July-August 2015
Vol. 6 Ed.7

The Bulletin

Official monetary and financial institutions • Asset management • Global money and credit

Zhou's challenge

Multiple tasks on renminbi

John Adams on dilemmas facing China
Ruud Lubbers & Paul van Seters on Europe's mindset
Plutarchos Sakellaris on Greek investment
Miroslav Singer on Czech National Bank equity profits
Gary Smith on why the renminbi should join the SDR
David Smith on chances for Brazil-Mexico alliance
Jin Zhongxia on China and Bretton Woods

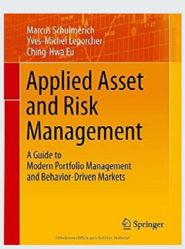
OMFIF

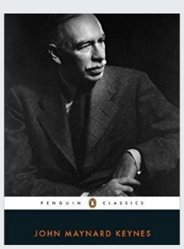
Zhou's challenges

Zhou Xiaochuan, People's Bank of China governor, shares one characteristic with his opposite number at the Bank of Greece, Yannis Stournaras – he is fighting a battle on multiple fronts. Zhou has to grapple with domestic slowdown, stock market convulsions and controlled liberalisation of financial markets. All of these tasks interact with each other. Negative outcomes will complicate China's bid to play a more active role in international monetary arrangements.

Book reviews

George Hoguet evaluates *Applied Asset and Risk Management – A Guide to Modern Portfolio Management and Behavior-Driven Markets* by Marcus Schulmerich, Yves-Michel Leporcher and Ching-Hwa Eu, discussing modern portfolio theory. William Keegan reviews *John Maynard Keynes – The Essential Keynes*, edited with an introduction and commentary by Robert Skidelsky. Keegan commends the book for those wishing to distinguish between 'household economics' and the macro approach.





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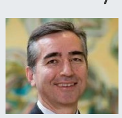
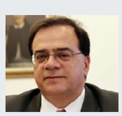
Spotlight on Greece

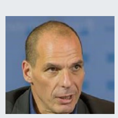
On 16 July OMFIF held a series of telephone briefings on Greece.



Prof. Plutarchos Sakellaris, professor at Athens University of Economics and Business and a former EIB vice president, outlined conditions for improved investment to overcome the devastating effects of the last five years' downturn.



Prof. Gikas Hardouvelis, former Greek finance minister, focused on the implications of the Brussels debt agreement and political and economic conditions after what was widely seen as a major setback for the Syriza-led government.



Yanis Varoufakis, who took over as finance minister in January from Hardouvelis and resigned on 6 July, spoke on Syriza's future, debt relief and the chances of the Brussels debt agreement leading improvement in the Greek economy.

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The Official Monetary and Financial Institutions Forum is an independent platform for dialogue and research. It serves as a non-lobbying network for worldwide public-private sector interaction in finance and economics. The aim is to promote exchanges of information and best practice in an atmosphere of mutual trust.

OMFIF focuses on global policy and investment themes – particularly in asset management, capital markets and financial supervision/regulation – relating to central banks, sovereign funds, pension funds, regulators and treasuries.

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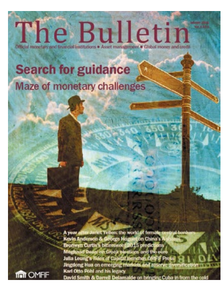
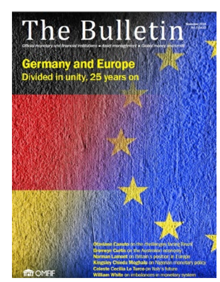




EDITORIAL

China and Greece cope with savings reversal

The twin themes of the July-August Bulletin are the immense challenges facing China's economic policy-makers and the delicate circumstances in Europe after agreement on a third bail-out deal for Greece. These developments are interlinked. One of the reasons for the disarray in economic and monetary union was a large inflow of capital into Europe by Asian investors, led by China, in the early 2000s as excess savings sought out what appeared to be relatively low-risk returns in what were then the booming economies of southern Europe. The European periphery used Asia's savings not wisely but too well, fuelling higher consumption and speculative activity rather than investment.

We now see a partial reversal. Many Asian countries are preparing to channel savings towards domestic destinations such as infrastructure development, a theme underlined by the much-publicised Asian Infrastructure Investment Bank. At the same time, China is opening up channels for domestic residents to move savings abroad – undoubtedly one of the reasons for the convulsions in Chinese stock markets that have proved so preoccupying for People's Bank of China Governor Zhou Xiaochuan, the subject of our cover story by Jonathan Fenby.

John Adams dwells on the Thucydides, Triffin and Lewis dilemmas facing China, while Gary Smith describes the review process on the renminbi and special drawing right. William Baunton explains the turmoil in the Chinese stock market. Jin Zhongxia presents his scholarly account of China's role in the Bretton Woods conference in July 1944. This prefigures in some ways this years' creation of the AIIB – an area where Pooma Kimis outlines how Chinese and other Asian investors can make the best use of international opportunities.

During the last month, OMFIF has given full attention to Greece, leading a party of investors to Athens on 23 June, which included several hours of meetings with Yannis Stournaras, governor of the Bank of Greece, and his colleagues. On 16 July we organised three telephone conferences on Greece after the parliamentary vote approving a draconian set of revenue-raising measures to meet the creditors' latest conditions. We bring a range of articles on Greece, the euro area and the international monetary scene – including the cautiously optimistic (Iain Begg, Plutarchos Sakellaris, Ruud Lubbers and Paul van Seters) as well as the critical (Shumpei Takemori, David Marsh, Meghnad Desai and Desmond Lachman).

Miroslav Singer discusses the equity build-up of the Czech National Bank and the bank's move into a positive capital position after years of negative equity, while Colin Robertson emphasises the importance of individual global public investors paying attention to their mandate and liabilities. On wider issues, Darrell Delamaide writes from Washington that the long period of waiting for the Fed to raise interest rates seems to be coming to an end. Steve Hanke cautions that any Fed rate hike must take account of slow money supply growth.

William Baunton looks at winners and losers from low oil prices. David Smith examines the potential for an alliance between Brazil and Mexico. Our advisory board gives its opinion on the growth potential of the Asean bloc of southeast Asian nations. In the review section, William Keegan expounds on a new summary of Keynes' works, edited by Robert Skidelsky. George Hoguet describes a monograph on investment behaviour from Marcus Schulmerich, Yves-Michel Leporcher and Ching-Hwa Eu that devotes particular attention to dissecting a subject in which Keynes would have been (like today's Chinese leadership) highly interested: stock market anomalies. ▪

China's gold update may not tell full story

Announcement on 60% reserve increase linked to IMF review

David Marsh

China has lifted a veil over its gold holdings and confirmed its interest in providing more up-to-date reserves data by announcing a near 60% jump in its official bullion assets since 2009. The declaration, in a Chinese language announcement on the People's Bank of China website, appears a judicious attempt to show more statistical transparency as China modernises its international currency arrangements. In particular, the announcement seems designed to lower potential impediments to a possible decision by the International Monetary Fund to introduce the renminbi into the special drawing right, the IMF's composite currency unit.

The PBoC said its gold reserves in June were 1,658 tonnes against 1,054 tonnes in April 2009, which was the last time China declared its gold holdings. In 2009 the reserves total was raised from just under 600 tonnes, a figure Beijing had maintained unchanged since 2002. Although China is making greater efforts to meet international standards on presenting its reserves and other sensitive data, it is unlikely that the announcement gives the full story on the PBoC gold reserves. These are believed to include both a foreign component – dollars converted into gold on foreign markets as part of general efforts to diversify reserve assets – as well as a domestic element – in the form of metal acquired from the Chinese mining industry, now the world's most important in terms of annual output. Since purchases from domestic suppliers are settled in renminbi, they are logically not thought to be part of foreign reserves. The Chinese central bank's overall gold holdings may thus in fact be much larger than the reported 1,658 tonnes, in line with estimates that, in some years, it has been purchasing several hundred tonnes of production from Chinese mines.

The Chinese central bank said laconically, 'Gold has a special risk-return characteristic, and at specific times is not a bad investment.' The timing and style of the announcement indicate that the PBoC has been trying to balance a number of considerations. In China's effort to join the SDR, there is no formal quid pro quo over data transparency in discreet bargaining between Beijing and Washington. Yet establishing China's place at the top table of world monetary powers naturally requires some relaxation of Beijing's restrictions on giving details of its foreign currency and gold holdings.

China has now made an important step in this direction, without fully submitting to a growing feeling that China should substantially tone down its traditional secrecy on reserves. ▪

ADVISORY BOARD

OMFIF has appointed Mario Blejer as Senior Adviser, and Mark Burgess, Hans Genberg, Thomas Kielinger and Atiur Rahman to the Advisory Board, which has risen to 179, subdivided into six groups ranging from Public Policy to Banking. For the full list of members see p.26-27.

Mario Blejer is vice-chairman at Banco Hipotecario, one of Argentina's largest commercial banks. Blejer is the former governor of the Central Bank of Argentina (2002) and previously held positions as adviser to the governor of the Bank of England and senior adviser at the International Monetary Fund. He is the president of Foro PAIS, a think-tank that promotes Argentina's position as a guarantor of food security.

Mark Burgess is former managing director and president of Australia's sovereign wealth fund, the Future Fund. He was previously the chief executive officer of Treasury Group, an Australian listed asset manager. Prior to this he was based in London with Credit Suisse Asset Management, as executive vice-chairman and chief executive officer (EMEA) and global chief investment officer for equities and multi-asset class. He joins the Capital Markets & Investment panel.

Hans Genberg is executive director of the Seacen Centre in Kuala Lumpur, having served as an adviser to the Centre since March 2014. Prior to joining Seacen Genberg was assistant director at the Independent Evaluation Office of the International Monetary Fund and executive director of research at the Hong Kong Monetary Authority and director of the Hong Kong Institute for Monetary Research (2005-09). He joins the Education & Research panel.

Thomas Kielinger is UK correspondent for the German national daily Die Welt and a well-known biographer of Queen Elizabeth II and Winston Churchill. He was previously editor-in-chief of German national weekly Rheinischer Merkur Earlier in his career Kielinger taught German at the University of Wales in Cardiff. He is a frequent contributor to TV and radio in the UK and Germany. He joins the Editorial & Commentary panel.

Atiur Rahman is governor of the Bangladesh Bank. Rahman previously held various positions in research institutes and academic bodies. After obtaining his MA in Economics from Dhaka University, he pursued studies in the School of Oriental and African Studies and the University of London. He has published numerous books and research papers in English and Bengali. He joins the Capital Markets & Investment panel.

LAUNCH

World growth and investment: move into real assets

At the London launch of the *Global Public Investor 2015* report at Armourers' Hall in London on 10 June, Robert Tessier, Chairman of Caisse de dépôt et placement du Québec, told an audience that supply-demand imbalances on world capital markets are driving up asset prices to unreasonable levels. Tessier was speaking in a panel discussion with Ulrich Otto, managing director of Quantum Global Alternative Investments, and Rick Lacaille, global chief investment officer of State Street Global Advisors, both supporters – with DZ BANK – of the 2015 publication.

GPI 2015 covers 180 countries and 500 institutions, highlighting similarities and contrasts among different categories of public entities owning assets equivalent to 40% of world output. It describes the growing attractiveness among global public investors of 'real' asset classes (often thought of as 'alternatives') such as real estate and infrastructure, and analyses how central bank investment in public equities and corporate bonds has gained momentum as a result of low interest rates and heightened risks on sovereign bonds. The publication looks at public sector investment in equities and gold among other assets promoting diversification.

To purchase a copy, contact sales@omfif.org | +44 (0) 207 965 4494.

Ulrich Otto and Robert Tessier

Rick Lacaille and David Marsh

Lord Desai with OMFIF colleagues

INFORMATION TOUR

European information tour focuses on ECB and QE programme

The second European Information Tour to Germany on 8-9 June followed an inaugural trip earlier this year. The OMFIF delegation, led by David Marsh, consisted of a group of OMFIF members and other organisations. The Frankfurt delegation on 8 June held discussions on the European Central Bank's quantitative easing programme, the position in the euro area and Germany's borrowing and debt management strategy, with officials at the ECB, Bundesbank and the German debt agency. In Berlin on 9 June, the delegation met a number of Germany advisory board members including Prof. Michael Burda (Humboldt University), Prof. Michael Stürmer (former speech-writer for Chancellor Helmut Kohl) and John Kornblum (former US ambassador to Germany). The visit extended to several German ministries and research institutes, focusing on the economic outlook for Germany and the European Union.

SEMINAR

Strategies for better-balanced world growth and investment

Greece is heading for insolvency, with time running out for a deal with creditors, said Bundesbank President Jens Weidmann in a speech opening OMFIF's inaugural Global Investment Seminar on 11 June in London. Weidmann set down a range of preconditions for more sustained economic growth in Europe, but was uncompromising in his judgement on Greece saying, 'There is a strong determination to help... But time is running out, and the risk of insolvency is increasing by the day.' Weidmann was joined by a range of other speakers discussing investment conditions in Europe, North America and emerging market economies, with particular emphasis on 'real assets'.

Jens Weidmann opening Global Investment Seminar

(From left) : Robert Tessier, chairman, Caisse de depot et placement du Quebec; David Marsh, OMFIF; Jens Weidmann, president, Deutsche Bundesbank; Lord (Norman) Lamont, former UK chancellor of the exchequer; John Plender, chairman, OMFIF, Alexander Lipponer, head of president's office, Deutsche Bundesbank.

ECONOMISTS MEETING

Economic growth and banking sector stability in Greece and Europe

At the Bank of Greece-OMFIF Economists Meeting on 23 June, Bank of Greece Governor Yannis Stournaras, gave an upbeat view of Greek economic prospects, despite uncertainty over debt repayments. He told participants at the Bank of Greece that his country nearly doubled its share of extra-EU goods exports since 2010. He said the OECD ranked Greece in first place in responsiveness to structural reform recommendations. He reminded listeners that European ministers had promised Greece in November 2012 that debt relief would be forthcoming. Participants exchanged views on prospects for reforming the Greek banking sector, including necessary bank recapitalisation.

BRIEFING

Path forward for Japan's inflation target

A briefing on quantitative and qualitative easing and Japan's economy was given by Naruki Mori, associate director-general of the monetary affairs department at the Bank of Japan on 22 June in London. Mori outlined how Bank of Japan Governor Haruhiko Kuroda (pictured) would continue boosting the monetary base through large-scale asset purchases until inflation neared the BoJ's 2% target. This was part of an overall attempt to stimulate the economy through a mix of greater fiscal discipline and structural reform.

CITY LECTURE

Changing landscape of central banking

Glenn Stevens, Governor, Reserve Bank of Australia (pictured with Lord Desai), at an OMFIF City Lecture on 30 June in London underlined the difficulties faced by central banks around the world in navigating a new set of challenges since the financial crisis. It was not impossible, he said, that in 10 years the goal of monetary policy could be changed from price stability to financial stability alone. He cautioned that returning to 'the central banking modus operandi that we had prior to the crisis' would require many years of adjustment.

BOOK LAUNCH

A critical exploration of money, morality and markets

At a reception co-hosted by the Financial Times, John Plender's new book *In Capitalism: Money, Morals and Markets* was launched on 8 July in London. In the book Plender, chairman of the OMFIF board, investigates concerns about the moral character of money that pre-dates the industrial revolution by more than two millennia. Articulating diverse tales of monetary rectitude and recklessness through the ages, and quoting a host of literary figures from Molière to Shakespeare, Plender summed up a series of lessons of value for today's financiers, savers and capital market specialists.

MAIN MEETING

Asia in transition: The role of the Asean economic community

Participants at the second Main Meeting in Asia, hosted by OMFIF and Bangko Sentral ng Pilipinas on 6-7 July in Manila exchanged views on monetary and macroprudential policy, risk management and economic co-operation initiatives. There was particular emphasis on the need to channel Asian savings to necessary investments in the region, including in infrastructure. Amando Tetangco, governor of Bangko Sentral ng Pilipinas, underlined the importance of greater capital market integration in the Asean region as part of efforts to improve growth potential. A theme of the seminar was the outlook for US interest rate rises later this year as well as the effect of European debt turbulence on global growth prospects.

