OMFIF BULLETIN

Global Insight on Official Monetary and Financial Institutions

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New paradigm for world economy

Time to copy the New Capitalists of Asia

Meghnad Desai, Chairman, Advisory Board

A new paradigm is needed to save the world economy. We need to return to the precepts of Classical economics: high savings and high investments, moderate growth in consumption, more work and less leisure. It is time for the Old Capitalist countries to recall their past. If they cannot do that, at the least they should copy the New Capitalist nations of Asia that are now forging into the lead.

A new approach is needed to engineer a way out of an apparently never-ending crisis which began with the collapse of Lehman Bros in September 2008. After three years and several warnings of a double-dip recession, the perception is that, far from a double-dip, the first dip has not yet ended. Technically, economists may judge the recession to have ended long ago; but that is not how it feels.

The way forward is to imitate the New Capitalists among the so-called emerging economies. They did not follow Keynesian norms but rather Classical ones: high savings and investment, and hard work. The Old Capitalist countries continued with high consumption, low savings and a preference for leisure. The Keynesian paradigm was that expenditure leads to income and savings may slow down an economy. But countries that spend, but do not produce at home, import consumption goods and build up a trade deficit. With ageing populations and persistent long-run structural unemployment, the low savings paradigm was no longer sustainable. The crash of 2008 brought the chickens home to roost.

(continued on page 4 ...)

OMFIF refashions Advisory Board to increase responsiveness

As part of a move to streamline its structure, OMFIF is refashioning its 79-member Advisory Board, chaired by Prof. Meghnad Desai, into six sub-committees covering Banking, Capital Markets, Education, Editorial & Commentary, Research & Economics and Public Policy. The reshaping is intended to increase the Advisory Board's cohesion and ability to respond to the needs of OMFIF supporters and patrons.

FOR DETAILS OF NEW ADVISORY BOARD STRUCTURE SEE P. 13 AND 15.

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Renminbi sukuk

Malaysia's pioneering role

A Special Correspondent

A bold move to enshrine the renminbi in international Islamic finance transactions has been pioneered in Kuala Lumpur through a Rmb500m sukuk bond issue by Khazanah Nasional, the Malaysian sovereign fund. The deal, finalised in mid-October, is billed as the world's first offshore renminbi-denominated sukuk, a bond certificate compliant with Sharia religious law.

Although relatively small, the bond issue reaffirms Malaysia's wish to be at the forefront of two landmark investment trends – developing international use of the Chinese currency and building a global hub for multi-currency Islamic bond issuance. Dr Zeti Akhtar Aziz, Bank Negara Malaysia governor, termed the transaction 'a major step forward for the sukuk market in Malaysia.' The issue coincides with news that renminbi-denominated corporate bond issuance in the third quarter of 2011 outstripped euro-denominated bond transactions for the first time, according to statistics from data provider Dealogic.

(continued on page 4 ...)

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OMFIF Official Monetary and Financial Institutions Forum

Rescuers from Asia

Emerging preserving submerging

David Marsh, Co-chairman

This month's edition has an Asian flavour, the result of the first OMFIF Asian Central Bankers' Watchers Conference being held at Bank Negara Malaysia on 1 November. An opportunity to reflect on what the emerging market or rapidly-growing economies have to offer the world. Even though they are far from immune to the shock waves reverberating from the sovereign debt ills of the nations now passing from developed to disturbed and even distressed status, Asians are now seen as rescuers.

The euro has done what its founders wanted – stamp itself upon the consciousness of global monetary policy-makers. Unfortunately, for the wrong reasons. The somewhat bizarre notion that the large reserve holders of Asia and Latin America should be supporting the over-borrowed West has been doing the rounds.

Meghnad Desai, who coined the phrase 'submerging markets' last year to describe the faltering nations of the US and Europe, issues a clarion call for the West to learn from what he calls the New Capitalists of the South and East. We survey a chunk of innovative finance that has just been launched in Kuala Lumpur – a small but intriguingly formed Islamic bond denominated in renminbi. Nick Wright looks at the large challenges that still lie ahead for integration of Southeast Asia's financial markets. Jonathan Fenby examines the Chinese economy and says the bears have got it wrong. Darrell Delamaide investigates a separate blame game going on in America. With so many enemies, he concludes that Ben Bernanke must be doing something right. The euro imbroglio has far-reaching implications for European banks. Coinciding with Goldman Sachs reporting a third quarter loss, Michael Lafferty gazes into his crystal ball and forecasts a wave of nationalisations for once-proud European banking icons.

