The Bulletin

June 2017
Vol. 8 Ed. 6

China's caution
Living with US tightening

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Georgina Baker on risk and reward
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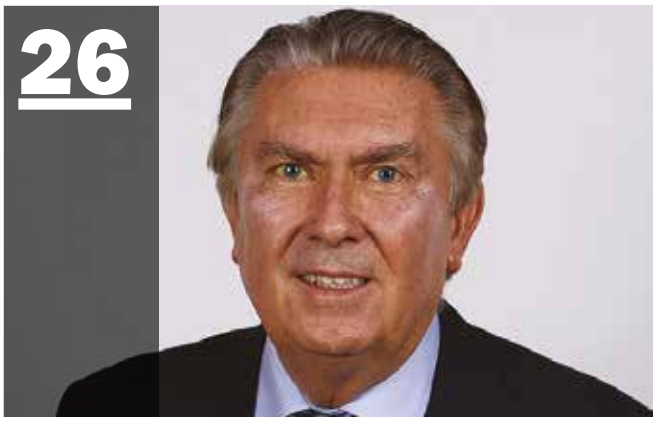

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Official Monetary and Financial Institutions Forum

30 Crown Place, London, EC2A 4EB
United Kingdom
T: +44 (0)20 3008 5262
F: +44 (0)20 7965 4489
www.omfif.org
@OMFIF

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The Official Monetary and Financial Institutions Forum is an independent think tank for central banking, economic policy and public investment – a non-lobbying network for best practice in worldwide public-private sector exchanges. At its heart are Global Public Investors – central banks, sovereign funds and public pension funds – with investable assets of $33.5tn, equivalent to 45% of world GDP.

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OMFIF Advisers Network

The 178-strong OMFIF advisers network, chaired by Meghnad Desai, is made up of experts from around the world representing a range of sectors: Monetary Policy; Political Economy; Capital Markets; and Industry and Investment. They support the work of OMFIF in a variety of ways, including contributions to the monthly Bulletin, regular Commentaries, seminars and other OMFIF activities. Membership changes annually owing to rotation.

EDITORIAL

China's caution: taking US tightening in its stride

China's economy has been accelerating – defying expectations that had been damped by worries of a 'hard landing' and geopolitical uncertainty. Expansionary government policy has helped the better growth picture. The economy is taking in its stride higher US interest rates, confirmed by the Federal Reserve tightening on 14 June. Less evidently, China has been redeploying foreign investments to seek higher yields by focusing on equities, report David Marsh and Bhavin Patel. China's delicate equilibrium constrains the authorities to proceed cautiously with its reform, liberalisation and openness agenda – with results that will affect the bond and equity markets, writes Nan Bai of ChinaAMC.

Qi Bin and Chao Chen of China Investment Corporation comment on how China is boosting its technical know-how through foreign acquisitions, with the country benefiting from institutions' low liquidity requirements and a long-term investment horizon. Regulatory coordination to curb shadow banking activities will be key, according to Le Xia of BBVA. John Adams reflects on the proposals for investing in soft infrastructure and strengthening institutions in his review of the International Monetary Fund's book, *Modernizing China*.

Central banks in Asia are preparing for capital outflows and exchange rate pressures by increasing their reserves. This month's edition of our regular analysis of central bank balance sheets in collaboration with Narodowy Bank Polski documents monetary developments in China, India, South Korea and Thailand. In particular they have been preparing for Fed rate hikes, even though labour market data have been giving a mixed picture, as Darrell Delamaide reports. Unconventional monetary measures have produced complex results that sometimes countermand central banks' mandates. Sayuri Shirai's book, *Mission Incomplete*, reviewed by John Plender, outlines Japanese experience.

OMFIF's fourth annual *Global Public Investor* focuses on investments by central banks, sovereign funds and public pension funds, documenting their shift away from traditional assets to more risky ones as they seek higher returns. Ben Robinson explores one such area of increasing interest: green finance. This year's edition provides details of developments in fintech and digital currencies, but Ruth Euling of De La Rue voices caution about assumed growth of a cashless society across the world.