ADVISORY BOARD ANNUAL DINNER

Desai 'did not study hard enough'– Judge

Lord Meghnad Desai celebrated his 75th birthday at the annual OMFIF Advisory Board dinner at the Reform Club in London on 10 July. Sir Paul Judge, the businessman and academic, a member of the advisory board, reminded the audience that, growing up in what is now Gujarat in India, Desai had been 'immediately a prodigy', going to secondary school aged seven and matriculating at 14.

He started his career at the London School of Economics in 1965. 'Despite this early glittering career Meghnad has said that his parents felt that he did not study hard enough and that growing up was all about living up to the expectations of his parents.'

Human history is shaped by ideas, Judge said. 'Meghnad has generated a huge number of thoughts during his career and as well as his publications he has promulgated his thinking to a countless number of students.'

Judge underlined a lesson from Prof. Ernest Rutherford who split the atom in Cambridge. 'He was visited by some American scientists,' Judge said. 'They were amazed at the cramped facilities and by the poor quality of the equipment. Rutherford explained that good science did not need plush laboratories. He famously said, "It is true we don't really have much money so what we have to do is think."'

Judge outlined how Desai wrote his first book *Marxian Economic Theory* in 1973 followed by *Applied Econometrics* in 1976 and *Marxian Economics*, a revised edition of his 1973 book, in 1979. He wrote *Testing Monetarism*, a critique of monetarism, in 1981 and in total has written or edited over 20 books. As well as in economics he published a biography of Indian film star Dilip Kumar which he has described as his 'greatest achievement'. He has seen some of Kumar's films more than 15 times.

Desai has published over 200 articles in academic journals and had a regular column in the British radical weekly Tribune and in various Indian newspapers and magazines.

The Desai Bulletin

Meghnad Desai and Michael Cole-Fontayn

Dina Patel, Ashley Andrews, Meghnad Desai, Paul Judge and Aslihan Gedik

Pooma Kimis, Linda Yueh and Louis de Montpellier

OMFIF Annual Advisory Board dinner, London

John Kornblum and Meghnad Desai

Zhou faces greatest challenge

Stock market unrest could derail liberalisation drive

Jonathan Fenby, Advisory Board

Zhou Xiaochuan, governor of the People's Bank of China, at the zenith of a career that has seen him in major roles in China's securities regulation body and at two of its major banks, is facing his biggest set of challenges.

He has to formulate monetary policy to help manage the slowdown of the world's second largest economy as it moves through a series of mini-cycles within the overall downward trend. Simultaneously, he faces the uncertainties for the financial reform agenda provoked by this summer's stock market fluctuations.

Managed liberalisation

How far these will limit the 'managed liberalisation' championed by Zhou and other advocates of modernisation is a major question. And he has to guide the renminbi on an awkward path between over- and under-appreciation as the Chinese seek to increase internationalisation of the currency and become part of the special drawing right under an IMF review.

Zhou, in office since 2002, is the longest-serving of 11 PBoC governors and has been in the job longer than his peers in all the major economies. He has made the PBoC far more efficient technically. He is a convincing speaker in front of international audiences. But he suffers from the inevitable constraints of the Chinese system. As long ago as 2001, Zhou came out in support of increased use of market mechanisms and a reduction in bureaucracy.

His is an important voice in the wide-ranging reform programme advanced by the Communist Party, backing Prime Minister Li Keqiang's desire to make China more efficient with, among other things, greater use of the stock market.

The question, however, is the political weight Zhou can muster when faced with vested interests which want to slow down change – and may seize on this summer's stock market perturbations to argue for slower liberalisation.

Economic and financial policy is determined, in the last resort, by a leading group in the Communist party politburo, not by technicians. Zhou has slid down the list of the hierarchy in recent years, losing his seat on the 205-member Communist party central committee in 2012.

The PBoC is not independent and the governor plays an advisory role, rather than having the power to call the shots. The politburo takes into account many factors that may not be in line with monetary orthodoxy. Zhou has shown himself well able to swim in these waters, but has frequently faced speculation about when he will step down.

He is two years beyond the normal retirement age. The most commonly mentioned potential successor is Guo Shuqing, former chairman of China Construction Bank. Hu Huaibang, chairman of China Development Bank, and Yi Gang, a deputy PBoC governor, have also been suggested. The leadership may prefer not to move swiftly to replace the governor given current uncertainties.

Zhou's time at the top of the central bank as governor has encompassed major change. Financial reform has been significant with action to deal with the mountain of local government bad debt, notably through issuance of municipal bonds. Interest rates are likely to be liberalised by the beginning of next year. A bank deposit guarantee scheme took effect this summer.

Fending off temptation

Interest rate policy has become increasingly important. The PBoC appears to be pursuing a policy of stability as regards the currency, fending off the temptation of serious depreciation to boost exports in the face of weakening regional currencies including the yen. The renminbi has appreciated by 57% since the dollar peg was formally dropped in 2005. The real trade-weighted exchange rate is up 13% over the past year (see Chart). The PBoC moved in early 2014 to end the 'one-way bet' nature of the currency by allowing more volatility in an enlarged trading band. A significant depreciation seems unnecessary. Exports in June rose 2.8% in dollar terms from a year earlier.

Depreciation would risk setting off a trade war in east Asia, as well as harming China's regional triangular trade, where it imports components which it assembles and then exports. However, the authorities will probably decide a widening of the trading band at the end of the year. Stability is a prerequisite for entry into the SDR club. But complete opening of the capital account looks a long way off since it would open the door to a further volatility.

Before he took over at the PBoC, Zhou was president of China Construction Bank and chairman of the China Securities Regulatory Commission, where he earned the nickname of 'the flayer' for his war on corporate corruption.

Zhou is a skilled official who has grown with the job. China's monetary policy is becoming more complex and the central bank has to tackle both the broad implications of reform and fire-fighting episodes such as spikes in inter-bank rates and stock exchange convulsions.

The big question is whether he has the political connections to shepherd him through what could be an ever more taxing future. Amid far-reaching financial change, he has to control reform while gaining benefit from market liberalisation – a difficult juggling act. ■

Jonathan Fenby is China Director of the research service, Trusted Sources. He is the author of Will China Dominate the 21st Century, Tiger Head, Snake Tails; China Today and the Penguin History of Modern China.

How the renminbi has appreciated

Real effective exchange rate of China, 2005-15 (2010=100)

Source: BIS

Three dilemmas facing China

Beijing wrestles with the lessons of history

John Adams, Advisory Board

A combination of fluctuating stock market and question marks over the economic downturn is confronting the Beijing authorities with three sets of dilemmas. How China resolves these sometimes conflicting challenges is one of the central issues facing the country's policy-makers.

The Thucydides Dilemma defines China's attempt to achieve a peaceful rise to world power. It refers to the Greek historian Thucydides and his attempt to explain why Athens, the major power of its day, challenged Sparta and was destroyed. In his view, what made war inevitable in Greece in 430BC was the growth of Spartan power (read China) and the fear which this caused the established Athenian domination (read the US).

The argument, much voiced in certain US academic circles, is that, for China at this particular time in history, a peaceful rise may simply not be achievable. On this reading China's renaissance would further disturb an already unstable world system.

The timespan is critical. The US took from 1776 to 1920 to replace Britain as an economic superpower. Other examples come from a series of empires that were eventually crushed by wars over a lengthy period, shown by the chronicles of France (1694-1815), Prussia (1866-1945) and Japan (1854-1945).

Peaceful outcome

It is hoped that China's outcome will be more peaceful. The country's more recent rise dates only from 1949, indicating that time may be on its side. However China has fallen out with many southern neighbours and the US by mounting territorial claims over most of the South China Sea, and by building airfields on guano atolls to enforce its will. This compounds quarrels over disputed oil in the region.

The geopolitics are complex. China's establishment of the Asian Infrastructure Investment Bank, with $100bn of capital, was supported by most of the countries which oppose Chinese claims in the South China Sea. China has put in nearly one third of the seed capital, and even Taiwan is involved.

China has hired a top World Bank lawyer to advise on corporate governance (i.e. corruption) and has pursued this post-Bretton Woods concept with due determination. The US administration, reluctant to support a 'made-in-China' idea with either diplomacy or money, tried some ineffectual arm-twisting to get other countries to stay away. The omens for the Thucydides Dilemma being resolved without serious tensions are not good.

The Triffin Dilemma named after the Belgian-American economist Robert Triffin, sets down limitations on a country running a world reserve currency, potentially posing giant complications for China at a delicate time. Triffin postulated that rising international monetary commitments sabotaged control of domestic monetary policy. Zhou Xiaochuan, China's central bank governor, has cited problems facing the dollar as indicating the intensity of this dilemma.

But, paradoxically, China seems to be following hard on the US heels, promoting renminbi internationalisation and relaxation of the capital account and outward investment as part of its overall liberalisation drive. How long before China has its own Triffin moment?

A growing number of central banks around the world hold renminbi in their reserves. China may expand its economic manoeuvering room through greater use of its own currency, but it faces setbacks if it loses control of money fluctuating outside its borders.

Another sign of the renminbi's rise is the likelihood that on markets for gold and other commodities that international renminbi-denominated transactions will soon be widespread. China is the world's largest gold producer and one of the biggest consumers. The Bank of China in mid-June 2015 joined seven other international banks participating in the new Intercontinental Exchange (ICE) gold price benchmark.

A Chinese gold mining promoter, CIC Gold, has just listed on the London stock exchange, and is examining gold investments worldwide.

The London metals exchange owned by the Hong Kong stock exchange since December 2012, is already running renminbi mini-contracts in aluminium, zinc and copper.

Underlined by the special drawing right review process now underway, the renminbi is slowly assuming the roles of reserve asset and currency of denomination. This will almost certainly increase China's difficulties in managing domestic monetary policy. This could be a short- to medium-term crisis waiting to happen.

On the positive side, with regard to a much-mooted crisis in Chinese shadow banking, the IMF stated in April that the level of outstanding loans in this sector had been overstated, and that the Chinese government had the fiscal capacity to bail-out any major bank. It showed that China's fiscal revenues have been growing at a satisfactory 8-9% annually, while those in the US could scarcely manage 2%.

Inevitable effects

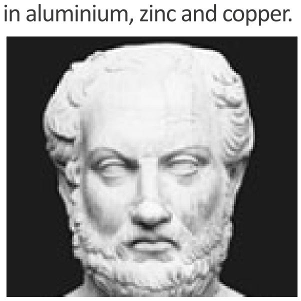
The third set of difficulties is characterised by the **Lewis Dilemma**, referring to the West Indies development economist Sir Arthur Lewis, who analysed the inevitable effects on wages of a drying up of cheap labour moving from agriculture into the industrial sector. This is happening in China, with average annual wage rates thought to have tripled between 2006 and 2014 (although the rise seems to be slowing).

China's entrepreneurs are already moving cheap labour industries (e.g. footwear and textiles) to other countries. A rentier Chinese society is emerging, with capital outflows higher than inward FDI. Labour unrest may ensue over time may be.

On the more positive side, over half of the population, for the first time in China's history, now lives in cities. This is transforming Chinese consumption patterns for goods ranging from washing machines to digital financial services.

The growing number of Chinese urban dwellers will play a vital role in determining whether, when and how China can resolve its series of dilemmas. ▪

John Adams is Director of China Financial Services



Thucydides

Robert Triffin

Sir Arthur Lewis

Opportunity for China

Ways forward for extending special drawing right

Gary Smith, Advisory Board

The international monetary system stems from negotiations conducted during the second world war. The special drawing right, the composite currency unit of the International Monetary Fund, was established in 1969.

Both developments reflect a period when America's relative economic, political and military power was at a maximum. As the SDR moves towards its 50th birthday it is a matter of fact that, on all three measures, the US footprint has diminished. The time is ripe for changes that reflect both America's reduced role and also the rise of China and increased use of the renminbi.

At one time a basket of 16 currencies, the SDR is now limited to four components: the dollar, euro, yen and sterling. The IMF's five-yearly review of the SDR's components, due to be concluded by the end of the year, focuses on the possibility of introducing the renminbi. This would further boost global usage of the Chinese currency and endorse it as a reserve asset – an adjustment to changes in the real world.

The SDR has been called many things over the years, including a 'basket case' and a 'paper tiger'. These comments stem partly from the SDR's failure to live up to its initial billing as 'paper gold', the replacement for gold bullion in the post-Bretton Woods world – and its inability to find a consistency of purpose since then.

The SDR was invented to provide liquidity for the world economic system, partly as a form of insurance policy against a break-up of Bretton Woods. It was amended to deal with precisely that break-up, and then amended again to deal with the evolving post-Bretton Woods monetary order. Since 1981 the core currency composition has not been changed (except when the euro replaced the French franc and D-mark in 1999).

Important role

Over this period hopes that the SDR might have an important role in the international monetary system have withered. A future change in composition might increase its relevance and make it more attractive as a unit of account of borrowing and lending.

As the Chart shows, bringing in the renminbi into the SDR – with an assumed 15% weighting – would have increased the SDR's past value, as a result of the Chinese currency's close connection to the firm dollar. If this happened, it would be reasonable for the IMF to start to measure renminbi in foreign exchange reserves in its Cofer statistics on currency composition.

I estimate that more than 50 central banks hold renminbi as part of their reserves, but the aggregate may amount to little more than 1% of the global total. If the IMF were to give the renminbi its formal blessing, more nations would add renminbi to their reserves. Those countries with very modest exposure would increase their holdings. The renminbi would be catapulted forward as a reserve currency, and would be likely to surpass in importance both sterling and the yen within a couple of years.

The rise of the renminbi has been significant. According to May 2015 data from Swift, the currency clearing system, the renminbi is now the primary currency for payments between China and the rest of Asia-Pacific, exceeding the dollar and the yen, a fourfold increase in just three years. Commodity exporters to China are increasingly ready to accept renminbi.

The use of renminbi by Iran and Russia is well documented. African nations are joining this trend. The Swift figures show that the renminbi is the fifth most used currency for global payments, and the second most used for trade finance. Further gains appear inevitable since the renminbi's share of international payments lags well behind its global share of trade.

A key argument for including the Chinese currency is the importance of China as a trading nation. The global economic footprint of the existing SDR members has shrunk. The arrangements put in place in 1969, and adjusted in 1974 and 1981, reflect a global economic status quo that is no longer valid.

If the renminbi is included, pressure to widen the SDR's constituents would probably not end. The renminbi's inclusion would reinforce the arguments for further change. The world appears to have a demand for more currencies, as a means both for settling trade and for holding foreign exchange reserves.

Other contenders for possible inclusion in the SDR are the currencies that the IMF already acknowledges as reserve assets, the Australian and Canadian dollars, and the Swiss franc.

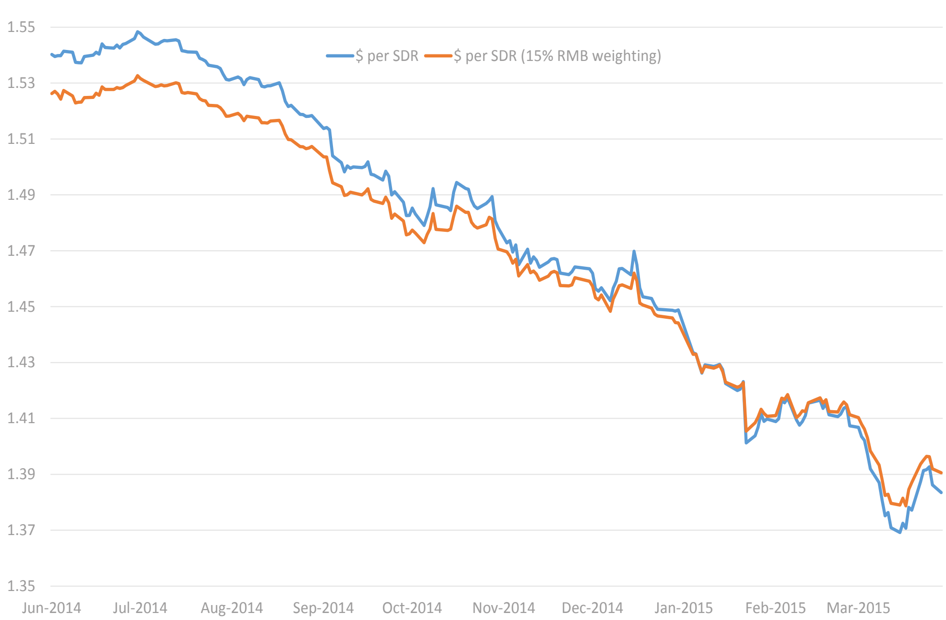
However, from the perspective of economic size and use in international trade, all three currencies command weaker arguments for inclusion than the renminbi.