One way to avoid that, of course, would be for the sovereign funds to help out in recapitalisation exercises. Particularly when viable retail banking businesses are for sale at knock-down prices, this could be an excellent way for the slogan 'emerging preserving submerging' to be put into practice – for the benefit of all concerned.

David Marsh

Looking ahead – 2011-12 diary dates

OMFIF Conference
First Asian Central Banks' Watchers Conference
1 November 2011, Kuala Lumpur
Asian Perspectives on World Finance

OMFIF Lecture with
Yves Mersch
Governor, Banque centrale du Luxembourg
13 December 2011, London
EMU's future – 20 years after Maastricht

OMFIF Dinner with
Gerhard Schröder
Former Chancellor of Germany
7 February 2012, London
OMFIF Statesman's Dinner

OMFIF Lecture with
Nils Bernstein
Governor, Danmarks Nationalbank
22/23 February 2012, London
The Future of the International Monetary System

OMFIF Meeting with
Deutsche Bundesbank
13-14 March 2012, Frankfurt
The World Economy at a Turning Point

OMFIF Lecture with
Philipp Hildebrand
President, Swiss National Bank
26 March 2012, Edinburgh
The Swiss franc's Role in World Money

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New paradigm for world economy *(...continued from page 1)*

Globalisation helped the creation of powerful growth-oriented economies in Asia and Latin America. They sucked in capital and exported manufactures to the previously industrialised nations. This is where the demand for resources and for capital was concentrated. The Asian countries had however suffered from the crisis of 1997 when the IMF and the global credit system abandoned them. So they became risk-averse and cut dependence on the international financial system. They accumulated large foreign exchange reserves so they would never have to go cap in hand to the IMF. And they made sure that their banking systems did not misbehave.

All this has given the emerging economies trump cards. Because of these structural problems, the room for a Keynesian solution to the recession has been shrinking. With low fiscal slack, the resort to monetary expansion was the only way left. But this compounds the problem of low savings. Spending would tackle the problem but it has to be spent on long-term investment.

We are witnessing in some senses a re-run of the events of three years ago. The initial shock in the US and the UK caused by over-borrowed households and governments was enhanced by the collapse of asset prices with banks needing recapitalisation. Three years on, we see the same phenomenon in the euro area with over-borrowed governments, and, again, banks needing recapitalisation. The central banks have flooded the markets with central bank credit through the Federal Reserve and the Bank of England initiating QE 1 and 2. Interest rates in western economies are at floor level and yet there is no turning point in sight.

Governments in the US and the euro area appear paralysed. This is not an accident. The post-war conventional wisdom has been that, in any economic crisis, all you need is government action. But that is no longer the case. This is the most serious consequence of the aftermath of the longest boom, in 1992-2007 (with a small technical dot com boom and collapse in between). This long upturn, propelled by the collapse of the Soviet Union and the reintegration of the formerly Socialist economies of Europe, gave extra vigour to the latest phase of globalisation.

In the US, as in many other OECD economies, there had been a steady erosion of manufacturing since the oil price shock of 1973. There had been a great and permanent loss of employment opportunities for unskilled and semi-skilled manual workers. With the erosion of manufacturing, jobs were available only in the service sector. But here there was a two-level playing field. The unskilled got very low wages while the skilled, especially graduates, were paid much more. In the US, the consequence has been a flat average wage for the last 40 years. In Europe, the welfare state absorbed the long term unemployed. In the US, the financial boom led to cheap borrowing for families who did not have a chance to borrow before.

The puzzle is why corporations sitting on large surpluses are not investing in long-term projects such as green technology, infrastructure or new services. One reason is uncertainty, deepened and not relieved by QE. By keeping the yield curve flat or even twisting it, the central banks are generating uncertainty as to how long this phase will last and when interest rates will turn up again. In colloquial terms, investors are waiting for the other shoe to drop. Until this uncertainty is removed, there can be little prospect of private sector investment. And, with that, the world economy will remain in the doldrums – or worse.

The puzzle is why corporations sitting on large surpluses are not investing in long-term projects such as green technology, infrastructure or new services.

Renminbi sukuk *(...continued from page 1)*

Bonds issued by non-financial companies in the Chinese currency totalled Rmb200bn ($31bn) between July and September. Euro-denominated bond sales more than halved to $26.4bn in the same period, reflecting uncertainties overshadowing the European single currency. The three-year Malaysian deal, issued through a special purpose vehicle, Danga Capital, was priced through a book-building process at the tightest end of the price guidance at 2.9%. Demand came from investors in Malaysia, Singapore, Hong Kong, the Middle East and Europe.