June's general election, which resulted in a hung parliament, has shaken the UK and may disrupt negotiations on Britain's departure from the European Union. Meghnad Desai outlines the reasons why Jeremy Corbyn, the Labour leader, performed much better than expected. Ben Robinson explains how sterling's sharp fall last year benefited Britain's net foreign investment position. In France, President Emmanuel Macron has achieved further success in the first round of the parliamentary elections on 11 June, and looks set to achieve an absolute majority in the national assembly for his new political party. Philippe Dauba-Pantanacce sets out possible scenarios for Macron to preside over genuine reform.

In the monthly poll of the OMFIF Advisers Network, Macron received a favourable score, with 46% of respondents expecting him to form a political majority. France and Germany are reinforcing plans for co-operation, partly as a result of the UK withdrawal. Despite this, Adam Glapiński, president of Narodowy Bank Polski, draws attention to the scepticism of smaller non-euro EU members towards deeper integration.

The Advisers Network is poorer after the death of Sir Paul Judge last month. We remember him as a successful internationalist, academic benefactor and man of ideas. Obituarist David Marsh recalls his ribald stewardship of Meghnad Desai's 75th birthday dinner in 2015.

Turbulence ahead for GPIs

Asia Pacific leads world in AUM

Global Public Investors have had a turbulent year – and fresh challenges lie in wait. As the world gingerly nears the 10th anniversary of the first stirrings of the 2008 financial crisis, public sector investment agencies of different hues and dimensions are uneasily aware that they may face a new trial of strength. These global institutions have weathered varying vicissitudes over the past decade, with public perceptions oscillating between often sharply exaggerated views of either their strengths or their weaknesses in public policy and investment.

In *Global Public Investor 2017*, launched on 14 June in London, OMFIF extends previous years' analysis to provide a ranking of assets under management of the world's Top 750 central banks, sovereign funds and public pension funds. These institutions hold assets of $33.5tn, equivalent to 45% of world GDP, and span 181 countries.

GPI 2017 focuses on key developments in world investment. After a protracted period of extraordinarily loose monetary policy to support economic recovery following the financial crisis, policy-makers in the world's major central banks are considering gradually raising interest rates. This will create opportunities as well as problems for GPIs, with the exit from unconventional policies expected to be unconventional in its own right.

Compared with the equivalent total last year, this year's assets saw a rise of 1.4%. Pension funds largely propelled this increase, with assets up by $435bn. Sovereign funds saw assets increase by $143bn, while central banks' assets declined by $103bn.

Asia Pacific remains the largest region by AUM, with $12.7tn, 37.9% of the total. The region has the largest public investment institutions, with four in the top 10 – the People's Bank of China, Bank of Japan, Japan's Government Pension Investment Fund and China Investment Corporation. The PBoC remains the biggest GPI by assets, despite suffering the largest decline ($307bn).

Global growth has started to accelerate, yet interest rates remain stubbornly low. This reflects a combined result of unresolved legacies from the last financial crisis as well as demographic pressures, low investment and poor productivity. Financial imbalances, at local and global level, have either not gone away or are building up again.

Capital markets seem relatively impervious to the possibility of shocks stemming from President Donald Trump's erratic behaviour, long-running problems in the euro area, Britain's European Union withdrawal, or sparring over China, North Korea, Russia, Iran and other potential flashpoints. Whatever action ensues, GPIs in all their diversity will be close to the epicentre.

Asia requires 'earthquake-proof' protection

A joint policy dialogue convened by OMFIF and the South East Asian Central Banks (Seacen) Research and Training Centre on 31 May in Kuala Lumpur focused on the dollar, the renminbi and the future of the international monetary system.

Speaking at the meeting Muhammad bin Ibrahim, governor of Bank Negara Malaysia, the Malaysian central bank, described the international monetary system as 'unstable, prone to shocks and broken'. Ibrahim suggested Asia requires 'earthquake-proof' protection through capital market regulations analogous to the high-resilience carbon fibre technology shielding Japanese buildings from tremors.

He warned Asian governments and central banks to protect themselves against erratic capital flows in a volatile multicurrency world affected by fluctuating monetary policies in the two biggest economies, the US and China.

Africa 'attracting worldwide pension funds'

Africa is in a good position to unlock hundreds of billions of dollars from worldwide pension funds to channel into infrastructure and other development projects to take advantage of a positive reappraisal of African risks. This was the view of speakers at a International Finance Corporation-OMFIF capital markets conference on 11 May in Nairobi.