If importance in international trade is a key factor, then in future reassessments the Indian rupee may feature as a strong candidate – along with other Asian currencies. Looking to the future, the outcome of the 2025 review could perhaps mark the return of a 16-currency SDR. ▪

Gary Smith is Head of Sovereign Wealth Funds and Official Institutions of Barings Asset Management.

What would happen if the renminbi joined the SDR

SDR exchange rate with the dollar, with and without renminbi (SDR per $)



Source: IMF and OMFIF calculations

Chinese stock market cools off

Propping up by the state unlikely to be sustainable

William Baunton

Shares in Shanghai experienced a strong bull market run since the end of 2014, with stocks on the Shanghai Composite Index rising 150% in value in under a year. But it all came to an end in June, with the bursting of what looked like an unsustainable bubble.

Curbing the resulting stock market decline, and clearing up the aftermath of massive support purchases of Chinese shares, presents the Communist party leadership with a major headache. The difficulty of policy-making in a harsh external environment could represent an important hurdle for further financial liberalisation.

On 12 June, when the Shanghai Composite hit a seven year high of over 5,100, the euphoria of the bull run turned to scepticism. Some shares were trading at 100 times earnings, with the market on average trading at about 20 times earnings. Amid awareness that prices had been bid up to artificial highs, sentiment swung from uneasiness to near-panic as stocks plummeted.

Frenzied selling since 12 June wiped more than a third off the Shanghai Composite, which hit a low point of around 3,500 on 9 July.

Economy slowing

With the economy slowing and the renminbi too high for the comfort of many exporters, the disconnect between economic fundamentals and prices at the peak was clear.

Although the People's Bank of China has mainly used interest rate reductions and lower reserve requirements to ease policy, there is speculation that it may turn to further unconventional action if unrest on financial markets continues. The authorities may possibly need to undertake quantitative easing (on a scale that could be the largest in the world) to soften the landing,

The government's intervention in the stock market to halt the sharp correction appears, at least for now, to be working.

Initial measures, such as banning stock sales by major shareholders appeared initially to have little effect. However, state-owned banks have been shown to have provided over $200bn to the China Securities Finance Corporation for lending on to brokerages to help restrain the stock decline.

The biggest of these loans appears to have been from China Merchants Bank, the sixth largest lender by assets. Stocks have now stabilised, with the Shanghai Composite recovering 20% since its 9 July low. Regulators have launched investigations to spotlight what they describe as 'malicious short selling', seeking out traders supposedly carrying out bearish bets on inside information or with intent to influence prices.

The relatively underdeveloped stock market has experienced a bubble before. In 2007, in similar though more extreme fashion, stock prices in Shanghai more than tripled in less than a year. The Shanghai Index reached an all-time high of just over 6,000 in October 2007. Within six months, as can be seen in the Chart, almost all these gains were wiped out.

Today's turbulence shows strong parallels, with high price-earnings ratios (although nowhere near the heights of 2007) sparking abrupt changes in sentiment when certain price barriers are breached. Back then, the level on the Shanghai Composite triggering aggressive profit-taking was 6,000. This time, based on events in June, it appears to have been 5,000.

Many market participants are pointing to the cooling real estate market as the reason behind the bubble. With the property market down over the last year, investors diverted capital to stocks – aided by looser monetary policy and increased lending by banks.

The big questions are how much further stocks need to fall to be 'correct' and what will be the effects on global markets. Stocks in Hong Kong have already felt the drain on liquidity. As of 8 July, the Hang Seng index downturn had wiped off all 2015 gains in a matter of days. It has since recovered some of these losses.

The Chinese equities decline has been a major factor pushing down commodity prices. China's slowdown has led to expectations of declining demand. Nickel, zinc and iron ore are trading at their lowest levels since the financial crisis. The convulsions have added to the effects of a general commodities glut. Chinese investors are rushing to exit commodity positions to raise cash. Investors are hoping that a combination of weak commodities, concern about slowed liberalisation, and China's competitive difficulties caused by the strong renminbi will not spill over to cause worldwide turbulence, as was seen in February 2007.

At the time, Chinese markets were almost completely shut off to outside investors. Now, China is becoming more open through initiatives such as the Shanghai-Hong Kong Stock Connect and measures to enable two-way flows of investment with the rest of the world. Chinese stocks should be watched closely for signs that turbulence could spark wider upheavals. ▪

Chinese stock market: rise, fall and recovery

Shanghai Composite Index, 2005-15

Source: Shanghai Stock Exchange, Bloomberg

Bretton Woods history relevant today

The role of the Chinese delegation at the 1944 conference

Jin Zhongxia, former Director General, Research Institute, People's Bank of China

In summer 1944, the United Nations Monetary and Financial Conference (commonly known as the Bretton Woods conference) was held in Bretton Woods, New Hampshire.

The conference agreed to create the International Monetary Fund and the International Bank for Reconstruction and Development, establishing the framework for the post-second world war international economic and financial order.

Drawing on the conference reports from the Chinese delegation and other related documents, I have retraced the footsteps of the delegation and explored the role played by the Chinese delegates.

The contents may be of relevance in the light of discussions in 2015 over issues such as the quota reform at the IMF, possible inclusion of the renminbi in the special drawing right, and the establishment of the Asian Infrastructure Investment Bank and the New Development Bank.

In many years of research on the Bretton Woods conference, historians have tended to focus only on the western countries such as the US and the UK. Little attention has been given to the other participants, let alone China.

From the recently discovered archives, which had been gathering dust for 70 years, we are able to reconstruct the Chinese delegation's passage to the conference in a relatively complete and clear manner. The narrative is, of course, from the perspective of the Kuomintang government and there could be some inflated elements; some content requires further research and verification. Yet the archives do offer a rather clear and complete outline of the Chinese delegation's participation.

Strong voice

Many details of the Chinese delegation's participation in the conference demonstrate that the Chinese government contributed actively to the conference and to co-operation between China and the US.

During the war, compared with the US, the UK and the Soviet Union, China was the weakest country in terms of infrastructure, yet it was the country (together with the Soviet Union) bearing the greatest losses. Yet, in comparison to France, a country that had been fully occupied by the Axis powers, China had not lost its territory completely.

Therefore China, among the Allies, still had a strong voice on the international stage. The US and the UK led discussion of the main strategic tissues of the conference, while China participated mainly at the technical level.

The conference took place at the most difficult moment of the Anti-Japanese war. Yet the Chinese government took the conference seriously, dispatching the second largest delegation after that of the US.

Among the Chinese delegates were the country's most professional and experienced economists, bankers and diplomats.

Kong Xiangxi (also known as H.H. Kung and Kung Hsiang-hsi), vice-premier of the Executive Yuan, finance minister, and governor of the Central Bank of China

Ji Chaoding, assistant to the chief delegate, was an underground Communist party member.

The Chinese delegation offered the US important support and assistance. At the inaugural plenary session, after the speech of Henry Morgenthau, the US Treasury secretary, Kong Xiangxi (also known as Hsiang-hsi Kung), the leader of the Chinese delegation (at the same time Chinese finance minister and governor of the central bank), made an address on behalf of the other participating countries, reflecting China's high standing among the Allied powers.

Towards the end of the conference, China and some other countries held reservations on the allocation of IMF quotas. Yet, considering the overall situation and other countries' interests, China was the first to withdraw its reservations, helping the conference to a successful conclusion.

Significant achievements

China registered some significant achievements as a participant. China's share of quotas in the IMF was $550m, with 5750 votes, 5.8% of total voting power and ranking fourth among participant countries. In December 1945, when the Soviet Union announced its withdrawal from the Bretton Woods system, China's quota and voting shares rose to third-largest among IMF members.

The Chinese delegation to Bretton Woods contained some Chinese Communist party members. The delegation, to a certain extent, was a product of co-operation between the Kuomintang and the Communist party. As a prime example, Ji Chaoding, assistant to the chief delegate, was an underground Communist party member.

In the context of the Bretton Woods conference, Chinese Communist party members used their intelligence and talents and co-operated quietly with the Chinese government, with a view to safeguarding and enhancing China's international standing. This was also the common goal of the Chinese people. The archives indicate that it is highly possible that Ji Chaoding participated in the work of the Drafting Committee, one of the most important committees of the conference.

The Bretton Woods conference resulted in a combination of the state intervention policies proposed by socialist countries and the free market policies proposed by capitalist countries.

According to different sources, Harry Dexter White, one of the US representatives, showed strong interest in the socialist course of the Soviet Union, so much so that some Americans claimed that he was a Soviet spy. For that reason, he failed to be appointed as the first managing director of the IMF.

John Maynard Keynes, the British representative, played a major role on the conference. The inclusion of state intervention in his capitalist theory demonstrates that he, too, had assimilated into his works some thoughts of the socialist system's planned economy – and, to a certain extent, had deviated from capitalism's free market policy.

Preserving differences

The Bretton Woods conference agreements, with inter-governmental co-operation as their framework and exchange rate intervention as their base, embody a mixture of the thoughts of both the socialist and capitalist economies.

The conference itself was an event in which both capitalist and socialist nations participated. It was an important trial and a form of rehearsal for countries of different social systems to learn from one another and to seek common ground, while preserving differences, under the name of peace and co-operation.

Almost all the delegates of the Bretton Woods conference have now passed away.

Just as the ancient lyric goes: 'All gallant deeds are now dispelled by wind and rain.' The Bretton Woods system was dissolved in 1971-73, more than 40 years ago.

The cold war ended with the dissolution of the USSR. The world economy has not yet fully recovered from the worst crisis since the second world war. The US remains the leading world power; yet China has risen to second place, looking to be the next world leader. The topics currently discussed among the leading countries are not significantly different from those debated at the Bretton Woods conference.

Those who open up and learn from the dusty archives of Bretton Woods may perhaps gain insights into many other issues of relevance for today. ▪

Dr Jin Zhongxia wrote this paper as Director General of the Research Institute of the People's Bank of China (PBoC). In January 2015 he was appointed Executive Director for China at the International Monetary Fund.

Sovereign Notes from Manila: Global Public Investors seek infrastructure assets

Global Public Investors stand to gain substantial returns from infrastructure investment in Asia. Across the continent, banks, regulators and financial intermediaries are trying to secure more attractive capital market to cater for infrastructure financing and boost the pipeline of projects. GPIs outside Asia – particularly sovereign funds and public pension funds – would do well to consider joint investments and partnerships alongside Asian partners. The Asian Infrastructure Investment Bank, the political origins of which might be thought as stemming from the Bretton Woods conference, will play a pivotal role in this undertaking.

Capital market reforms are a key part of this drive, aimed at breaking down barriers to cross-border funding and harmonising documentation. Singapore for instance is making strides in template documents to transform completed public-private partnership schemes into appropriate products for capital markets. There is a wider push across the Asean Economic Community to formulate blueprints for mutual recognition and cross-border capital-raising. Legal frameworks will include homogenous exit mechanisms and new methods of handling risk management.

Public-private partnerships support, rather than supplant, waning bank lending for infrastructure projects. There is a material duration mismatch between traditional bank lending and the long-term capital required for infrastructure projects. GPIs can help bridge this gap. Where GPIs require a diversified portfolio without direct investment, asset allocators can look to listed infrastructure equities and funds. Where possible, these should include some element of inflation linkage to ensure stable returns.

As well as absorbing capital, Asia is taking steps to become an effective mobiliser of capital, in a way that will eventually challenge traditional investments centres in Europe and North America. The AIIB is a natural outcome of long discussions in Asia on recycling regional savings. It complements the Asian Development Bank's own Asean Infrastructure Fund which now has 11 shareholders supporting funding for projects in the region. Although rivalry among China, Japan and the US may cause some political bickering, competition between these institutions will end up increasing the efficiency of capital allocation for Asian infrastructure.

Real problems remain in relation to the use of capital for infrastructure projects. Capacity constraint is one them – there are only so many projects that can take place at any one time in one location. Limited information is often a stumbling block for investors undertaking due diligence.

Project usage can fall short of expectations predicted by economic models, so a highway financed with a certain toll income may not produce forecast revenues. Despite these potential pitfalls, ample returns are available in both debt and equity instruments as Asian governments push for a more integrated approach to infrastructure funding. GPIs from around the world will be part of this move. ▪

Pooma Kimis is Director, Markets and Institutions.

Grounds for euro optimism

Behind the scenes, EMU becomes more resilient

Iain Begg, Advisory Board

The never-ending Greek crisis has highlighted many of the flaws in the design and governance of economic and monetary union, while exposing the inability of Europe's leaders to resolve what ought to have been an eminently manageable problem.

Yet, out of the limelight, Europe's leaders have been introducing reforms intended to improve the resilience and effective management of the single currency. Indeed, since 2009, the great paradox of the euro is that, while the rest of the world sees only dithering, denial and double-dealing, the pace of change has, at times, been frenetic – at least by EU standards.

Fiscal discipline

New measures have been introduced to strengthen national fiscal discipline and to improve the coordination of fiscal policy. A procedure for identifying and, if required, correcting other sorts of macroeconomic imbalance – backed by the threat of financial sanctions for backsliders – has become law.

Greece, naturally, has hogged the headlines. The country's previous balance of payments deficits and deteriorating public finances, caused by policy errors earlier in the 2000s, are to blame. This is just part of a series of shortcomings that has resulted in a difficult-to-eradicate build-up of debts (see Chart).

For the euro area as a whole, recovery has failed to take hold. Growth may have limped back to positive territory under the impetus of the European Central Bank's belated resort to quantitative easing and lower oil prices, but GDP expansion is not strong enough to make inroads into high unemployment. Politically, the rise of populist parties in many EU countries testifies to the weariness of citizens with harsh policies. Divergences in competitiveness between northern export-orientated economies and the more vulnerable countries in the south are evidence of more systematic difficulties.

Improving governance

Furthermore, by taking on new responsibilities, the European Central Bank is slowly becoming a fully-fledged central bank, rather than a mere custodian of price stability, and the first elements of capital markets union are being introduced.

By common consent more had to be done. Three years ago, Herman van Rompuy, European Council president, published the 'four presidents' report' setting out plans for achieving 'genuine' economic and monetary union.

The report proposed closer integration and coordination in several main areas. These are in the fields of banking union; budgetary policies, including a possible euro area budgetary capacity to provide economic stabilisation and a common debt instrument; and non-fiscal economic policies. Additionally, in the political arena, there are plans for strengthened democratic legitimation and accountability – potentially bringing a degree of political union.

Many of the plans in that report proved to be too ambitious and only banking union has made much progress through the agreement of a new structure for prudential supervision of banks (the single supervisory mechanism, with the ECB at the pinnacle of a network of national supervisors), and a common approach to resolving failing banks (the single resolution mechanism).

A fresh attempt has now been launched to improve euro governance, in the form of what is being called the 'five presidents' report', made public on 22 June. It contains updated plans for 'completing' EMU, focusing on the same broad themes as the earlier report, but with some tempering of the more ambitious components.

Two of the more eye-catching new proposals are intended to complete banking union. The first is to establish a common deposit insurance scheme to complement what national agencies offer. This was one of the original ideas for banking union which failed to garner enough support after 2012.

The new proposal hints at making the common scheme a form of reinsurance for national deposit insurance, rather than an all-encompassing supranational one, and it will be based on contributions from the banking sector, rather than public money.

The second development will be what is called a 'bridge financing mechanism' as a backstop to the single resolution fund already agreed at end-2013. Critics had complained that the fund risked being too small and too slow to build up to its target size, since it was planned not to be fully operational until 2025.