The deal underlines the close links in financial infrastructure and regulatory issues between the Chinese and Malaysian authorities – an area to which Governor Zeti ascribes great importance.

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Fed chief faces further battles

Bashed-up Bernanke keeps easing options open

Darrell Delamaide, Board of Contributors

Federal Reserve chairman Ben Bernanke has so many people angry at him he must be doing something right. After all, his predecessor, Alan Greenspan, alternately charmed and awed his constituencies but allowed a debt bubble to inflate to disastrous proportions and banks to develop new products that increased that risk.

In fact, much of the vitriol directed at Bernanke might simply be a reaction to the Fed's loss of credibility thanks to its dual failure in monetary policy and bank supervision that led to the financial crisis of 2008-09. Despite all the anti-Bernanke invective charging that he's too soft on inflation, minutes of the latest Federal Open Market Committee meeting indicate that the Fed stands ready to take further credit easing action if warranted by the faltering economy.

At the start of a volatile period in the presidential election campaign, the Fed is being attacked from both ends of the political spectrum. This reflects not only ideological issues regarding the power of the Fed, but also suspicion that any effort by the Fed to stimulate the economy is supporting President Barack Obama's re-election effort. That's why one of the candidates for the Republican nomination, Texas Governor Rick Perry, promised to treat Bernanke 'pretty ugly' if he came to his state. Another, former House speaker Newt Gingrich, would fire Bernanke immediately, even though no one, including the president, has the power to fire a Fed chairman. And yet another Republican hopeful, Texas congressman Ron Paul, would like to eliminate the Fed altogether. He would also like to return to the gold standard. He blames the Fed for debasing the currency because, well, a dollar doesn't buy as much today as it did when the Fed was established in 1913.

On the left, the Occupy Wall Street movement wants to 'end the Fed' because it bailed out Wall Street, pumping cheap central bank money into the profligate banks to keep them afloat. On the other hand, progressives who actually understand something about economics criticise the Fed for being too timid and not doing its part to stimulate the ailing economy. All this cannot be dismissed merely as a radical fringe enjoying the megaphone of an overheated media. The reactionary forces of the right, for instance, are hardly fringe. Even in the absence of any evidence of inflation or other debasement of the currency, Gingrich accused Bernanke of being the 'most inflationary' Fed chairman ever. Much of the criticism of the Fed chairman says more about the wilful ignorance of the US political class than about his performance as a policy-maker.

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Against this backdrop, the Fed at its September meeting embarked on further monetary accommodation through Operation Twist, aiming to swap out $400bn of shorter-term securities for longer-term Treasuries. Even though three of the four rotating regional Fed chiefs dissented, Bernanke got solid backing from the entire board of governors and two other regional heads. The disclosure of the minutes three weeks later showed that several members of the FOMC are prepared to go further if necessary. 'A number of participants saw large-scale asset purchases as potentially a more potent tool that should be retained as an option in the event that further policy action to support a stronger economic recovery was warranted,' the minutes said. FOMC members were concerned that the US economy would not pick up by the end of the year, the minutes said. The slow rate of growth makes the economy vulnerable to adverse shocks, such as fiscal tightening by federal and state governments or possible spillover from the financial crisis in Europe. In mid-October, Chicago Fed chief Charles Evans, one of the voting regional chiefs who supported Operation Twist, went further and recommended that the Fed communicate an unwavering commitment to economic recovery. 'I think we should consider committing to keep short-term rates at zero until either the unemployment rate goes below 7% or the outlook for inflation over the medium term goes above 3%,' Evans said in a speech in Detroit. If that kind of talk continues, and hostilities with the political right intensify, then Bernanke could face further battles that will make his skirmishes hitherto look like child's play.

Why China crash will not happen

Political imperatives will trump market bears

Jonathan Fenby, Board of Contributing Editors

China's economy has benefited most from global trade. So it faces evident challenges from low growth and a stagnant outlook in the US and Europe. That has led to a burst of pessimism among commentators and on financial markets about Chinese growth prospects, specifically about the People's Republic ability to provide a major world economic stimulus as it did in 2009-10.

Yet predictions of continued 12% growth were always overblown. A correction from double to high single digits was on the cards as soon as Beijing began to rein in the credit explosion launched in late 2008 of more than $1tn in new loans. Indeed, Wen Jiabao, the prime minister, has spoken of a 7% annual growth target as the aim of the Five Year Plan that started this year – though some ambitious provinces have set the level much higher, 11 of them aiming to double GDP in five years.