Africa needs to develop a 'big picture ecosystem' to attract foreign investors at a time when $9tn of bond market investments in advanced countries are generating negative yields.

Ibukun Adebayo, co-head of emerging market strategy at the London Stock Exchange, reassured African fundraisers that access to the UK capital markets would continue unabated after Britain's departure from the European Union. He pointed out that only 9% of international funds placed in London emanated from the rest of Europe.

Paul Muthaura, chief executive of the Kenya Capital Markets Authority, said encouraging flows of capital across borders, including through market and stock exchange link-ups and standardisation within East Africa, is 'not an option – it is a necessity'.

The IFC is the private sector financing arm of the World Bank Group. David Marsh, OMFIF managing director, told the conference that, at a time of low investment rewards as well as change and uncertainty in the US, Asia and Europe, Africa provides investors with an alternative source of returns where 'at least we know that risk is adequately priced'.

'Macron the anti-populist populist'

'Mainstream politicians in Europe are taking over some populist arguments,' said Marek Belka, former prime minister of Poland, in an OMFIF telephone briefing on 25 May. 'Look at Mark Rutte and Emmanuel Macron, who is an anti-populist populist. It is commendable that they are responding to the electorate's fears.'

Moderated by Vicky Pryce, board member at the Centre for Economics and Business Research, the discussion included Lord (Michael) Jay, former permanent secretary at the Foreign and Commonwealth Office, and Phil Middleton, senior adviser at EY.

The panellists discussed the UK political parties' manifestos, European integration, the UK withdrawal from the European Union and the weakening of sterling. They saw the election as a crucial test of Britain's confidence in Theresa May's position for exiting the EU.

In the light of Macron's victory, and May's difficult position in the UK after the 8 June election, competing economic interests in Europe could form a new political structure: France and Germany pitted against the UK.

UK and Brexit 'in total uncertainty'

Phil Middleton, senior adviser at EY, chaired an OMFIF telephone briefing on 9 June on the results of the previous day's UK general election with Lord (Meghnad) Desai, Labour party chair for Islington South and Finsbury between 1982-92, Lord (Peter) Ricketts, former UK ambassador to France, and Gabriel Stein, OMFIF's former chief economic adviser.

They spoke on the consequences of the hung parliament for Prime Minister Theresa May and her Conservative party. The future of the opposition Labour party and Jeremy Corbyn, its formerly much-maligned leader, were also discussed in the light of Labour's unexpectedly strong performance.

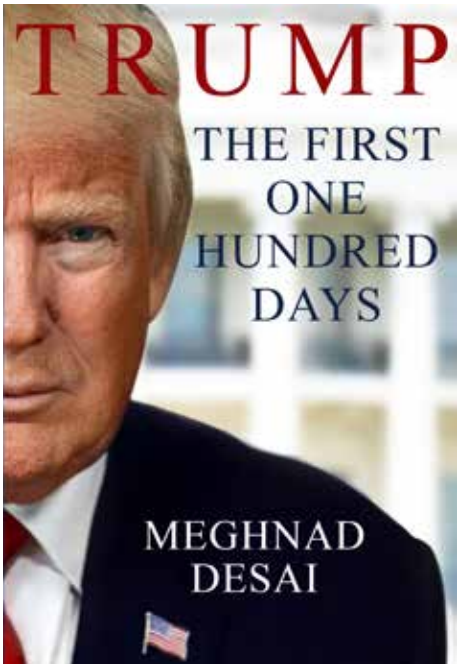
May 'asked for a mandate for the sort of Brexit that she had set out in her documents to Brussels, and she didn't get that,' said Ricketts. 'But there isn't a clear mandate from the Labour party either. We're in total uncertainty.'

Trump's first 100 days

Darrell Delamaide and Marsha Vande Berg joined Lord (Meghnad) Desai on 28 April to discuss his book *Trump: The First One Hundred Days*.

They discussed how Trump faces a steep learning curve, but Desai praised some of Trump's early economic steps, especially with the Federal Reserve, and his 'transition to fiscal policy rather than monetary policy'. Desai highlighted his emphasis on the 'power of the dollar' and his goal of full employment, whereas Vande Berg – a keen Hillary Clinton supporter before last November's election – took a much more negative line.