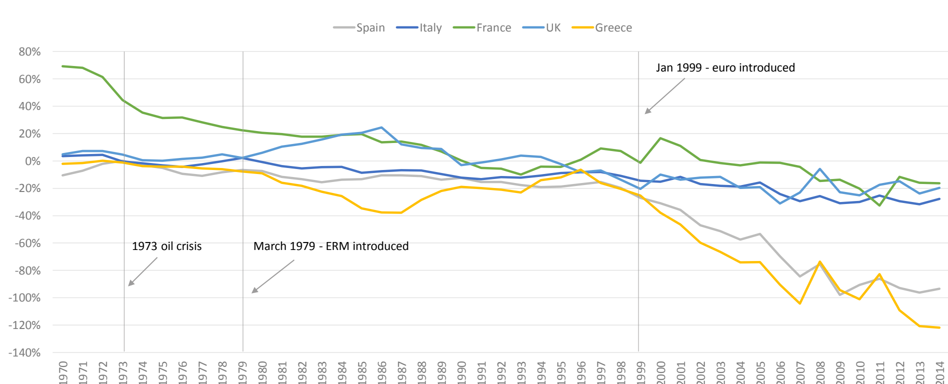
If both these proposals make headway, the result would be a more integrated and resilient euro area banking system. This would go a long way towards breaking the damaging 'doom-loop' between banks and sovereigns.

The continuing precariousness of many euro area banks and the weak flow of finance to business underscore the urgency. Many of the other new measures remain to be properly tested. Unfortunately, past experience of non-compliance, including by Germany, does not inspire confidence that all will be well.

Nevertheless, there are grounds for optimism – despite all the gloom over Greece – that the euro area's leaders do realise the size of the challenges they face. To misquote Mark Twain, rumours of the euro's likely demise are greatly exaggerated. ▪

Debts of Spain, Italy, France, UK and Greece

Net foreign assets,1970-2013, % of GDP



Source: External Wealth of Nations Mark II data set (Lane and Milesi-Ferretti 2007); and Lane and Milesi-Ferretti 2012; Eurostat.

Iain Begg is a Professorial Research Fellow at the European Institute, London School of Economics and Political Science and Senior Fellow on the UK Economic and Social Research Council's initiative on The UK in a Changing Europe

How to get Greece back on its feet

Marshall Plan-style initiative needs global support

Plutarchos Sakellaris , Athens University of Economics

Greece needs the combined forces of three large international financial institutions in an action programme to get back on its feet and restore the economy after the devastating downturn of the past five years.

I hope that agreement will be reached in the next few weeks on Greece's third bail-out package. My country will need much more support under a Marshall Plan-style growth contract between Greece, its official creditors and the international community.

This requires the involvement of the European Investment Bank, the International Finance Corporation and the European Bank for Reconstruction and Development. I recommend that they work closely with a coordination and facilitation office in the Athens prime minister's office to promote interaction with the Greek administration.

The country needs to return to reasonable levels of growth. The essential pillars of a new economic contract are deep and multifaceted structural reform, less fiscal austerity coupled with restructuring of the public debt, fixing the Greek banking system to restore lending, and promoting investment. The EIB would concentrate on advice on preparing infrastructure and large investment projects as well as on policy reforms necessary for these projects to become sustainable and bankable.

The IFC, from the World Bank group, is needed to help resolve the difficulties from non-performing loans. The EBRD would help with privatisations and bank recapitalisation.

Greece has a lot of assets for harnessing growth. But it has to recover from a loss of income comparable to the 1929-33 US depression. The good news is that, with the right programmes, Greece can prosper.

The country has a large pool of highly educated young people, many of whom are now idle, who can be employed in ventures in high technology and life sciences, in particular.

A second asset is its geography. Greece is the entry point in Europe for China's New Silk Road., making Chinese involvement natural. Greece is part of the 'southern gas corridor', an essential component of the EU's energy strategy.

Greece's cultural heritage, biodiversity and climate create opportunities in high value-added tourism, natural cosmetics, specialised agriculture and agribusiness. There is a place for energy and environment infrastructure. Privatisations will play a significant role in generating new investment.

The plan launched by Jean-Claude Juncker, the European Commission president, administered by the EIB, will help fund strategic investment across Europe. Nowhere in the continent is it needed more than in Greece, as a pool of investment funding designed to attract other sources of funding. Once Greece stabilises its sovereign finances, attention will switch to the country's investment challenges and opportunities. The international financial institutions will play a crucial role in helping increase the availability of bankable projects and in working with the Greek government to create a better environment for business to flourish. ▪

Plutarchos Sakellaris is a Professor at Athens University of Economics and Business and a former vice president of the European Investment Bank.

Priority is debt relief

Europe needs a radical turnaround

Ruud Lubbers and Paul van Seters, Advisory Board

The Eurogroup of European finance ministers needs to change course, modify its targets on Greece and aim for a reasonable balance between debt relief and deficit reduction.

The International Monetary Fund has admitted that Greece should receive further debt relief. Since Greek people still show deep-seated opposition to further austerity – demonstrated by Prime Minister Alexis Tsipras' victory in the referendum on 5 July – creditors need to show a sense of magnanimity.

The debt relief is a matter of separate negotiations between the IMF, the European Central Bank and the European rescue funds (EFSF and ESM). The process begins with the extra credit tranche that Greece urgently needs. That extra tranche should be entirely financed by EU institutions. In return, the IMF should be prepared to accept a cut of 50% on Greece's current obligations. In a longer-term step, the IMF and Eurogroup should determine an approach to debt relief over several years and how the burdens can be distributed between the two institutions. This debt relief should be based on the principle that Greece needs extra financial headway to comply with the economic convergence criteria agreed in the Maastricht Treaty.

This requires a political accord between Greece and the other euro countries, reflecting a balance between necessary deficit reductions and recovery of Greece's growth potential.

Ireland, Portugal, and Spain have shown that countries which now take the Maastricht criteria seriously can produce better economic figures when they take action based on appropriate democratic processes.

Tsipras has to show he is more than simply the leader of a left-wing party. He must become a prime minister for all Greeks. Greece's humanitarian challenges show how welfare cuts alone are not appropriate as a means of cutting deficits sustainably. The Greek population seems to have united in opposing this route, and instead asks for solidarity and saving to be spread throughout all layers of society.

European politicians must accept that a long-term solution for Greece requires Europe to undertake a full-scale political and psychological turnaround. The right policy on Greece is one that acknowledges Greek dignity and stimulates growth.

The Eurogroup will then be able to play its originally conceived role. This is to help member states to build on their own efforts and to compare their achievements with those of other member states. If they take full note of bruised feelings in Greece, and launch appropriate action, then the Greek turbulence will turn out to have been a salutary wake-up call for Europe. ▪

Ruud Lubbers is a former Netherlands Prime Minister and Paul van Seters is Professor at Tilburg University.

France shifts the blame to Berlin

Authors of Greek tragedy are French, not German

Shumpei Takemori, Advisory Board

At the high point of the wrangling over Greek debt, Wolfgang Schäuble, the German finance minister, made public a memorandum suggesting a minimum five year 'time out' for Greek membership of economic and monetary union.

Germany has also made clear its responsibility for the proposed trust fund for to-be-privatised Greek assets – the harshest condition in the New Greek deal that was reluctantly approved by the Athens parliament in the early hours of 16 July.

After Schäuble's proposals were circulated, I was shocked at the escalation of tension between Germany and France.

The Paris government came to Athens' rescue at the last moment by suggesting, along with the International Monetary Fund, that Greece should benefit from creditors agreeing a debt write-down.

I have from time to time entertained the idea of EMU breaking up, but I never had a clear idea of how it could happen. Now, thanks to the weekend developments, I get the picture.

But this is not all. Paul Krugman, the US economist and habitual critic of Germany, exceeded his normal standard of violent language by attacking Germany for 'breaking down the European Union'. At the same time, on the blogsite 'this is a coup', which is well-known in Japan, there are now calls to boycott German products. To be fair, I think that the authors of the Greek tragedy are French rather than German.

We have to remember that the idea of the euro was promoted above all by President François Mitterrand, and that France gave a warmer welcome than Germany to Greek membership of EMU. French banks had by far the largest exposure to Greek government bonds in 2009.

Rescue operation

We must recognise, too, that the sensible suggestion of writing down privately-held Greek government debt was made at the outset of the Greek rescue operation in 2010. The IMF proposed this, and Chancellor Angela Merkel basically accepted it.

But it did not come about because on the French side, in particular, two key players vehemently opposed it. One was Christine Lagarde, now IMF managing director, then French finance minister. The other was Jean-Claude Trichet, then European Central Bank president.

France made a misjudgement. Yet if Greece ever left EMU, France would lose face totally. Quite probably, as a result of these episodes, we won't see another French managing director of the IMF for another 50 years.

Leading the Fund

We anyway must doubt the wisdom of a European leading the Fund, as has been the case since it started 70 years ago. In particular, the Japanese government should push for a Japanese MD; we have an excellent candidate in the shape of Prof. Takatoshi Ito of Columbia University.

There have been some fascinating shifts in the Paris-Berlin relationship. In the past, German chancellors have wisely stood behind French presidents to avoid the image of German dominance. Merkel may revert back to this tradition in future.

In the case of Greece, President François Hollande, with typical French astuteness, gave backing to Greece at a crucial moment. He simultaneously shifted the blame for the Greek tragedy from France to Germany, and mounted a bid to reclaim European leadership. ▪

Prof. Shumpei Takemori is Professor of Economics at Keio University.

German policy on Greek exit, supported by eastern states, provokes discord with France

A 'temporary' Greek exit from EMU, proposed by Germany, yet hotly opposed by France and Italy, has been narrowly averted. But the suggestion may still eventually decide Greece's fate in monetary union. The divergence between the two countries demonstrates new fragility in Franco-German relations that looks likely to mark European co-operation for years to come.

Wolfgang Schäuble, the German finance minister, ended up determining Chancellor Angela Merkel's negotiating stance. Whereas it once would have feared European isolation, Germany now puts forward views opposed by France with demonstrative self-confidence. This reflects not only manifest German economic strength but also EMU membership of several smaller nations from central and eastern Europe that take an even more robust attitude than Germany on the Greek economy.

From the Baltic to former Yugoslavia, small euro states that were previously part of the Soviet bloc have been converted to German allies and steadfast proponents of monetary orthodoxy. European changes since German reunification 25 years ago represent a double blow for France. The Germans used to be France's buffer zone against the Soviet Union. Yet as the new round of EMU antagonism shows, a cluster of small ex-communist countries now play a similar role – but now as buffer states to protect Germany against France. We shall see reinforced efforts in coming months by French President François Hollande and Italian Prime Minister Matteo Renzi to build a European coalition opposing German-style austerity – an alliance that could find support (depending on economic and political developments) in Madrid and Lisbon.

Wolfgang Schäuble

The problem for Hollande is the same one that faces Sigmar Gabriel, the German Social Democrat leader and deputy chancellor in Merkel's coalition. Full-blooded efforts to resist the Merkel-Schäuble line on Greece, and downgrade efforts at economic discipline or supply-side reforms, are likely to generate strong countervailing pressures. They would be met, in Hollande's case, by a widening of Franco-German bond spreads, and, for Gabriel, by a fall in his domestic popularity ratings and a further improvement in Merkel's. The tough stand on Greece by the chancellor and her finance minister may have provoked indignation in parts of southern Europe, but it has won admiration among many German voters. ▪

The harsh generosity of Angela Merkel

Why we should think back to pre-euro era

Meghnad Desai, Advisory Board

European observers need to cast their minds back to the pre-euro period. Greece (and Italy for that matter) became prosperous by frequently lowering the value of their currencies and running lax fiscal policies.

Greece became wealthy enough for the rest of Europe to admit it first to the European Community and then to the euro area. So why not let Greece go back to the regime which suits its genius? Greece needs the southern European-Mediterranean laissez passez approach that lets it pass through economic and political barriers with innate flexibility and suppleness. Why harness it to the northern European forced march of Sturm und Drang when the journey requires daring, dexterity and appropriate doses of devaluation? Grexit is the only way out.

German control of the euro is difficult to argue with. Any deviation from fiscal orthodoxy seems like celebrating sin. Yet that is exactly what is needed. Greece needs to get out of this hideous contract. Print its own money – and renounce its debts, as it has done in the past. The euro's macabre comedy must end. The negotiations have brought Greece some interim relief to meet instalments due to the International Monetary Fund and European Central Bank.

So the euro bloc is paying money to Greece and then getting it back again. This apparently preserves the euro area's integrity, where, as Angela Merkel has said, no haircuts are allowed. Merkel believes she is being generous. If this is the case I wouldn't like to see her in an unchivalrous mood.

I wonder what the private creditors think of this rule which preserves the loans of public sector lenders from other euro states but allows Greece to pay the private creditors less than their due. It would be far easier to postpone or forgive the instalments.

The euro was established, if we are to credit history, to assure Europe that a united Germany would not be a bully for the rest of Europe. A single currency was meant to bind them in 'ever closer union'.What we have instead is a gold standard-like arrangement which robs member countries of macroeconomic sovereignty.

Yet, bizarrely, the system failed to check excessive borrowing when credit was flowing. No one warned the peripheral states that repayment might be a problem.

The gold standard in its heyday was strict but the Bank of England ran it with a light touch. The euro has turned out to be a harsher version. If monetary union was supposed to protect Europe from German bullying, then it has failed. The only country which has gained from this cosy arrangement is Germany with its built-in exchange rate depreciation.

If negotiations proceed as planned, Greece will tie itself to years, if not decades, of excess deflation. The Greek government will be exporting to its creditors whatever budgetary surplus it can manage, rather than reinvesting it in the economy. All the relief will get sent back to the creditors, a dispiriting form of round-tripping.

No private investor, domestic or foreign, would want to invest in a depressed economy which will stay depressed for decades. This is no way to run a country, let alone a continent. ▪

A troubled IMF legacy

Lagarde should have backed Schäuble on Athens exit

Desmond Lachman, American Enterprise Institute

Over the past five years, the Greek economic and political tragedy has seriously damaged the credibility of the International Monetary Fund. The IMF has consistently indulged in wishful thinking and led Greece along a policy path that has brought it close to economic and political ruin.

So it is all the more lamentable that at the Brussels summit on 12 July, Christine Lagarde, the IMF managing director, did not insist that the new economic programme imposed on Greece had practically no chance of working.

She should have supported Wolfgang Schäuble, Germany's finance minister, in proposing that the international community should assist Greece in making an orderly exit from the euro. Lagarde is trying to absolve the IMF from any responsibility for Greece by saying that its debt is unsustainable and by calling on the Europeans to help. One wonders why she didn't make these points in Brussels.

It is hard to understand what purpose is served by top-level IMF representation at such a gathering if the Fund waits until afterwards – as it did last week – to voice fundamental scepticism about the points on which European leaders allegedly agreed.

We should recall that the Greek economy is already in a 1930s-style depression. A major contributing factor to Greece's economic collapse has been the imposition on Greece, by the IMF and Europe, of excessive budget belt-tightening within a euro straitjacket.

That straitjacket has precluded the use of either monetary or exchange rate policy to offset the negative effect on demand of tax increases and public spending cuts.

The basic flaw of the Greek agreement is that it is mandating policies for Greece that are very little different in substance from policies that have spectacularly failed in the past. Specifically, it is again requiring major tax increases and pension cuts from a country that remains constrained by the euro rules, now in the grip of an economic depression.

Greece's creditors are demanding these austerity measures at a time when the country's economy is facing a massive body blow from the shutting of its banks these past three weeks. Although the banks reopen today, and this should help confidence, capital controls and withdrawal limits remain in place.

Why, if past Greek budget belt-tightening within the euro contributed to Greece's depression, will the same such policies now promote economic growth? Alexis Tsipras, the Greek prime minister, says he does not believe in the programme. This is hardly likely to instil confidence in Greek's battered economy. ▪

Desmond Lachman is a resident fellow at the American Enterprise Institute. He was formerly a Deputy Director in the International Monetary Fund's Policy Development and Review Department.