So a slowdown in China is nothing untoward. It represents a step towards more sustainable growth as the government tries to bring CPI inflation below 6%. This task is made tougher by pressures on the food front but will be helped by the base effect in the last quarter of this year. But at the moment China bears have the ear of the market. Their arguments seem, at first sight, to make sense. Sluggish western demand will hit Chinese exports, slowing the economy, diminishing demand for raw materials and intensifying the downward spiral, while monetary tightening and rising Chinese wages hit manufacturers, particularly those in the low-margin private sector.

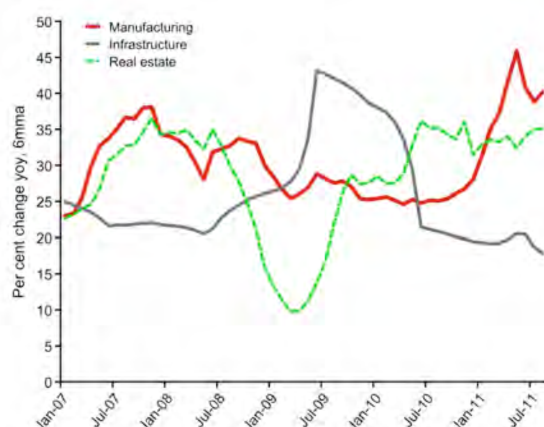
China cannot escape the effect of trouble elsewhere. It would be seriously affected by a double-dip western recession. But, together with my colleagues at the research service Trusted Sources and Bo Zhuang, the head of our Beijing office, I believe that, on current evidence, a China crash is not on the cards - even though market sentiment is pushing in this direction in today's febrile atmosphere.

One important factor concerns politics. Economic analysis tends to leave out major political factors. In 2008 the leadership had to implement a major stimulus programme to ensure the preservation of a regime which promises that it, alone, can deliver growth. In the same way, now it needs to avoid a shock to the system as the Communist Party and then the government undergo major change at the top between autumn 2012 and spring 2013.

Weaker external demand, falling property construction and infrastructure spending will reduce GDP growth in 2012 from this year's 9-9.5%, but the fall is likely to be relatively small, down to 8-8.5%, assuming growth in the US and the EU of 1-1.5% and 0.5% respectively. Quarterly year-on-year expansion may temporarily drop further in the first quarter next year, to 7.5-8%, but is unlikely to go any lower. We see no case for a hard landing. Though the rate of export growth was down year-on-year, the trade surplus rose in the third quarter. The Purchasing Managers' Indices have perked up and not plunged into negative territory. Inflation fell in September. Mining companies say demand remains healthy.

The charts on this page and on p.7 illustrate China's expected economic development in 2011-12, on the principal assumption that there is no double-dip recession in the West.

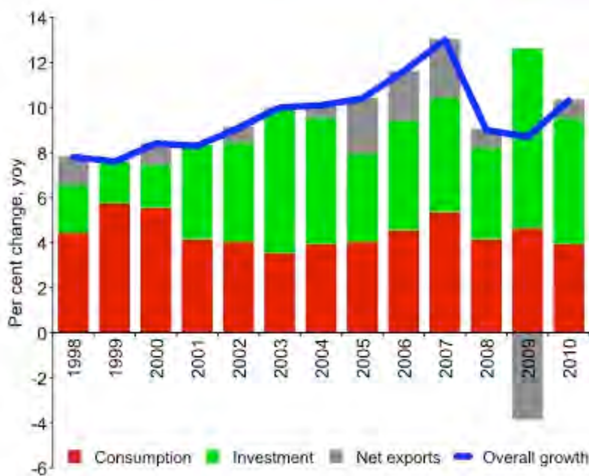
Chart 1: Fixed asset investment, 2007-11



Investment The contribution of investment to GDP falls to 4.2 percentage points of the growth total from 8.7 and 5.6 percentage points in 2009 and 2010. Chart 1 shows how manufacturing investment has risen relative to real estate and infrastructure investment.

Consumption The contribution of real consumption to growth will rise to at least 4.4 percentage points of the overall growth figure in 2012, from 3.8 points this year, as a result of the policy of wage increases launched last year.