Desai and his fellow panellists dissected the Trump phenomenon across a broad range of economic and social policies. They considered the array of foreign policy questions to which Trump is, somewhat reluctantly, having to pay attention. Desai said that, though 100 days is a short time, Trump is attempting to lay foundations for a long-term strategy of growth in the US to ensure his legacy.



Europe's elections

'While we should be pleased at Emmanuel Macron's success, we can't assume populism is finished,' said panellists during OMFIF's second Election Year telephone briefing on 11 May, which focused on the French election.

The discussion involved Lord Tugendhat, former European Commission vice president, Iain Begg, research fellow at the London School of Economics and Political Science, and Joergen Oerstrom Moeller, former state secretary at the Danish Foreign Ministry. They discussed the political developments on the UK election campaign trail and the results of the French presidential election.

Forthcoming meetings

US economic growth and monetary policy
James Bullard, president of the Federal Reserve Bank of St. Louis, gives an OMFIF City Lecture in which he will discuss the Federal Reserve's monetary policy moves and the overall economic picture in the US.
29 June, London

Developments in Chile's labour market
OMFIF and the London School of Economics hold a discussion with Mario Marcel, governor of the Banco Central de Chile. They examine developments in Chile's labour market, strong economic growth, as well as the impact of tightening US monetary policy for Latin America.
30 June, London

The times of elastic money
Mojmír Hampl, vice governor of the Czech National Bank, gives the first in a series of roundtable meetings focusing on central banks and digital currencies. The briefing examines the development, risks and benefits of digital currencies and decentralised ledgers, best practices and the potential for global standards.
11 July, London

Green bonds and low-carbon finance
The German Ministry of Finance, Bank for International Settlements and OMFIF are convening a meeting on how Global Public Investors can help combat climate change. German Minister for Finance Wolfgang Schäuble will deliver a keynote address.
13 July, Frankfurt

For details visit www.omfif.org/meetings.

Europe's path to recovery

OMFIF organised a roundtable briefing with Governor Klaas Knot of De Nederlandsche Bank, the Dutch central bank. Attendees to the meeting, which took place on 25 May in London, discussed the role of monetary policy in the euro area's recovery, including issues related to interest rates and tapering.

China and the world

A People's Bank of China School of Finance forum held on 3-4 June, with participation by OMFIF, at Tsinghua University in Beijing focused on China's policies and practices for financial markets, the global financial system and financial innovation in the region.

The new economy of the dollar

A joint OMFIF-DZ BANK meeting on 30 May in Singapore highlighted the dollar's role as the world's primary reserve currency and the future of the multicurrency reserve system. The panel of speakers included Duvvuri Subbarao, former governor of the Reserve Bank of India.

Financial stability success in Asia

Hans Genberg, executive director of Seacen, presented findings from his report 'Global shocks and risk to financial stability in Asia' at an OMFIF briefing on 17 May in London. He discussed how Asia has been successful in maintaining both macroeconomic and financial stability.

China rebalances foreign assets

Beijing turns away from bonds towards equities

David Marsh and Bhavin Patel, OMFIF

How China deploys its considerable foreign assets, acquired as a result of two decades of sizeable current account surpluses, is one of the most important issues facing the world economy.

Balance of payments and international asset statistics underline how China is rebalancing its foreign investments away from holdings of other countries' debt (led by US Treasuries) towards greater ownership of foreign equities, with a particularly large build-up in Europe.

This redeployment is part of Beijing's deliberate strategic efforts to gain extra leverage and value from foreign investments. It is seeking to emulate the successes of the US and other Anglo-Saxon countries in borrowing from abroad at relatively low interest rates and investing outside the country at significantly higher rates of return.

Strain on international position

China's corporate spending in Europe has slowed significantly this year because of Beijing's sharpened controls on capital outflows, introduced to damp downward pressure on the renminbi. But the underlying trend is clear and suggests China may wish to continue foreign equity purchases once balance of payments constraints ease.

Strains on China's international position were shown in May's announcement by Moody's of a cut in China's credit rating. The rating agency based its decision on expectations the country's financial strength would 'erode somewhat' over coming years as debt rises – even though China's outlook was lifted to stable from negative.

China is the world's third largest net foreign creditor in value terms, according to data on the net international investment positions of different economies collated for OMFIF's annual *Global Public Investor* report. The publication summarises the investment management performance of 750 public sector agencies around the world.