Portfolio shift ends years of negative equity

How Czech central bank gains from share purchases

Miroslav Singer, Czech National Bank

The Czech National Bank's foreign exchange reserves expanded significantly in both absolute and relative terms in the early 2000s. Between the end of the Asian currency crisis in 1998 and 2005, reserves grew by $16.8bn to $29.3bn, 23% of GDP.

This growth sparked an informal discussion at the CNB about whether and how to invest the reserves. As at other central banks, the principal aims of such diversification were to reduce non-market risks and improve returns.

Equity purchase

In considering a possible equity purchase programme, the key issues that had to be analysed were the liquidity and ownership. In terms of liquidity, it was clear that only equities represented in major indices could be used. As to ownership, there was talk of transferring the part of the reserves not needed for monetary policy purposes to the Treasury or using it as the initial capital of a new Czech sovereign fund.

However, both such ownership transfers entailed legal uncertainties, so CNB focussed on an in-house equity programme. The bank was acutely aware that any losses incurred at the start of an equity investment programme would do huge damage to its reputation. Timing was the most sensitive issue.

The possibility of investing part of the reserves in equities was first discussed in June 2005. Preparatory work continued until it was time to decide on the form of the tender to find an asset manager. However, in June 2006 the board postponed the process. It decided gradually to invest 10% of the euro portfolio in the composite equity index comprising national stock markets within the euro area, and 10% of the dollar portfolio in US, Japanese and UK equity indices according to weights derived from capitalisations in June 2007.

In retrospect, the delay – requested by board members wary of the dizzy heights reached by equity markets in mid-2006 – saved the CNB from entering the equity markets just before one of the sharpest equity price corrections in modern history.

Asset managers

In October 2007 the board finally approved the tender for asset managers, and in March 2008 BlackRock and State Street Global Advisors were selected as managers. The gradual build-up of the equity portfolio began. By mid-2011 the portfolio had reached the 10% target level, and in November 2011 the board set the maximum allowed deviation from that level at 2% of reserves. The CNB, meanwhile, had further diversified its reserves into the currencies and financial assets of Sweden, Australia and Canada. In October 2012 a decision was made to diversify the bank's equity investments into Australian and Canadian equity indices using the same asset managers.

The CNB has recently had to increase its equity investments to follow the increase in reserves stemming from the board's November 2013 decision to set a floor against the strengthening of the Czech koruna.

As to the results, the equity portfolio has been loss-making in only two years – 2008 and 2011. The relatively large loss in 2008 (about one-third of the investment value) was mitigated by the fact that it was incurred on only 2.5% of the reserves – one-quarter of the intended equity portfolio size. The total cumulative return for the six years from June 2008 to September 2014 was 61.4% – quite a respectable figure in these times of low returns.

The fixed-income returns were meanwhile close to the benchmark, reaching 15% cumulatively in the same period. Thanks to the considerably better performance of the equity reserves, CNB reserve management was profitable during the financial crisis.

Inflation targeting tools

New issues are always cropping up. The use of the exchange rate as an inflation-targeting tool at the zero lower bound on policy rates may lead to a further build-up of CNB reserves and thus necessitate sizeable increases in the equity reserves this year or in the future. The CNB may decide further diversification.

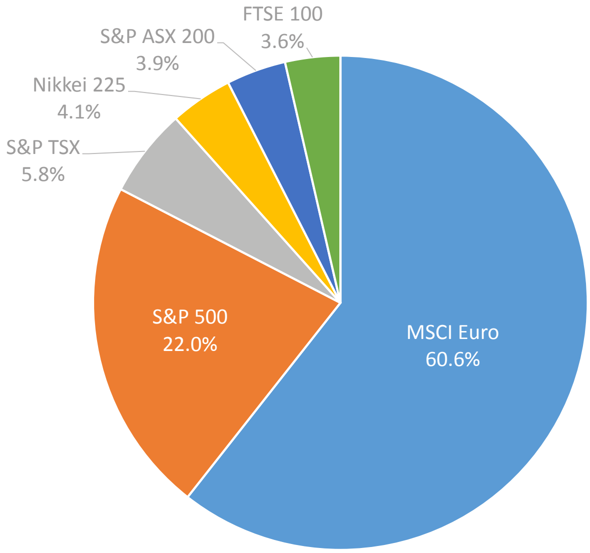
There has been one more important side-effect. After more than a decade of operating with negative equity – with a cumulative loss on its balance sheet – the CNB has achieved a position of positive capital. This may result in increased demands from the Treasury to transfer part of the bank's current profits to the state coffers. Such demands are likely to increase the attention paid by the general public to the quality and results of CNB reserve management.

Investing 10% of the CNB's reserves in equities has been a success. The bank has diversified into a better-performing asset class and improved its risk-return position. It has diversified, too, into territories other than the EU and US. Crucially, by delaying the start of the reserve build-up phase, the Bank prevented initial losses that might have compromised the programme. ■

Miroslav Singer is Governor of the Czech National Bank.

How the Czechs have moved into equities

Structure of CNB equity portfolio, Dec 2014



Source: Czech National Bank, annual report December 2014

Common themes, different aims for GPIs

Liabilities are crucial in unstable financial markets

Colin Robertson, Advisory Board

***Global Public Investor 2015* analyses the growth in assets across the public sector in 2014 and indicates the likely investment strategy this year. The themes are similar to those in the private sector: diversification away from equities, a desire for real inflation linked assets and a search for income.**

However, global public investors are not a homogeneous grouping and they will need to handle these themes according to their own individual responsibilities.

For decades sovereign funds have invested in public equities, often taking substantial stakes in western companies. In many cases the mandate has been to preserve wealth derived from oil revenues for future generations and the long term nature of equity investment has matched this well.

Attractive returns

Returns have been attractive and this has encouraged greater investment in equities, notably when there has been a very high level of existing investment in bonds. Often this has incorporated a less domestic focus, spreading the risks.

These trends can be expected to continue. The danger is that other types of public investor, with different aims – and which therefore may not be able to handle the volatility inherent in equity markets – get drawn into this asset class.

Public pension funds are conscious of the length of their liabilities. Many are contemplating some degree of 'derisking' by switching equities into bonds. Equity purchases by central banks to obtain higher yields, influence risk appetite, or boost the economy in some other way, seem a dangerous game.

The intention of global public investors to allocate more money to real estate and infrastructure is a key conclusion of *Global Public Investor 2015*. This is supported by the behaviour of private sector institutions which, following the credit crisis, have been diversifying away from equities in an attempt to reduce risk while maintaining exposure to growth-orientated assets.

The linkage to economic growth of real estate and infrastructure is clearly attractive to public sector investors, which have long-term investment horizons and hence no need for liquidity. For these investors in particular, an added attraction is the potential for an element of 'self-investment' as social and political needs can be simultaneously satisfied.

The very strong performance of commodities in the run-up to the credit crisis, and their supposed lack of correlation to other asset classes, drew attention to inflation-linked assets. For some investors, the aggressive actions of central banks have strengthened the argument for holding 'real' assets.

Real estate and infrastructure stack up well on this criterion, with rents and revenues often formally linked to the inflation rate. The huge potential supply of infrastructure investments is an attraction to large institutional investors.

The inflation protection case for real estate and infrastructure has been boosted by the fall from grace of investment in commodities.

However, with the notable exceptions of some Canadian and Australian funds, investment in infrastructure has progressed slowly. The need for a sizable skilled in-house team poses challenges. So does the mismatch between the desire of investors to buy mature infrastructure with attractive yields and the requirement of governments to obtain capital to initiate projects.

Investment in commodities is likely to remain unfashionable for private sector investors. But some large sovereign funds may be able to take advantage of distressed sales of commodity assets to further national economic security.

Search for yield

The collapse in government bond yields and narrowing of credit spreads has prompted pension funds and central banks to maintain income by moving up the risk spectrum. However the risks implicit in this strategy are different for these two categories of investors.

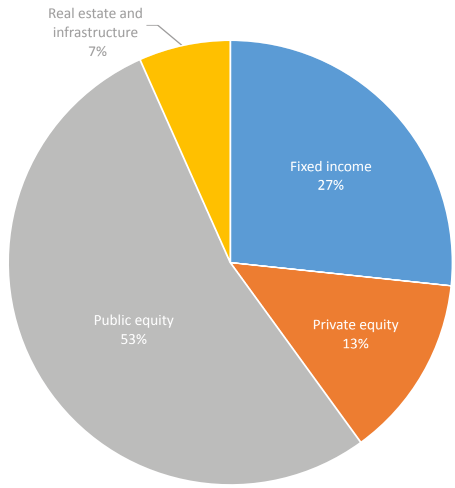
Pension funds have introduced or increased allocations to emerging market and high-yield debt. Fearing a future rise in government yields, they have also invested in 'absolute return bond funds' which have targeted 'Libor plus' returns. The problem is that all of these new investments have much shorter durations than their liabilities. So derivative strategies are needed to maintain the duration of their assets.

In contrast, moves by central banks along the credit spectrum tend to lengthen the duration of their portfolios and increase the credit risk.

In many ways 'absolute return bond funds' should be more suitable for central banks than for pension funds. But avoiding conflicts of interest, as well as liquidity considerations, can make external management difficult.

Public equity best performer

Percentages of respondents



Source: OMFIF GPI Asset Management Survey, 2014

With yields higher than investment grade bonds, real estate and potentially infrastructure fit the bill for pension funds. However, a problem for pension funds is the artificial distinction made by investment consultants between 'matching' and 'growth' assets. Real estate and infrastructure lose out by qualifying for both categories but not being the most attractive asset class in either.

Hedge funds are the least attractive broad asset class according to the investment intentions indicated in *Global Public Investor 2015*. This reflects poor returns and high costs, as well as the difficulty of selecting suitable hedge fund managers.

Nevertheless, 'Libor plus' hedge fund mandates should be appealing to those seeking cash like investments and hedge funds do offer diversification.

Different categories of global public investor in different regions will share intellectual leadership and best practice. To meet its overall targets, individual global public investors have no alternative but to examine very closely their own mandate and liabilities, and take appropriate matching steps . ■

Colin Robertson, former global head of asset allocation of Aon Hewitt, is an independent consultant.

Global Public Investor 2015 is available for purchase at www.omfif.org or sales@omfif.org.

Fed on course for September lift-off

Wary but not worried about Greece and high dollar

Darrell Delamaide, US editor

It may have been an early onset of summer doldrums that resulted in the most vigorous monetary debate in the US. In June came the news that the Treasury Department was going to remove Alexander Hamilton from the $10 bill to follow through on its plan to put a woman on the US currency.

On the monetary policy front, meanwhile, there was very little guidance emanating from policy-makers on the Federal Open Market Committee, as market participants reached a widespread consensus that lift-off would come in September with a small hike in interest rates, followed perhaps by another small hike in December.

However, the crisis in Greece and the uncertain consequences of that country's possible exit from the euro led some to speculate that the Fed might postpone action.

Banknote front

On the banknote front, Hamilton was the first Treasury secretary in the US and is widely credited with putting the young country on a sound financial footing and setting the foundations for a resilient economy.

Federal Reserve officials observed a discreet silence, at least in public, to avoid stepping on the Treasury's toes, given that the currency is a clear prerogative of the government even though bills are labeled Federal Reserve Notes.

Ben Bernanke, former Fed chairman, was not so shy about expressing his opinion. 'I must admit I was appalled to hear of Treasury Secretary Jack Lew's decision last week to demote Alexander Hamilton from his featured position on the $10 bill,' Bernanke wrote in his blog at the Brookings Institution, where he is a distinguished fellow.

Bernanke and others argued that it would be preferable to remove Andrew Jackson, the nation's seventh president who is now widely condemned for his brutal attacks against American Indians, from the $20 bill.

For one thing, Jackson was vehemently opposed to a central bank vetoing a bill that would have kept alive the country's second effort at a national central bank.

Moreover the $20 bill, the dominant bill in ATMs, enjoys much wider circulation. Lew's explanation that the $10 was the next one up for redesign struck many as a weak defence.

The June unemployment figures (released in early July) showed a decline in the jobless rate, to 5.3% from 5.5%, but labour market participation declined and wages remained stagnant.

St. Louis Fed chief James Bullard **(non-voter)**, for one, wasn't too concerned about the impact of Greece on the US economy or on Fed policy. Bullard told reporters after a speech in St. Louis that a September rate hike 'is still very much in play.' The situation in Greece would have little effect on the US, he said, and the European Central Bank should be able to contain any contagion.

And in a flash of the monetary version of Realpolitik, he added: 'I see the US as being a likely beneficiary of the situation in Greece,' as investors seek the safety of US bonds. 'It's not that I take joy in that, but that's the way the global macroeconomy tends to work.'

Loretta Mester **(non-voter)**, head of the Cleveland Fed, also continues to see a rate hike as probable. 'I do think the economy can support a 25-basis point increase in interest rates,' she told reporters after giving a speech in Pittsburgh. But Mester, who has shown hawkish tendencies in her first few months in office, demurred on the timing of the hike or the possibility of more than one this year.

The dovish head of the San Francisco Fed, John Williams **(voter)**, also remained confident the Fed would raise rates soon.

'I still believe this will be the year for lift-off, and I still believe that waiting too long to raise rates poses its own risks,' he said in a speech in San Francisco. 'Monetary policy has long and variable lags,' he added. 'Specifically, research shows it takes at least a year or two to have its full effect.' Their remarks came after the June FOMC meeting that left rates near zero, where they have been since the onset of the financial crisis in 2008.

Interest rates

At the press conference following that meeting, Fed chair Janet Yellen **(voter)** acknowledged that a higher dollar is acting as a drag on the US economy. 'In spite of the appreciation of the dollar,' she said, the Fed 'obviously thinks that the economy is likely to do well enough to call, likely call, for some tightening later this year.' The charts released each quarter showing the forecasts of individual Fed policy-makers on an anonymous basis in fact showed members scaling back their growth forecasts for this year to a range of 1.8-2.0% from 2.3-2.7% in March.

FOMC members

New York Fed chief William Dudley **(voter)** encouraged watchers to keep an eye on this data and the remarks of FOMC members to assess the timing of Fed action. Participants endeavour to be clear about what factors are important in driving the timing, he said.

'This does not mean providing advance notice about precisely when lift-off will occur because the timing should depend on the incoming economic news and how this influences the economic outlook,' he said in a speech in Minneapolis.

'Instead, if you pay attention to the incoming economic news and listen to our assessment about how the outlook is evolving, then I think you will be able to judge for yourself when lift-off is likely.'

Former Dallas Fed chief Richard Fisher joined Barclays as a senior adviser at the beginning of July, after stepping down from his post in March. The search for his replacement continues.

The Minneapolis Fed announced that its president, Narayana Kocherlakota **(non-voter)**, will be joining the faculty of the University of Rochester in upstate New York in January, moving up his departure from the Fed to December from end-February. ▪

Darrell Delamaide is a writer and editor based in Washington.

Bedevilled by schizophrenia

Fed must take growth recession into account

Steve Hanke, Advisory Board

Since May 2013, Fed taper talk has fluctuated between hot and cold. When it's hot, the markets anticipate a monetary tightening and prices become volatile.

Speculation about just when the Fed will increase interest rates has reared its head again. Since early 2013, I have said that the Fed would not act until late 2015. Well, it's now approaching that date and I think the Fed will act, but later, rather than earlier.

The US monetary stance remains schizophrenic and tight. In consequence, the US remains in a growth recession – growing, but below the trend rate. The CFS Divisia M4 – the most important measure of the money supply for those of us who embrace a monetarist approach to national income determination – is growing at an anaemic year-over-year rate of 2.8%.

Money and regulations

How could this be? After all, over the past few years, the Fed has been engaged in the largest quantitative easing programme in its history. To find explanations, we must revert to John Maynard Keynes at his best. Specifically, we must look at his two-volume 1930 work, *A Treatise on Money*. Keynes separates money into two classes: state money and bank money.

State money is the high-powered money (the so-called monetary base) that is produced by central banks. Bank money is produced by commercial banks through deposit creation.

Today, bank money accounts for about 80% of the total US money supply, measured by M4. Anything that affects bank money dominates the production of money. So, we must look at bank regulations – courtesy of the Basel regulatory procedures and the Dodd-Frank legislation.