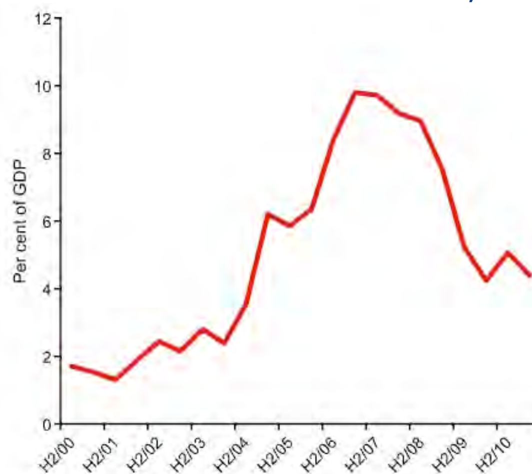
Chart 2: GDP growth breakdown by expenditure, 1998-2010



Exports Our 8-8.5% GDP growth figure in 2012 assumes a -0.5 percentage point contribution from net exports. This is much smaller than in the past as shown in chart 2. That reduces China's exposure to a big drop in demand from developed nations. Having weathered the last global slowdown, exporters are better prepared for any trouble ahead. Inventory levels are much lower than during the 2008 downturn. Many weaker companies have gone out of business and larger firms, which are better managed and funded, have grown at their expense.

If the situation becomes sufficiently serious to worry Communist Party leaders as the new generation moves in, China will do whatever it needs to do to buttress growth - even if it is left with unpalatable medium-term consequences.

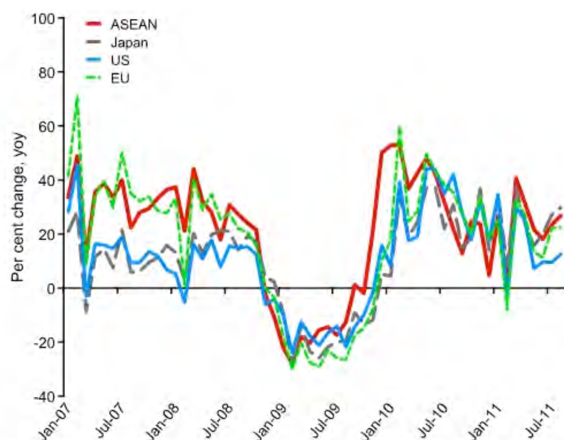
Chart 3: Current account to GDP ratio, 2000-10



China's current account surplus is falling (Chart 3) and its exports are geographically diversified (Chart 4).

Tightening Inflation remains a significant long-term risk. However, we expect it to fall below 5% in the next 3-4 months, thanks to lower food prices, stable non-food prices, softer commodity prices and the base effect. We strongly believe that the tightening cycle has ended, in view of significant external uncertainties, a slowing domestic economy and easing inflation. We also believe that monetary policy will be flexible. Targeted or selective easing, in the form of support for vulnerable sectors such as SMEs and social housing via local government financing, will probably be under way as headline inflation drops below 5%. There has been a flood of media reports recently of the troubles of private sector manufacturers in the hub of Wenzhou in eastern China but these need to be put in perspective. Reports speak of around 100 firms in trouble but the Wenzhou region counts some 400,000 companies according to a UBS estimate, and those which have gone bust are marginal, low-cost operations.

Chart 4: Chinese exports by region, 2007-11



Source: CEIC.

Policy response and political imperatives If the global economy weakens more significantly than we anticipate, policy-makers will respond quickly by reducing reserve requirements for banks and targeted credit easing, followed by spending on low-cost housing, water supply and irrigation, consumption and high-tech sectors. If the situation does become sufficiently serious to worry Communist Party leaders as the new generation moves in from next autumn, China will do whatever it needs to do to buttress growth – even if it is again left with unpalatable medium-term consequences. Commentators must not forget that, in China, political imperatives are paramount.

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Task of Southeast Asian integration

Need for coordination to meet objectives

Nick Wright, State Street Bank and Trust

Through the Association of Southeast Asian Nations (ASEAN), many countries in the region are working to liberalise and integrate their financial markets, aiming to improve individual market efficiency and better position themselves to compete for international capital. While they are making progress, many challenges still lie ahead. ASEAN's member countries will need to work hard over the next few years to reach and implement agreements, develop investment opportunities for the global community, and coordinate with integration initiatives in other regional organisations.

There are compelling arguments for the ASEAN countries to work together to create a more integrated market. Together, the ASEAN economies have a GDP of around $2tn, representing the fifth largest market in the world in terms of purchasing power parity. The cumulative trade volume of the ASEAN-5 economies (Indonesia, Malaysia, Thailand, the Philippines and Singapore) is more than three times India's and about 60% of China's.

