <b>Feb '11</b> – General election brings new government to office</li> <li>• <b>July '11</b> – Moodys downgrades Sovereign to junk status</li> <li>• <b>Dec '11</b> - Budget fiscal adjustment of €3.5bn and targets reduction of deficit to less than 3% by 2015</li> <li>• <b>2012</b> – Austerity continues</li> <li>• <b>Oct '13</b> - Budget fiscal adjustment of €3.5bn</li> <li>• <b>Dec '13</b> – Ireland exits EU/IMF bailout</li> </ul>	<ul style="list-style-type: none"> <li>• <b>March '10</b> – Govt takes control of Irish Nationwide and pumps further €8.7bn in Anglo</li> <li>• <b>May '10</b> – Govt takes 18% stake in AIB</li> <li>• <b>June '10</b> – Govt raises its stake in BOI to 36% at a cost of €3bn</li> <li>• <b>Sept '10</b> – Central Bank estimates final cost of Anglo will be €34bn</li> <li>• <b>Nov '10</b> – ECB refuses to let Ireland “burn the bondholders”</li> <li>• <b>Dec '10</b> – Govt nationalises AIB and forces it to sell its Polish subsidiary to Santander</li> <li>• <b>Feb '11</b> - Stress tests show Irish banks need further capital of €24bn</li> </ul>
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**Finally let's return to the Minister's statement of 28<sup>th</sup> April which concluded as follows,**

"A growing economy is not an end in itself – it is the means by which we will improve living standards, create employment and deliver better public services to the Irish people.

Economic recovery provides us with the platform upon which to build for a future of economic growth, job creation and increased living standards.

We must never again repeat the mistakes that left Ireland on the verge of bankruptcy in 2010 and resulted in a lost decade and such hardship in the lives of so many people.

This Government's strategy of steady, stable economic growth will benefit all of our citizens. It will provide the resources for investment in our public services. It will fund the building of new schools, health centres and essential infrastructure. It will deliver secure jobs to more people than ever before in the history of the State, it will put more money in people's pockets and give people security around their income and their pensions. It will entice our emigrants to return home and they in turn will help to build strong communities throughout the Country".

**THANK YOU**



An illustration featuring a large, textured red sphere that resembles a globe. On its surface, a map of Europe is visible in a lighter shade. Three stylized, pixelated figures are shown working on the sphere: one at the top left uses a pickaxe, another at the top center uses a hammer, and a third on the right side is pulling a rope. The overall style is reminiscent of early digital art or video game graphics.

# UNLOCKING INVESTMENT

The European Commission has unveiled its plans to create a Capital Markets Union. Philip Smith examines the implications

In February, EU Commissioner Lord Hill launched a three-month consultation on his ambitious Capital Markets Union (CMU). It is a bold initiative that bids to improve business access to finance through deeper, liquid and more integrated capital markets.

The green paper, *Building a Capital Markets Union*, sets out the options that could be available, and the policy levers that need to be pulled, in order to create a Europe-wide finance market. This market would give businesses and investors greater opportunities

ILLUSTRATION: IMAGE SOURCE

throughout the 28 member states, irrespective of borders and nationality.

It is ambitious in timing and in scope; Lord Hill is aiming to develop an action plan that will put in place the building blocks for a fully functioning capital markets union by 2019. That is only four years away.

## Great expectations

The ambition in scope is laid bare in the green paper. "The direction we need to take is clear: to build a single market for capital from the bottom up, identifying barriers and knocking them down one

by one," says Hill, who is responsible for financial stability and financial services as well as CMU. "Capital Markets Union is about unlocking liquidity that is abundant, but currently frozen, and putting it to work in support of Europe's businesses, and particularly SMEs. The free flow of capital was one of the fundamental principles on which the EU was built. More than 50 years on from the Treaty of Rome, let us seize the opportunity to turn that vision into reality."

The paper sets out four objectives that the Commission is aiming to achieve



through CMU. First, it wants to improve access to finance for all businesses and infrastructure projects across Europe. Second, it wants to help SMEs raise finance as easily as large companies. Third, the Commission is aiming to create a single market for capital by removing barriers to cross-border investments. Finally, there is a desire to diversify the funding of the economy and reduce the cost of raising capital.

Simon Lewis, chief executive of the Association for Financial Markets in Europe, welcomes the proposals, saying: "Capital Markets Union is an essential reform project to revive the EU economy, and the financial industry can and will make an important contribution." He adds that he particularly welcomes the emphasis that Lord Hill is placing on securitisation and the Prospectus Directive (a directive specifying the requirements for prospectuses that are prepared for investors when securities are issued), both of which are subject to separate consultations in the coming months.