These new regulations have been ill-conceived, procyclical, and fraught with danger. Indeed, bank money, the elephant in the room, has been struggling under a very tight monetary policy regime since the financial crisis of 2008–09. This has forced the Fed to keep state money on an ultra-loose leash.

The net result of this schizophrenic, tight monetary policy stance has been a sluggish growth rate in broad money and a continued growth recession, absent inflation, in the US (see Chart). But, that's not the only one swirling around Washington.

In 2013, the US government decided that the greenback needed a facelift. That didn't raise eyebrows. But, Treasury Secretary Jack Lew's 17 June announcement did, by proclaiming that Alexander Hamilton (1755-1804) – the first and foremost Treasury secretary – would be demoted and share the ten-dollar bill with a yet unnamed woman. While this shocked many, it shows how political currency can be.

Hamilton's legacy is – like it or not – the US federal system of government. It follows rather closely the outlines laid out by Hamilton and his fellow Federalists.

This, of course, probably makes Hamilton's lifelong nemesis, fellow founding father and president Thomas Jefferson, turn in his grave. And Jefferson is not alone. Indeed, Hamilton was, and always has been, a lightning rod. In consequence, Hamilton's fame has experienced ups and downs.

When Hamilton died in 1804, Jeffersonians seized the opportunity to launch a smear campaign to diminish the reputation of their rival. This campaign was effective. Hamilton's reputation slumped from his death until the 1860s. Once the civil war broke out, Hamilton's star rose. His popularity began to surge in the north because he had been an active abolitionist.

His fame would peak during the Gilded Age (1873-1900), a time when America experienced unprecedented industrialisation and the spread of high finance – both Hamiltonian features. With the US stock market crash in 1929 and the Great Depression, Hamilton's star plummeted, as Hamilton's name was associated with Wall Street, banking, and high finance. It is not surprising that Hamilton proved to be an inviting target. Indeed, Franklin Delano Roosevelt, in his 1932 Commonwealth Club Address, lambasted Hamilton.

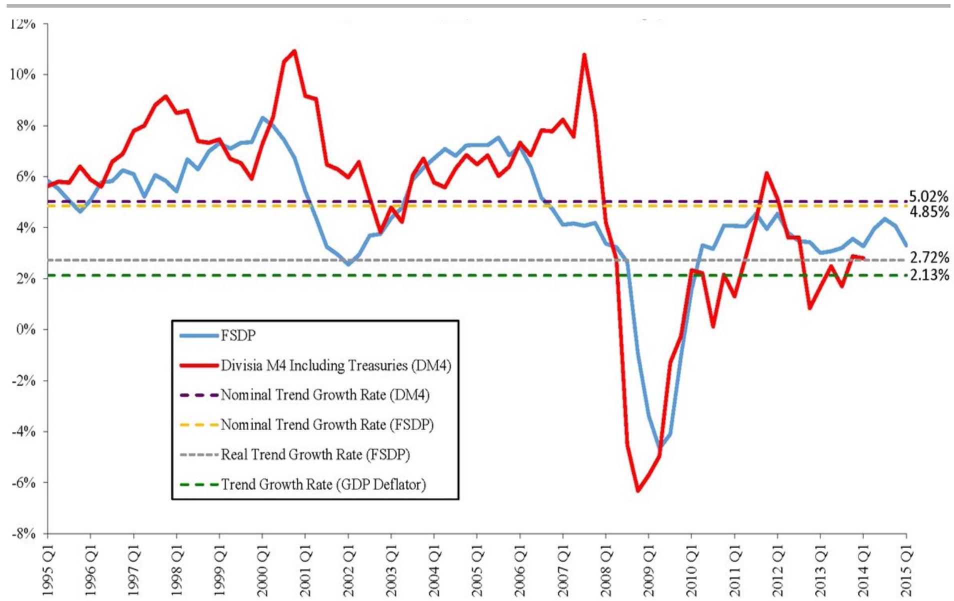
Hamilton would stay down until 1982, when the Federalist society was founded during the first Reagan administration. Hamilton's image remained on the upswing until the recession of 2009.

The current crisis brought with it the anti-Wall Street, anti-bank, and anti-capitalistic sentiments. And, yes, Hamilton's fame took a hit, once again. To relegate the great Hamilton to a bit part on the $10 bill is going too far, however. But, when it comes to currencies, we should never be surprised by what politicians can serve up. ▪

Steve H. Hanke, member of the OMFIF Advisory Board, is a Professor of Applied Economics at The Johns Hopkins University in Baltimore and a Senior Fellow at the Cato Institute in Washington.

US final sales to domestic purchasers (nominal) and Divisia M4 (nominal)

1995-2015 (annual percent change)



Source: Federal Reserve Economic Database, Center for Financial Stability. Calculations by Prof. Steve Hanke, The Johns Hopkins University Notes: FSDP=GDP + Imports - Exports - Inventory; FSDP data measured quarterly; Divisia M4 data lagged 5 quarters. The correlation coefficient is 0.77. Last data points: 2015 Q1 for FSDP and GDP Deflator; May 2015 for Divisia M4.

Winners and losers from low oil prices

Mixed effects among producers and consumers

William Baunton

Since the fall in oil prices in June 2014 from around $115 to the current price of around $55, the effects on national economies have been immensely disparate.

Many oil producers, particularly in developing markets, rely heavily on oil exports to balance the budget. In an extreme case, Nigeria funds almost 90% of its budget from oil receipts. The winners from low oil prices are, more generally, the importers and, on balance, the world economy.

Shifting capital

The IMF estimates that a $10 fall in oil prices increases world growth by 0.2% annually, with capital shifting from producers to consumers. This could mean low oil prices have added nearly 1% to world growth over the last 12 months.

The fall in oil prices, as shown in Chart 1, in the midst of conflicts in oil producing nations Iraq, Syria, Nigeria, Libya and the third largest producer Russia intervening in Ukraine, caught many off guard.

The world's largest producers, detailed in Chart 2 (for importers see Chart 3), will be the most under pressure from low oil prices. Every month the oil price remains stubbornly low, the pressure mounts on oil exporters. For example, Russia loses $20bn for every $10 drop in the oil price, according to the World Bank and Citi analysts believe a $10 drop in oil prices lowers Venezuela's revenue by $7.5bn. In Venezuela's case, the low oil prices could not have come at a worse time, already struggling with a budget deficit measuring over 15% of GDP in 2014. Most recent estimates put the oil price needed to balance Libya's budget in 2015 at $215 a barrel.

Next in line is Algeria, which needs $111 to balance its books, followed by Saudi Arabia ($103), Iran ($93), Venezuela ($89), Nigeria ($88), Russia ($78), UAE ($73) and Iraq ($71).

Qatar and Kuwait are among the few oil-producing nations which are on track to balance their 2015 budget with current oil prices. They need oil to be selling at $59 and $47 respectively.

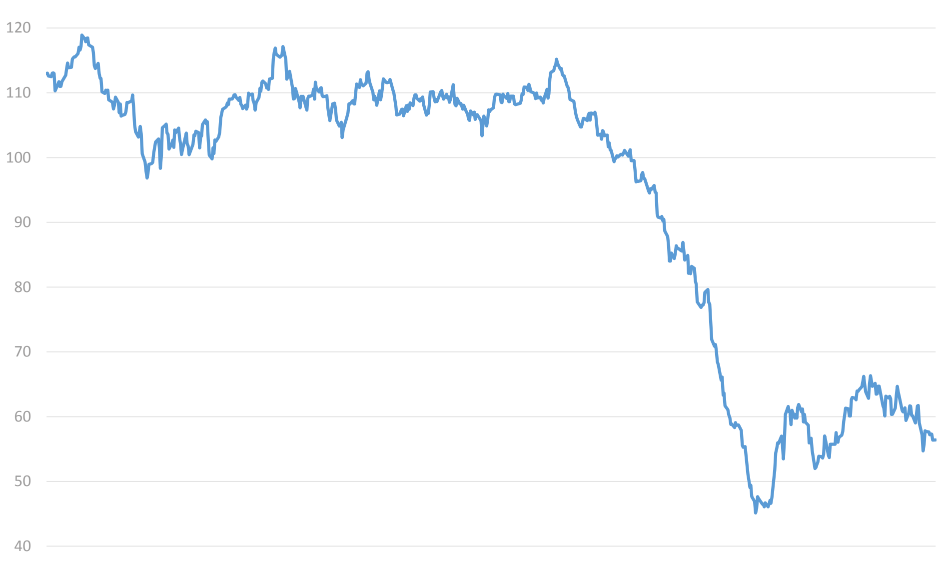
Most of these countries can sustain a short period of low oil prices, however sub-$100 a barrel prices look to be staying.

Both the World Bank and IMF project that oil prices will only return to around $70 in 2019, with the Economist Intelligence Unit projecting $90 in 2019 (see Chart 4). Among these nations it will be survival of the fittest, exposing those who have not diversified their economies and built up reserves during periods of high oil revenue.

Opec heavyweights Saudi Arabia, UAE, Qatar and Kuwait, although losing revenue, could win long term with a period of sustained low prices.

Chart 1: Oil prices stabalise in 2015 after sharp fall

Brent crude spot price, 2013-15 ($ per barrel)



Source: US Energy Information Administration

By continuing their policy of stubbornly maintaining production levels, these nations will maintain their market share and outlast the weaker, high-cost operators. Even though government budgets will certainly be in deficit for the foreseeable future, these countries have amassed vast reserves and have set up sovereign wealth funds during periods of high oil prices.

The central bank in Saudi Arabia for example, the Saudi Arabian Monetary Agency, held $737.4bn in total reserves at end-2014. This makes it comfortably the fifth largest global public investor in the world, as highlighted in the latest edition of OMFIF's Global Public Investor Top 500 Ranking.

These reserves alone could finance the entire government budget, which is projected to be $229bn in 2015, on its own for three years. The budget deficit is projected to be $39bn in 2015, or 5% of GDP. By borrowing from itself, the government can sustain two decades of deficits of this level.

Market share

It's a similar story for its neighbours which have amassed huge wealth in forms of the Abu Dhabi Investment Authority ($679bn), Kuwait Investment Authority ($600.1bn) and Qatar Investment Authority ($175bn). These vast war chests will aid them to outlast anyone in the battle for market share. It is no wonder the most powerful members of Opec are staunchly against reducing oil production.

At the top of the list of winners is, almost certainly, China. In 2013 the largest net importer would have saved $2.1bn for every $1 drop in the oil price sustained over the year. A $50 drop, as experienced over the last 12 months, could lower the world's second largest economy's import bill by over $100bn annually.

India is also benefiting, with low oil prices helping inflation come back under control and strengthening its exports. An added bonus is the government's ability to reduce fuel subsidies, helping the government balance the budget.

Perversely, for many importers, cheap oil could not have come at a worse time. Japan's Prime Minister Shinzo Abe was finally making ground on the two decade-long battle with deflation in Japan. As the third-largest importer of oil in the world, the oil price shock has brought back the downward pressure on prices.

The same is true in Europe. European Central Bank President Mario Draghi believes 80% of the decline in inflation since 2011 was due to low oil prices, as well as low food prices.

Though not straightforward, the overall effects of low oil prices on the US economy is marginally positive. When oil prices plummeted in 2008, it was a clear cut boost to the economy suffering from the worst financial crisis since 1929. Thanks to shale oil, the US is now the largest producer of oil in the world, a position it did not hold in 2008.

The more powerful and immediate effect is that it stimulates consumption, comparable to a cut in taxes, leading to spending on something else. However, there are longer term structural effects to US oil producers and the states in which they operate. A lower oil price filters through to lower tax revenue and consumer income for those states.

Long-term effects

Shareholders of the oil companies will also be hit with reduced dividends further down the line. Many of these may reside abroad. These effects are long-term and affect only some states and industries, the stimulus from lower prices to the consumer are far larger and immediate.

Other major losers, on the surface at least, appear to be the oil and gas producing and refining corporations. Tens of billions of dollars of planned investment have been canceled and cuts are being implemented across the board.

Renewable energy developers and companies producing 'green technology' such as solar panels are finding investment and demand are slowing from investors and consumers alike.

Showing some parallels with Middle East oil producers, the only winners in the energy industry are perhaps the giants. They, like Saudi Arabia, have amassed vast amounts of capital and market share, leaving the smaller firms weak, undervalued and exposed to takeovers allowing the large firms to consolidate their market position.

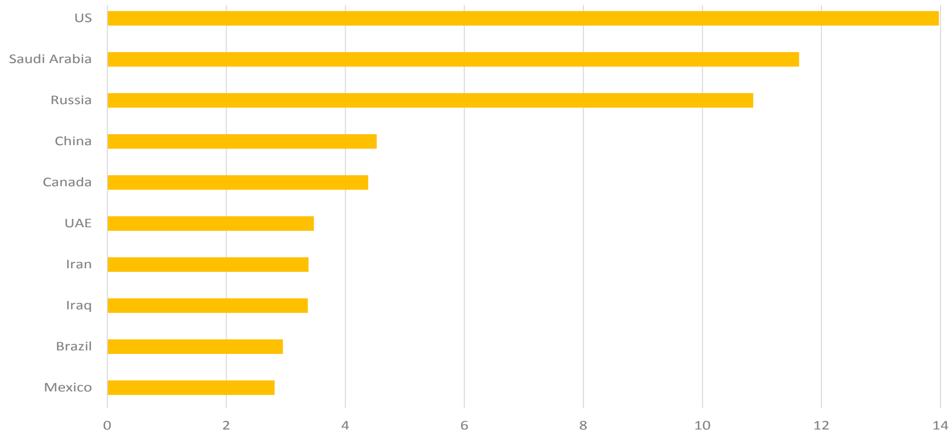
For importers, although unwelcome in some cases where this complicates inflation targeting, low oil prices are providing a welcome boost to consumers. In the oil producing countries, with prices expected to remain low until at least 2016, pressure is mounting in the other direction.

In the same way as wealth is moving internationally from producers to consumers, among the oil producers, capital is flowing from sovereign funds back to governments as the latter seek funding to compensate for lost revenues.