Economic growth in the region and changes in government policy have led to a rapid rise in financial assets. Pension schemes in Southeast Asia's five largest economies totalled $377bn in mid-2010, a 70% increase from just five years earlier. Assets from collective savings schemes in those countries totaled $186bn at the end of 2010 and are forecasted to surpass $320bn by 2014. Overall, institutional investable assets in the ASEAN-5 market are projected to grow substantially, approaching $2.5tn by 2014.

Regional assets will likely continue to show good growth as economies benefit from the resources boom and increased trade linkages with major economies such as China and India. The integration and liberalisation of regional financial markets will contribute to further economic growth.

ASEAN is in the process of creating an ASEAN Economic Community (AEC) to liberalise movement of goods, services, investment, labour and capital. The intention is to create a network of mutual recognition agreements and harmonised regulations, rather than a European Union-like structure of political and economic unity. An Implementation Plan seeks to achieve meaningful capital market integration by 2015. This includes plans for developing market infrastructure and regionally focused products and intermediaries, and strengthening the implementation process through a greater role for the ASEAN Secretariat. An ASEAN finance ministers' meeting in Indonesia in April 2011 decided several new initiatives relating to equity exchanges, monitoring and surveillance, and mutual recognition of market professionals. These build on other steps over the last few years relating to bonds, currency swaps and cross-border offerings of equity and debt securities [see box on p.11.]

Despite the progress so far, several challenges still remain to achieving regional financial integration and liberalisation. One recurring stumbling block is that member nations' finance ministers do not have control over some of the key issues that will determine whether integration succeeds, including tax, customs, legal reform and currency controls. However, this problem is being countered by setting up channels within ASEAN to promote dialogue on these issues. At the April 2011 ASEAN finance ministers' meeting, for example, a forum on taxation was endorsed to support dialogue on tax issues related to regional integration, particularly with regard to withholding tax and double taxation.

Another difficulty is that ASEAN takes an opt-in approach where member countries can choose to join an initiative or sit out. Even if countries opt in to an integration initiative, it can still take some time for any meaningful action to occur. Singapore, Thailand and Malaysia, for example, have signed up for the ASEAN and Plus Standards Scheme, but the initiative has not been widely used.

Regulatory complexity and fragmentation across the broader region represent further risks because of lack of coordination between ASEAN and other regional bodies. While ASEAN is developing its Collective Investment Schemes (CIS) initiative, Asia Pacific Economic Cooperation (APEC), the 21-member organisation including the US that works to promote integration in the Pacific Rim, is working on a parallel initiative. A partnership would allow ASEAN to make use of progress in APEC and reduce the chance of conflicting regulations. There is room for cooperation in areas such as financing for small and medium enterprises, infrastructure development, insurance regulation, and privacy issues in addition to collective investment schemes. Since ASEAN and APEC plan to enhance consultation, this may address some of these key issues.

(continued on page 11 ...)

ASEAN at a glance

Created in 1967, ASEAN comprises 10 diverse Southeast Asian nations — Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, the Philippines, Singapore, Thailand and Vietnam — and encompasses nearly 600m people. East Timor may soon join as the 11th member. ASEAN's members show widespread differences. GDP per capita of Singapore, the richest country, is more than 60 times that of Myanmar. Political systems vary greatly, ranging from democratic Indonesia to socialist Vietnam. Similarly, tax rates and capital controls diverge from country to country.

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(...continued from page 9)

As it pursues integration, ASEAN faces the challenge of persuading international investors that ASEAN countries present worthy investment opportunities, particularly when measured against India and China. While perceived as more difficult markets to enter, China and India offer great potential due to their large populations, growing economies and relatively unified financial regulations. ASEAN ministers have launched international roadshows and seminars to raise the profile of the region, but more could be done.

As ASEAN builds its community, foreign companies with an interest in Southeast Asia occasionally voice concerns about possible restrictions on market access to the region. For example, there is some concern that foreign providers will be excluded from an ASEAN payments system now under development. For the most part, concerns about limited access seem unwarranted. ASEAN and non-ASEAN issuers are, for example, able to utilise the ASEAN and Plus Standards Scheme detailed in the box below. But as new initiatives emerge, and for ASEAN to be internationally competitive, it will need to remain open and accessible to companies headquartered within and outside the region.

As integration takes shape, international financial institutions should monitor ASEAN's integration efforts closely. Southeast Asia has the potential to provide asset managers and investors with a meaningful complement to the depth and strength of financial markets in China and/or India. If the right opportunity is identified, countries in Southeast Asia might be more willing to discuss obstacles and negotiate concessions than other larger, single markets in the region given ASEAN's openness for foreign investment.