Lewis's views are echoed by Sally Scutt, deputy chief executive of the British Bankers' Association (BBA), who says that the initiative is extremely important for the EU's attempts to kick-start growth in Europe. "We would like the final proposals to reduce fragmentation and increase the depth of Europe's capital markets, which will lower the cost of capital, improve its allocation and ultimately better support Europe's growth companies to create jobs," she says.

It has, however, also been suggested that there could be resistance to CMU among certain sections of the banking community, particularly those regional banks that are focused on national markets and medium-sized companies. But the BBA believes there is little to fear because it does not see banks and capital markets as competitors; it sees them as complementary.

Yet Scutt warns that the proposals need to be seen in the context of other EU plans that could prove counterproductive. "Introducing a financial transaction tax or restricting banks' ability to conduct market-making activities for their clients through further structural reform could undermine attempts to inject greater liquidity into capital markets," she says.

### Problems and pitfalls

So what are the real problems that CMU is trying to address, and what are the pitfalls that could lie ahead? As Hill says, the free movement of capital was enshrined in the Treaty of Rome more than half a century ago. But the European Commission argues that capital markets today remain fragmented and are typically organised on national lines. This was brought into sharp relief following the financial crisis of 2008, since when the degree of financial market integration across the EU has fallen, with banks and investors retreating to home markets.

So, from a position of heading towards a unified market, similar to that seen across the Atlantic in the economic powerhouse of the US, Europe appears to have turned around, and is heading back towards a position of 28 smaller markets with less liquidity, and therefore less investment and capital available to be put to use by business to help achieve the Commission's stated aim of creating more jobs and economic growth.

The differences between the US and European environments are laid bare in *The EU IPO Report: Rebuilding IPOs in Europe*, a new report from the EU IPO Task Force, a group led by quoted company membership association European Issuers, the European Private Equity & Venture Capital Association and the Federation of European Securities Exchanges. Highlighting the 'lost investment' in the European economy, the report compared the actual

## KEY PRINCIPLES

The European Commission's green paper identifies the following key principles, which should underpin a Capital Markets Union:

- **It should maximise the benefits of capital markets for the economy, growth and jobs;**
- **It should create a single market for capital for all 28 member states by removing barriers to cross-border investment within the EU and fostering stronger connections with global capital markets;**
- **It should be built on firm foundations of financial stability, with a single rule book for financial services that is effectively and consistently enforced;**
- **It should ensure an effective level of investor protection; and**
- **It should help to attract investment from all over the world and increase EU competitiveness.**

levels of certain investments (such as leverage loans, high-yield bonds, initial public offerings (IPOs) and private equity (PE)) with their potential size if European capital markets were as big relative to GDP as in the US.

The report reveals that there was some \$3,725bn 'lost' in leveraged loans, \$775bn in high-yield bonds, \$110bn in IPOs and \$390bn in PE. Quite some difference.

As MEP Philippe de Backer, chairman of the Task Force, says: "In order to deliver a Capital Markets Union in Europe that can provide more diverse funding sources for companies and cut the cost of raising capital, notably for smaller companies, we need policymakers, regulators and industry to work together to deliver reforms to regulation, to the tax regime and to market practices that will make IPO funding through the public markets accessible to all European companies."

Although the report focuses on IPOs, its conclusions cut across the whole equity and capital piste. It calls for a more balanced and flexible regulatory environment, easing of constraints that restrict investors' access to markets, improved tax incentives and >

**"We would like the final proposals to reduce fragmentation and increase the depth of Europe's capital markets, which will lower the cost of capital, improve its allocation and ultimately better support Europe's growth companies to create jobs"**



a market system that better serves companies at different stages and different types of investors.

But, perhaps most importantly, it calls for the creation of an equity culture in Europe through education and non-legislative initiatives.

### Emphasis on equity

This last conclusion is an area that needs to be tackled head-on if the CMU idea is to gain any traction, according to John Grout, ACT's policy and technical director. "It is very important to start to educate the whole of Europe about equity," Grout says. "If you are going to set up a European-wide capital market for both equity and bonds, you are starting with a low level of education in much of Europe. If the Commission does not come up with soft actions rather than hard law, it will fail."