Most countries are winners or losers, with some falling somewhere in between. But most importantly, the world economy will benefit. ▪

Chart 2: US, Saudi Arabia and Russia top production league

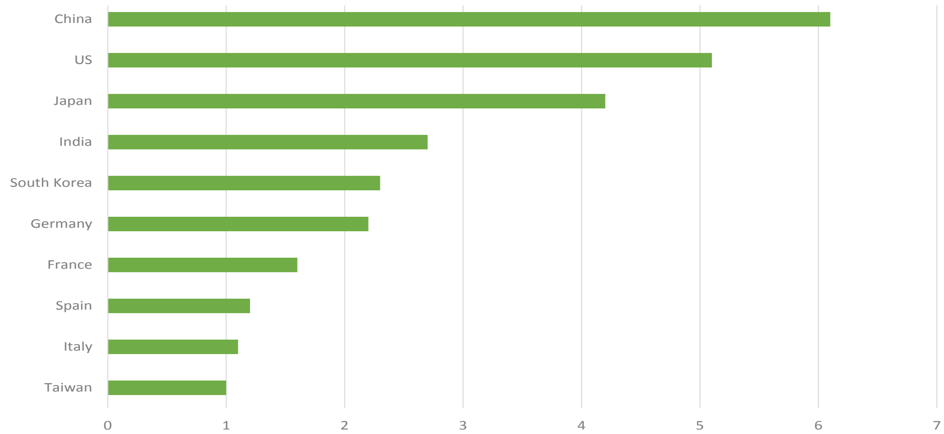
Top 10 oil producers 2014 (millions of barrels per day)



Source: US Energy Information Administration

Chart 3: China, US and Japan import most oil

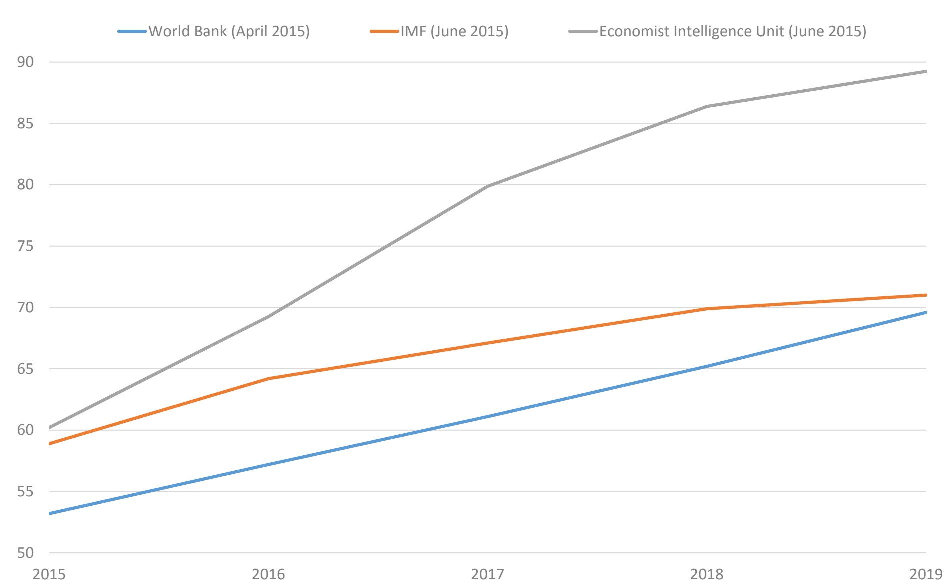
Top 10 net oil importers, 2013 (mpbd)



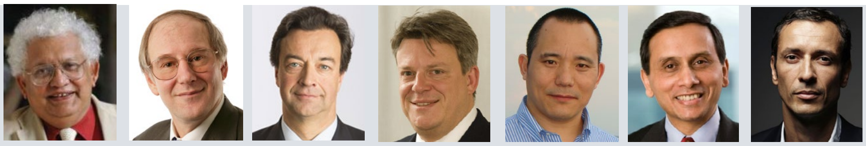
Source: US Energy Information Administration

Chart 4: Sub-$100 oil price forecast until 2019

Projected oil price, 2015-19 ($pb)



Source: World Bank, IMF, EIU



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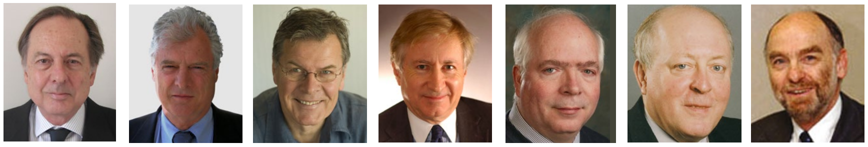

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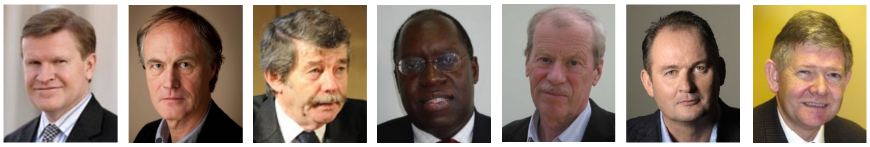

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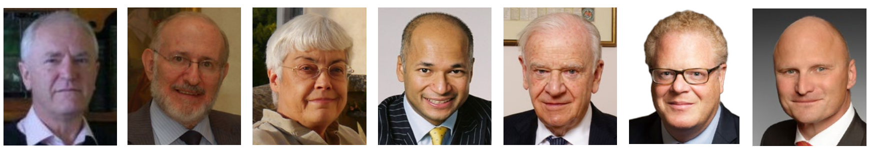

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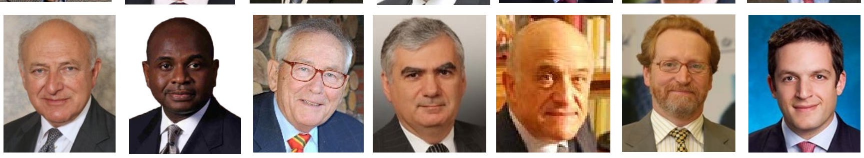

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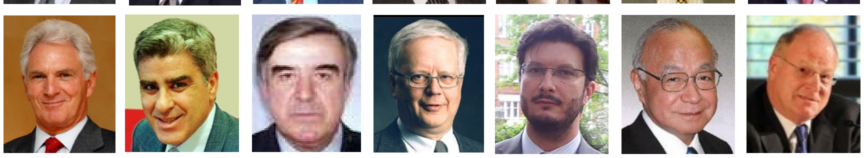

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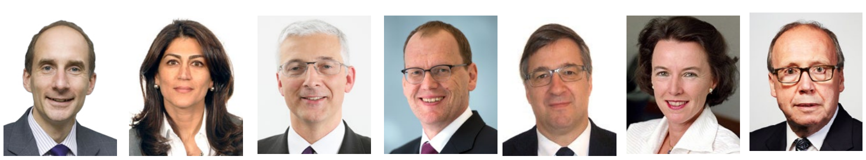

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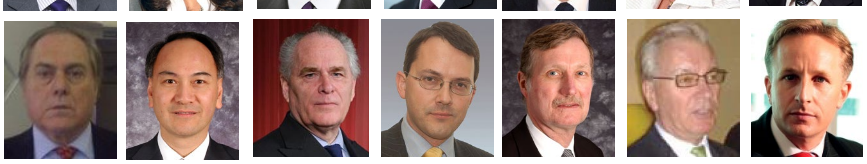

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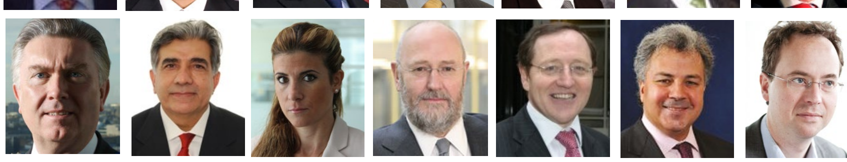

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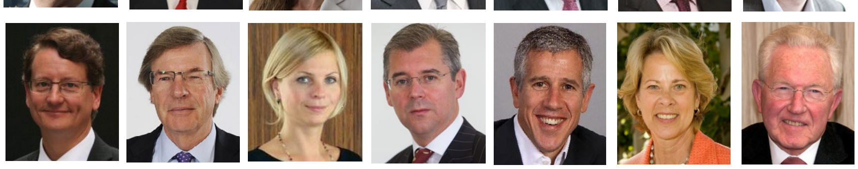

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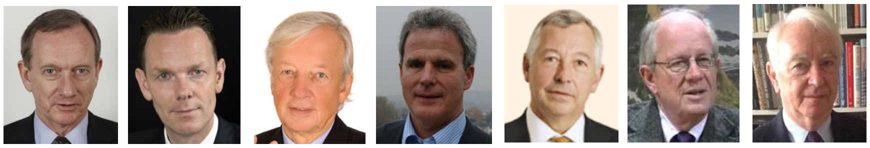

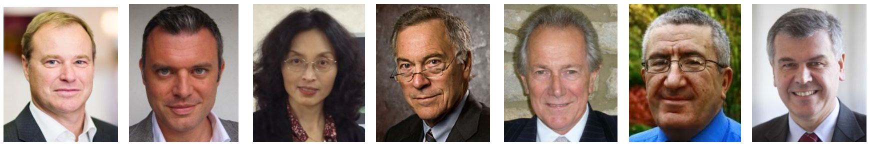

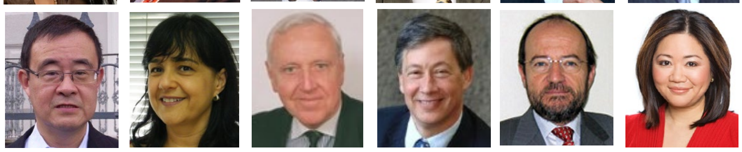

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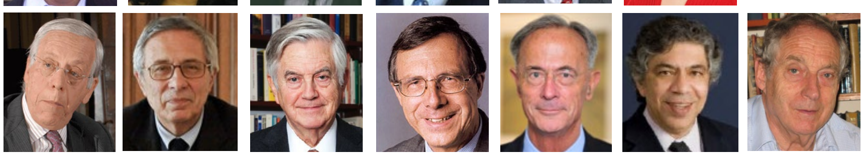
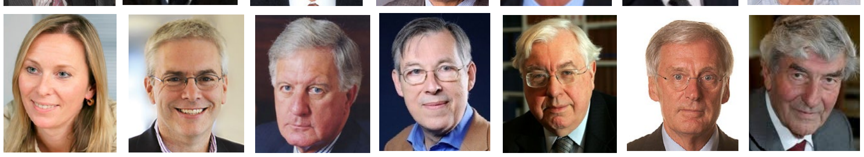
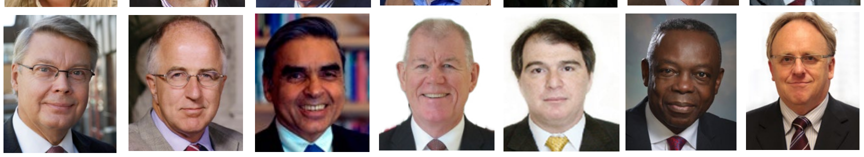
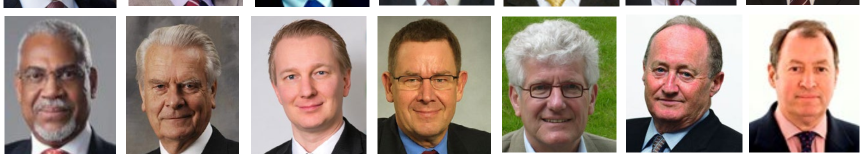
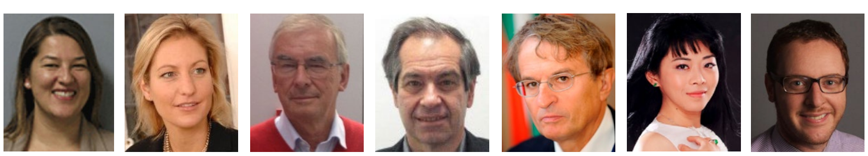


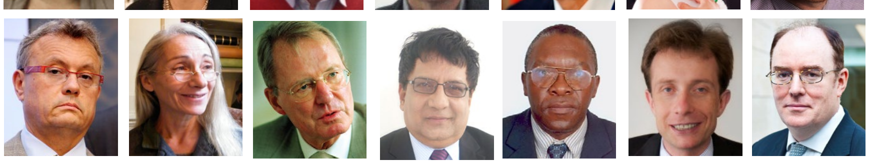


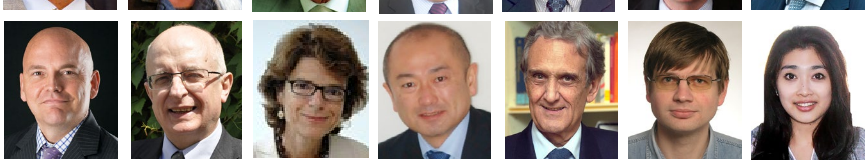


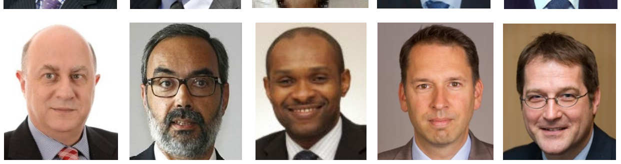


ECONOMICS & INDUSTRY









Brazil and Mexico in new alliance

Leading economy and 'sleeping giant' make formidable team

David Smith, Advisory Board

Almost everywhere you looked at the end of the second quarter, the prognosis for Latin America was bleak. Brazil and Argentina, the traditional heavyweights, experienced an economic contraction.

Mexico and Colombia are both embracing change, but suffering as the drop in oil prices hijacked the agenda. Even Chile, for so long a beacon of progress, experienced domestic unrest. Venezuela is in free fall economically, and politically a de facto dictatorship.

One cause for hope lay in the shifting alliances of the first half of this year and the search for new leadership in a region full of expressions of political unity, but short of a growth agenda based on economic consensus. This is where the government of Brazil comes in, under Dilma Rousseff, a populist president who knows that time is running out for the Brazilian model. She needs to change tack and regenerate a giant, faltering economy beset by corruption, inflation, rising unemployment and street protests.

Another important figure is President Enrique Peña Nieto of Mexico, a reformer who challenges his country to open up the state sector to foreign investment, both in the established bastion of oil and the modern behemoth of telecoms.

Hence the summit meeting a few weeks ago in Mexico between Rousseff and Peña Nieto. Behind the warm expressions of mutual goals, the realpolitik spoke volumes. 'Both of them are in trouble, both need to find partners who can be economic investors and political allies. It's the ultimate marriage of necessity,' said a World Bank expert on the region.

In numerical terms, Mexico and Brazil make a formidable team. Together they account for 62% of GDP in Latin America, 55% of the region's population, and 55% of the territory in the subcontinent. And then there's the economic imperative. The reform agenda of the Mexican leadership has been derailed by the fall in the price of oil, as 30% of government revenue comes from oil exports.

Brazilian President Dilma Rousseff and Mexican Prsident Enrique Peña Nieto, May 2015

The state oil giant Pemex, which Peña Nieto has opened up for foreign involvement, is now scaling back, to produce 2.3m bpd. The president's hope is that growth will top 3% this year, but that's a far cry from the 5% he sought on taking office.

The ruling Partido Revolucionario Institucional survived mid-term elections in June, narrowly retaining control of the Congress. Mexico's great asset is its cheap human capital, but low wages can be a source of vulnerability. Six out of 10 workers are employed in the informal sector, many on a minimum wage of less than $5 a day. That may help Mexico compete with China, but it leaves millions in poverty.

Approval ratings

Brazil is facing a year of economic contraction, even though the first three months were better than expected, with the quarterly decline 0.2%, showing a 1.6% year-on-year fall. Unemployment is at a four-year high. Inflation remains stubbornly above 7%, and consumption is falling for the first time in more than a decade.

The president's approval ratings are stunningly poor at just 10% in one recent survey, lower than President Fernando Collor de Mello, who was famously ousted by street protests a generation ago.

Yet Dilma, as she is known to all Brazilians, seems to have decided that she has no option but to reform the very populist, heavy-handed central government that she created in her first term. Hence dramatic cuts in welfare spending, likewise swingeing reductions on the government's discretionary budget, and the devaluation of the currency since she won a second term late last year.

'We are taking the medicine,' says her Finance Minister Joaquim Levy, a product of the Chicago school. 'Brazil is under new management.'

Levy's words suggest that Mexico, under Peña Nieto, is a natural partner. Brazil's leadership has grown weary of the self-centred political manoeuvring of the country's traditional partner Argentina, under outgoing President Cristina Fernández de Kirchner.

'Argentina is a great friend of ours, and we have not lost patience with Argentina,' said Dilma. The fact that she felt obliged to say it spoke volumes for the tired relationship between Brasilia and Buenos Aires.

Mexico could expand its considerable investment in Brazil, currently $30bn a year. Pemex is expected to invest heavily in the exploration and production of hydrocarbons in deep waters off Brazil's coast, a venture that lies at the centre of Rousseff's programme to restore growth and revitalise the economy.

Political agenda

Perhaps the real significance of this emerging alliance lies in the political agenda of reform. Presidents Rousseff and Peña Nieto, for starkly differing reasons, have come to believe that they must embrace change – or else. Both are dealing with corruption scandals that pose a major challenge to their leadership.

The money-laundering saga at Brazil's oil monolith Petrobras is seeping upwards. It may not have reached the presidency yet, but it has tarnished Dilma's reputation dramatically.

In Mexico, President Peña Nieto has barely recovered from the abduction and murder of 43 students in Iguala last year, a tragedy that showed how the Mexican police force is riddled with drug lords and drug money. Now his wife, a soap opera star, is part of a political soap opera, accused of enjoying lavish property courtesy of contractors who did government business with her husband. Adding to Peña Nieto's problems, the well-publicised escape from prison of top Mexican drug lord 'Chapo' Guzman has exposed the country's security lapses.

A key factor in Latin America's modern narrative, so often one step forward, two steps back, has been the lack of strong regional leadership. At the half-way mark of a painful year in Latin America so far, this emerging partnership offers some hope.