For their part, ASEAN members need to communicate more effectively to international investors. Greater coverage should be sought in the international media. ASEAN should work closely with regional groups such as APEC. More cooperation is needed on funds passporting, SME financing, infrastructure and insurance to to gain synergies across Asia rather than a more complex web of regulations.

Greater regulatory cohesion to facilitate the more efficient sale of products and services within ASEAN, combined with continuing growth in assets, will make Southeast Asia immediately more attractive to international investors. Governments in Southeast Asia seem committed to achieving a more integrated and open market by 2015. However, substantial progress needs to be made across the spectrum of financial services to meet fully these ambitious goals.

ASEAN Initiatives

Equity Exchanges	A collaboration of seven stock exchanges (from Indonesia, Malaysia, the Philippines, Singapore, Thailand and Vietnam) to create an integrated, ASEAN-branded market where ASEAN products are viewed as an asset class that investors can trade freely on any ASEAN exchange. The ASEAN Stars Initiative is a first step and lists 30 stocks from each exchange, ranked in terms of market capitalisation and liquidity.
Monitoring Financial Integration	Establishment of a Macroeconomic and Finance Surveillance Office (MFSO) at the ASEAN Secretariat, responsible for implementing macroeconomic surveillance in ASEAN and monitoring regional economic integration.
Chiang Mai Currency Swap Initiative	Establishment of the ASEAN +3 Macroeconomic Research Office (AMRO), an independent regional monitoring and surveillance unit in Singapore, as part of the Chiang Mai Initiative Multilateralisation (CMIM). The newly created AMRO will monitor developments in the region such as the need for swap lines to be activated.
The ASEAN Bond Markets Initiative (ABMI)	In progress for some time, the ABMI creates local currency-denominated bond markets in the region. Efforts are also under way with the Asian Development Bank, under the sponsorship of the Japanese government, to catalogue and improve post-trade and settlement practices.
ASEAN and Plus Standards Scheme	Facilitation of cross-border offerings of plain equity and debt securities within ASEAN and is available to ASEAN and non-ASEAN issuers making offerings within ASEAN. Standards based on international securities; accounting and auditing standards; and additional standards required by some ASEAN jurisdictions due to individual market practices, laws or regulations.
Market Professionals	Promotes harmonisation of accounting and auditing standards and mutual recognition of certification and qualification of market professionals. If an agreement could be reached about allowing sales and marketing activities across ASEAN countries, the distribution of products and services would become much easier, to the benefit of consumers and companies.

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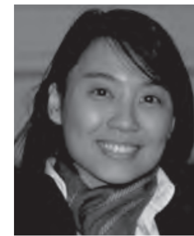
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On course for nationalisation

European banking faces sovereign debt shake-up

Michael Lafferty, Co-chairman

The consequences of European banks' misplaced faith in sovereign debt are dire and will probably result in widespread nationalisation and major fire sales of valuable assets. European banking is at a crossroads, of a kind we have not seen in modern times. The sovereign debt crisis is the main cause, but European banks have made other serious mistakes as well.

Nationalisation in the shape of taxpayer-funded bailouts of one form or another is fast becoming the only realistic option for many big European banks. Disposals of valuable assets and massive consolidation of domestic banking systems will ensue.

There is a gigantic hole in the balance sheets of Europe's banks – from France to Germany, from Spain to Italy. Even the UK, which thought it had put all this behind it with an unprecedented bailout of leading banks in 2008, cannot be excluded. The banks need large amounts of new capital to function properly but discomfited shareholders adamantly refuse to pick up the bill. The only options left to severely-stretched bank management teams – short of issuing new capital to sovereign funds and other foreign investors – are taxpayer bailouts and fire sales of valuable assets, mainly on the retail banking side.

The size of the balance sheet hole is conservatively put at €200bn to €300bn at the minimum – but there is vast scope for accounting manipulation in computing the figure. Europe's politicians, for so long bereft of ideas, are being forced to act now that the European Central Bank has warned that a systemic crisis is imminent.

Nationalisation in the shape of taxpayer-funded bailouts of one form or another is fast becoming the only realistic option for many big European banks. Disposals of valuable assets – suddenly categorised as 'non-core' by desperate management teams – and massive consolidation of domestic banking systems will be the inevitable result. Cross-border mergers will follow.