It is one of several points highlighted in a European Commission staff document that accompanied the

2013 stated that they had lost confidence in the financial sector as a result of the financial crisis. This low level of confidence, the paper says, hinders the flow of savings into capital market instruments.

### Who's the boss?

One way to solve this lack of confidence problem would be to address issues over supervision. Significant progress has been made in strengthening the regulation and supervision of capital markets across the EU. But, as the staff paper itself concedes, while there has been considerable progress in harmonising rules needed for the transparency and integrity of securities markets, legislation relating to investors' rights in securities is not yet harmonised. Different member states define securities in different ways. Some stakeholders argue that this hampers the integration of EU capital markets because investors in one member state cannot correctly

**"If you are going to set up a European-wide capital market for both equity and bonds, you are starting with a low level of education in much of Europe"**

publication of Lord Hill's green paper. The briefing paper recognises that Europe has traditionally relied more on bank finance, with European total bank assets far exceeding those of the US. But even this hides wide variations between different countries and their appetite for equity investment. For example, domestic stock market capitalisation exceeded 121% of GDP in the UK, compared with less than 10% in Latvia, Cyprus and Lithuania.

Grout warns that expectations must be realistic, and that change will not happen overnight, and perhaps not for many years. "If there is an expectation that they will get much done in less than a generation, they will fail. If there is not a real understanding of what equity is and what it does, why you might invest in it and how you might invest in it if you are a smaller investor, it could take 20 years for people to become used to it."

The staff paper also notes that more than 60% of EU citizens surveyed in

assess the investment risk in another member state.

This is a point raised by Andrew Strange, financial services risk and regulation director at PwC. He says: "While there is an important role for the European Supervisory Authorities, firms will want to consider carefully which bodies should get responsibility under CMU. Already we have seen the Bank of England suggest that this is not necessary, and we expect regulators in the UK to oppose ceding additional powers. Firms across the EU will not welcome any further uncertainty, particularly the eurozone banks that are getting used to the reality of direct European Banking Authority supervision."

The House of Lords EU sub-committee on economic and financial affairs backs this view. The committee's chairman, Lord Harrison, says: "Of course, we need to tread carefully. A move to more diversified sources of funding needs

to go hand in hand with improved investor protection, and greater clarity for the consumer.”

A further issue revolves around which companies could benefit from the CMU initiative. While the Commission talks about SMEs, it is clear that capital markets are really only relevant for mid-cap and larger companies. The costs of going direct to the markets for financing rather than to banks are significantly higher.

As Marte Borhaug, senior policy adviser on financial services for the Confederation of British Industry, told a stakeholder’s meeting hosted by Lord Harrison prior to the release of the green paper, it was important to focus on who CMU was trying to help and ensure it was not just talking about SMEs in terms of their size, but whether they were growing and had the ambition to grow. She added that there were things that could be done to improve the market, but companies also needed to take the initiative to look for alternative sources of finance.

#### Learning curve

SMEs could still benefit, however. As Grout says: “If you further the ability of larger companies to take funding from the market rather than from banks, banks might need to look for something else to do, and that might mean lending to SMEs. It is a second tier effect.”

So what will this mean for corporate treasurers? If the objective of the CMU is to reduce the reliance upon bank debt, then larger and mid-sized companies will have to go to the markets, argues Grout. “The relevance to treasurers is that they need to follow what is going on; they will need to work out how they are going to use capital markets and when they are going to use capital markets. How will they explain this to their boards?”

“There will be a learning curve for treasurers, and the nature of their relationships with banks and the capital markets will change.” ♥



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PHOTOGRAPH: CHARLIE BEST

## THE TREASURER’S VIEW

“The objectives of the proposals on Capital Markets Union are quite laudable,” says James Kelly, head of treasury at pest controller Rentokil Initial. He notes that while there are some “big challenges” to the proposal, such as encouraging investment across borders and changing the preference for funding in-country, the benefits could be significant if the union is successful.

Kelly continues: “At the moment, euro markets are receptive to smaller trades, such as our recent €50m floating-rate note, but in more volatile markets,

minimum deal sizes would be substantially higher. Creating a broader range of markets, including developing the private placement market and encouraging peer-to-peer lending, would reduce the risk for borrowers of either not being able to raise money or only being able to raise an amount that is substantially more than is needed.”

He concludes: “Clearly, there’s no guarantee of success and we’ve seen with the Single Euro Payments Area how timescales can slip. But, overall, these are initiatives that should be encouraged.”



The publication of the IGTA e-Journal  
is kindly supported by