Mexico, for so long a sleeping giant, and the region's biggest economy Brazil represent an intriguing prospect for a dynamic regional alliance. One condition for success will be that the two presidents can find a way to survive crises, both personal and political, and keep alive the crucial agenda of reform in Brazil and Mexico. ▪

David Smith is former United Nations Director in Argentina.

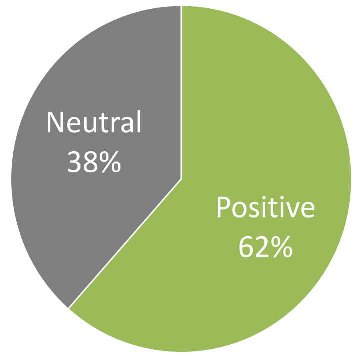
Asean underlines growth potential

OMFIF Advisory Board positive on Singapore and Vietnam

After 48 years in existence, 2015 will be the most significant year for the Association of Southeast Asian Nations when the Asean Economic Community is established at the end of the year. This landmark enshrines Asean as one of the world's regional growth areas with the brightest economic prospects.

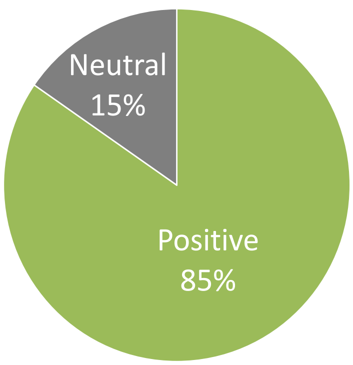
OMFIF asked its Advisory Board for their outlook on the region, both economically and politically, over the next two to three years. In the poll, carried out over July, 62% of respondents felt the prospects for Asean as a whole were positive, with the remaining 38% neutral. No Advisory Board members gave Asean a negative outlook, underlining a general consensus that Asean will be a better than average destination for global trade and investment.

Asean



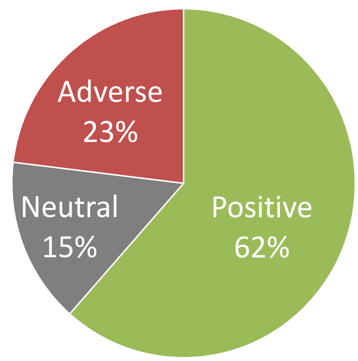
Singapore and Vietnam received the most enthusiastic response, with 85% of the Advisory Board giving both countries a positive rating, and no adverse responses. There was a general feeling that Singapore would maintain its stability in spite of geopolitical rivalries with China that overshadowed some countries in the region. 'Despite the passing of the guiding hand of Lee Kuan Yew, Singapore has strong economic credentials and there is little sign of any real challenge to the status quo,' said Boyd McCleary. **Vietnam** grew 6% in 2014 thanks to rising manufacturing output and inward investment. The country is maintaining a healthy current account surplus despite a weakening banking sector.

Vietnam



Malaysia, the third largest economy in the community, garnered a 62% positive outlook, with 23% adverse. The more negative score reflects political uncertainty weighing down strong economic growth, as well as low oil prices hurting oil exports.

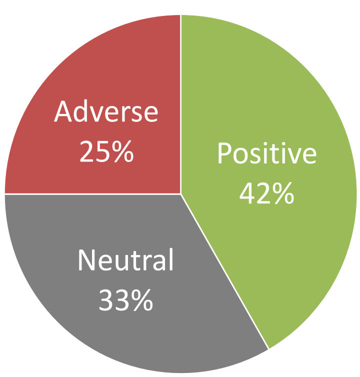
Malaysia



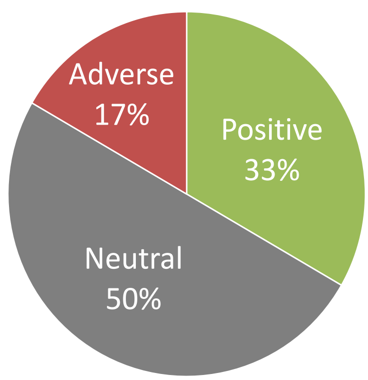
Philippines, with a 61% positive outlook and only 8% adverse, achieved growth of 6.1% in 2014. Low oil prices are helping the struggling agricultural sector.

The two largest economies, **Indonesia** and **Thailand**, received mixed outlooks. Indonesia received the highest adverse outlook from respondents of 25%. Half of respondents were neutral on Thailand, with 33% positive and 17% adverse. Thailand has been running into difficulties with weak domestic demand and exports. Growth in 2014 was only around 1%.

Indonesia



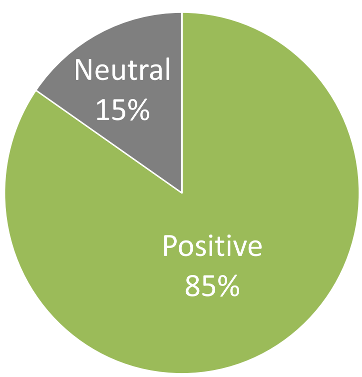
Thailand



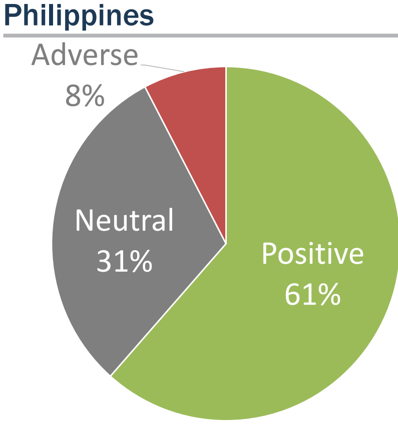
Of the smaller nations in the Asean community, **Myanmar** received a positive response from 23% of respondents, with an equal number giving it an adverse outlook. **Brunei** received a 42% positive outlook, with only 8% giving an adverse outlook, although this is heavily dependent on oil prices.

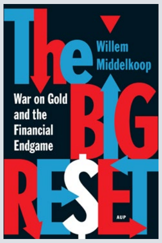
Cambodia achieved a 50% positive outlook, with only 8% giving it an adverse outlook. The smallest nation in the community, **Lao**, received the lowest positive score, at only 17%. A large majority, 75%, gave it a neutral rating, with the remaining 8% attesting an adverse outlook. ▪

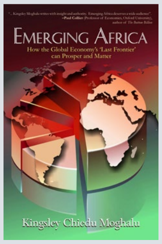
Singapore

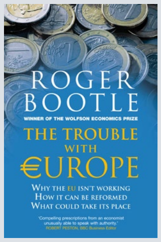


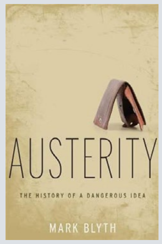
Philippines

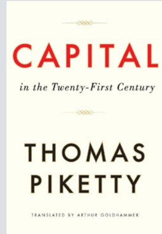


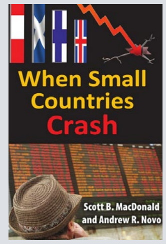


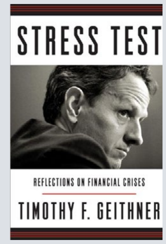


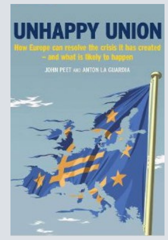












Why the world needs Keynes

When growth needs more than the household approach

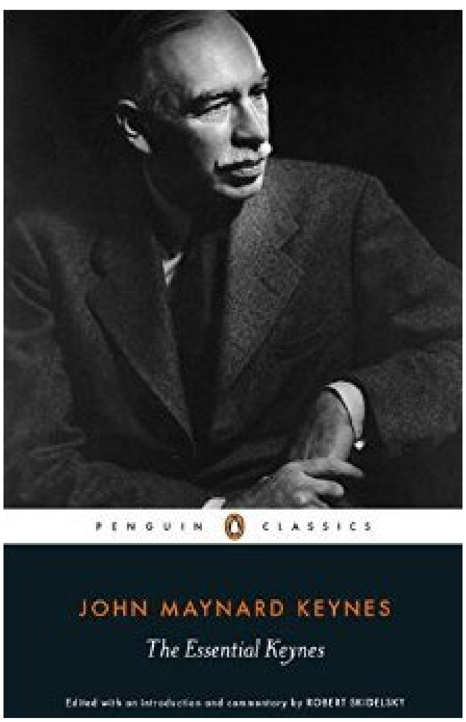
William Keegan, Advisory Board

If ever a non-fiction paperback was worth a tenner – or slightly more – it is *The Essential Keynes*, edited with an introduction and commentary by Robert Skidelsky.

John Maynard Keynes was an intellectual giant of the 20th century, and, to my mind, Robert Skidelsky's and many others, the most important economist of that century, his vital contribution and influence live on.

Alas there were times in the last century when his wisdom was ignored – over post-first world war reparations, the return to the gold standard in 1925, and the response to the Great Depression. He had some influence on President Roosevelt in the 1930s, but not enough.

There is more recent evidence in this country and the euro area of some very un-Keynesian approaches to policy. During and after the second world war Keynes' essential insights were accepted and acted upon.



Keynes paid tribute to the wisdom of Adam Smith in one of his last writings. But he established that the invisible hand and the classical economists who paid obeisance to that hand were capable of producing so called 'equilibrium' in the economy at dismally low levels of employment for a considerably long time. This was economically and socially wasteful. As Keynes wrote during the economic horrors of 1929, 'There is work to do; there are men to do it. Why not bring them together?'

Fiscal policy

Keynes developed his thoughts on how to run an economy more successfully in voluminous writings, with an initial emphasis on the importance of low interest rates, and an increasing concentration on fiscal policy.

Fiscal policy came to embrace changes in the level of taxation and public expenditure, but the Master's main interest was in public spending as a tool for boosting aggregate, or 'effective' demand. There could be an interaction between an initial boost to public spending, which would have 'multiplier' effects – an insight attributed to Keynes' disciple Richard Kahn – on the private sector.

Keynes was no socialist, but he recognised the importance of what he called the 'animal spirits' of businessmen. There were times when confidence was so low that a low interest rate did not necessarily produce the boost to private sector investment that was needed to boost output and employment. That was when the state came in.

One way of explaining the Keynesian approach is to point out that what makes good sense for the individual household does not, at a time of recession, make sense for the entire economy. If everyone cuts their expenditure, that only makes the recession worse. Unfortunately it appears from modern focus groups that the Keynesians, among whose number I count myself, have been putting people's backs up by referring somewhat contemptuously to 'household economics.'

We must be more careful. This is a very important area. Time and time again, in pubs and coffee shops, I found during the recent recession that otherwise highly intelligent people do not distinguish between 'household economics' and the macro approach.

To them, and indeed to every reader, I commend this wonderful book, as good holiday reading to accompany all those of Le Carré and Montalbano. Robert Skidelsky, with his lifetime devotion to Keynes, has distilled the essence of the work of a many-sided genius, with carefully chosen extracts and a truly impressive commentary.

There are no fewer than 30 volumes of Keynes' collected works in the series produced by Macmillan. And there are wonderful biographies by Roy Harrod, Skidelsky himself (three volumes plus a one column summary) and Don Moggridge (who edited most of the Macmillan series as well).

But for those who are never going to get round to such volumes, this edition is something to be dipped into and treasured.

It also contains a handy section of quotable excerpts and gives the lie to the idea that Keynes ever said: 'When the facts change, I change my mind. What do you do, sir?'

On top of everything else, Keynes founded the Arts Council of Britain and was a strong supporter of the BBC. In a broadcast in 1945 about the new body he said: 'Do not think of the Arts Council as a schoolmaster. Your enjoyment will be our first aim.'

This volume provides much enjoyment as well as elucidation. Facts do not change. But new information may persuade people to change their minds. ▪

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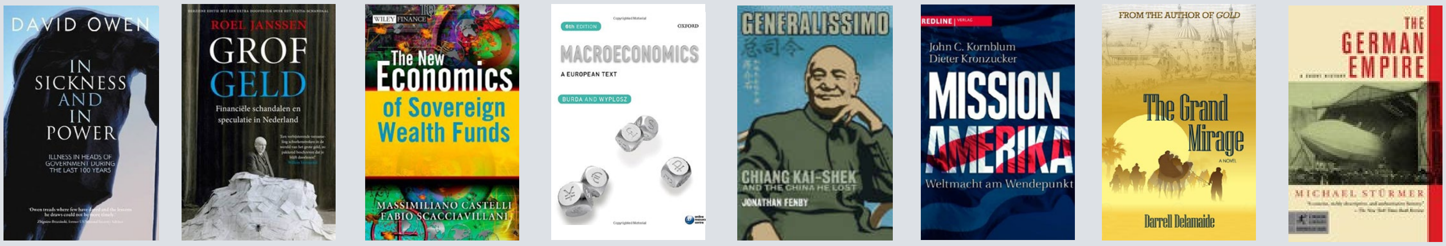

Managing portfolios post-crisis

How to master investment risks

George Hoguet, Advisory Board

In *Applied Asset and Risk Management – A Guide to Modern Portfolio Management and Behavior-Driven Markets*, Marcus Schulmerich, Yves-Michel Leporcher and Ching-Hwa Eu have produced an up-to-date, well-researched, well-organised and well-edited book that reviews modern portfolio theory and its behavioural finance critique.

The book is intended as a handbook for investment professionals, and reflects both the market experience and rigorous academic training of the authors, who all work for major financial institutions. Mercifully, however, this monograph is free from complex equations and very clear in its exposition.

Investment strategies

The book focuses on some major questions. Why do (stock market) crashes happen in theory when they should not? How have investors reacted to the global financial crisis in terms of their risk measurement and management? And what are the implications for the chosen investment strategies?

In Chapter 1, the authors review basic risk measures in asset management, including less frequently used metrics such as semi-variance and the Sortino ratio, a downside risk measure.

In Chapter 2, entitled 'Modern Portfolio Theory and Its Problems', they then explicate the capital asset pricing model and discuss the famous Fama-French three-factor model of equity returns. The discussion then turns to stock market anomalies. The authors say these occur in 'a market situation that cannot be explained by traditional finance theory.'

For each of the nine anomalies discussed the authors describe the anomaly; present the evidence; review various theories as to why the anomaly exists; and discuss the anomalies' persistence. Curiously, despite the internet-fuelled 'financialisation' of the global economy since the late 1990s, around the world there is still considerable evidence of 'home bias', whereby global investors substantially underinvest in foreign stocks. The discussion of stock market crashes is particularly informative and reflects the authors' careful research.

The French mathematician and chaos theorist Benoît Mandelbrot pointed out that on average, if we assume a normal distribution, the stock market crash of 1987, in which the Dow Jones Industrial Average fell 22.6% in a day, would occur only once every 10^{50} days. But this single number is meaningless, the authors remind us, because since the estimated start date of the solar system 'only' 2.2×10^{12} days have passed.

The authors define a crash as 'a decline from the most recent peak of more than 20% for developed markets and more than 35% for emerging markets.' They then review both US and non-US crashes throughout history, 12 of them since 1973 alone.

A particularly devastating, but less frequently cited, bust was the collapse of the Souk Al-Manakh in Kuwait in 1982. When the market fell, there were no bids at all. Losses came to $90,000 for every man, woman and child in Kuwait.

The logos of crashes then leads to a discussion of the fallibility of models of *homo economicus* and behavioural finance, defined as 'the study of the influence of psychology on the behavior of financial practitioners and its effect on market prices.' The authors review seven behavioural biases and relate them to stock market crashes.

While they do not discuss misaligned incentives and other institutional factors that may lead to financial excesses, to their very great credit they acknowledge two important points. First, tail (extreme) events are likely to happen more frequently in the modern era because of increased correlations of financial markets. Second, tail risk events are likely to be more severe than in the past because of the increased interconnectedness of financial markets.

The authors demonstrate that traditional diversification strategies may not work in times of severe market stress and note, somewhat plaintively, that 'for politicians and economists, it is evident that a solution for crises has to be found.' The last chapter of the book then discusses approaches taken by investors around the world to manage risk post-crisis.

Applied Asset and Risk Management is empirically based and contains an extensive and up-to-date bibliography. The book may try to cover too much; any one of the chapters could be the subject of a book alone. But no words are wasted in this substantive monograph, which will be of interest to all serious investors. ▪

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