The process has already begun. Société Générale, one of France's largest universal banks, has just admitted that consumer finance – a major area of the bank's foreign investment in recent years – is no longer a core business. The bank's challenge will be to find a buyer willing to pay a good price for a business that many corporate and investment bankers have tended to disregard. Private equity players, sovereign wealth funds from Asia and the Middle East and the big Chinese banks must be the most likely buyers. Chances are that the eventual buyer will secure a great bargain.

Few European bankers would argue with the assertion that conditions are now as bad if not worse than they were in 2008, with the qualification that liquidity across Europe's banking system is said to be somewhat better today.

For now, Europe has too many banks – and too little capital to run them viably. There are some paradoxes. As one top international banking consultant puts it, 'Right now we have sick economies in Italy and Spain – and sick banks in France and Germany.' Business is booming for his global network of accounting and consulting firms – and he seems to know more about what is going on than most bank regulators. He, after all, has a global perspective – while they are mainly concerned with their own countries.

A review of European banking reveals great diversity:

- Germany has an incongruous banking system – with a host of public sector Landesbanks that keep getting into trouble, an overall set-up dominated by public sector savings banks and mutual cooperatives that seems partly designed to keep politicians in jobs and only one credible global player – Deutsche Bank.

- Italy's 'Rip Van Winkle' banking system, which came back to life only 20 years ago after many decades of undisturbed slumber, sees itself as world-class but is unconvincing in that role.

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- Spain has two giant banks – BBVA and Santander, a world-class mainly retail player – Banco Popular, and a lot of poorly-run savings banks most of which are now being bailed out by the government at great expense to the Spanish taxpayer. Spain used to be revered by central bankers for the pro-cyclical provisioning policies mandated by its central bank for bank financial accounts – a fact that has long puzzled accountants, who regard Spain as one of the lesser-developed accounting countries in Europe if not the world.

- France, long regarded as having the most-improved banking system in Europe after the damage inflicted by President Mitterrand's nationalisations in the 1980s, is in serious trouble. This is mainly because French banks did what the bank regulators of the world called for, and invested in government securities. With vast holdings of much depreciated euro area bonds, France is seen as the most exposed major country in Europe to the sovereign debt crisis.

- The UK has long regarded itself as having the best banking system in Europe, if not the world, but the crisis has destroyed that reputation with the state bail-outs of giants such as RBS and Lloyds. Pessimistic London bank-watchers say both banks may well need further capital injections – even though the UK government takes a more optimistic line.

- Switzerland's two major banks – UBS and Credit Suisse – both posing as new-style Anglo-Saxon universal banks, have been through terrible times over the past decade. Swiss taxpayers are rightly questioning whether such a small country can take the risk of hosting two of the world's largest and, some say, most reckless investment banks.

- Central and Eastern European countries like the Czech Republic, Slovakia, Hungary, Poland, with banking systems dominated by western European-owned banks, can only wait and hope that everything will come right in the end. They are not even being properly briefed on how the euro area countries can escape the quagmire.

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Whatever the limitations of Europe's bank regulators and central banks, there can be no doubt that the balance of power has shifted dramatically in European banks: away from bank chief executives and their management teams, and towards finance ministries, central banks and other regulators. In Britain, for example, the Treasury is said to distrust and disregard almost everything it hears from Britain's banks. This is perhaps unsurprising in view of the self-serving lobbying by the UK banks against the recommendations of the Vickers Commission on the future of banking in Britain. While bank chiefs are better regarded in other European countries, the likelihood must be that many of the current incumbents of big European banks will have departed within a year.

Without doubt, Europe needs a new banking industry – and European leaders would be well advised to look to the recent report of the UK's Independent Commission on Banking for guidance on how to plan a better way forward. The so-called Vickers Commission is by now famous for its recommendation, already accepted by the British government, that retail banking should be ring-fenced within a universal banking group. Its unspoken objectives are much more fundamental and include:

1. De-leveraging and unwinding the financial conglomerates that make up Britain's major banks
2. Making it impossible in the UK for investment banks to be built on the back of retail banks
3. Forcing the investment banking subsidiaries of universal banks to fund themselves independently and without reliance on the retail bank
4. Creating stand-alone retail-style banks out of today's universal banks

The world that Vickers wants to create will take more than a decade to emerge but it will happen and may well resemble – at least in part – the banking industry that existed 30 years ago. More and more countries are beginning to think like Vickers – and even the French will join the bandwagon once they experience the fall-out from Anglo-Saxon-style universal banking. Sadly for French taxpayers, they will not have to wait too long.

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