The world's largest net foreign debtor, by a wide margin, is the US. This reflects its extraordinary position as the home of the primary international reserve currency and a haven for much of the world's savings.

> ***"Data on China's holdings of reserve assets underline how China shifted its foreign investment structure during the last few years.***

The large debt position in the US co-exists with the country's role as the world's largest holder of gross assets. In the list published in *GPI 2017* of the world's 750 top public investors – central banks, sovereign funds and public pensions funds – the US accounts for around 20% of global public investable assets.

China accounts for three of the world's top Public Investors – the People's Bank of China, China Investment Corporation and the National Social Security Fund – with assets of around 12.5% of the total.

Data on China's holdings of reserve assets at the PBoC, which are heavily weighted to US Treasury bond holdings, compared with portfolio, direct and 'other' investments, which are mainly in publicly quoted and non-quoted equities, underline how China shifted its foreign investment structure during the last few years. This follows recognition by the Beijing authorities that the country was achieving suboptimal returns on its foreign investments by gearing an undue amount of its allocations towards unprofitable holdings of US fixed income securities.

China's gross external assets at the end of last year – which may not include all the country's overseas wealth, some of which seeped abroad via illicit channels – were roughly equally split between reserve assets and other types of investments, most of them in equities, according to publicly available data from the International Monetary Fund and other sources, compiled by OMFIF.

This was a marked shift from previous analysis for 2013, when around two thirds of external assets were in reserve assets and one third in other types of investments. According to our analysis, China's direct investments abroad roughly doubled over the last three years, reflecting the foreign corporate buying effort that has slowed considerably because of capital controls.

These data show a clear switch to direct investments in advanced countries and away from the developing world over the past decade. They demonstrate how the PBoC's fall in China's reserve assets of more than $1tn from 2014 highs has helped finance a fall in Chinese corporate foreign debt and a build-up in overseas equity holdings.

Europe and North America accounted for only 3% of China's overall foreign investment flows abroad in 2006. Their share soared to almost half of a much larger total last year as part of the foreign investment rebalancing. ■

David Marsh is Managing Director and Bhavin Patel is Economist at OMFIF.

Chart 1: China moves into equities

China's composition of external assets, $tn

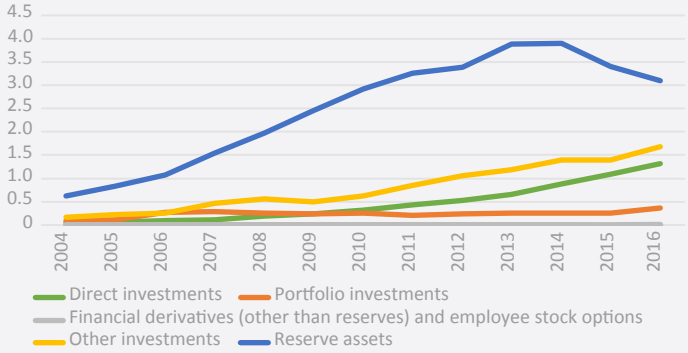
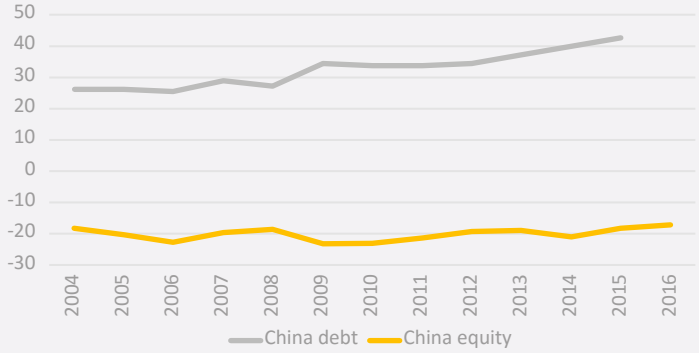


Chart 2: China's net assets mainly in debt securities

China's net foreign assets, total positions, % of GDP



Source: IMF, OMFIF analysis, based partly on data using methodology of BIS discussion paper No.424 by Robert McCauley and Guonan Ma, 2013

Internationalising Chinese equities

MSCI index opens new route for investors

Nan Bai, ChinaAMC

The Shenzhen-Hong Kong Stock Connect, two years younger than its Shanghai counterpart, is a major step towards opening Chinese equity markets and encouraging MSCI to include China A-shares in its leading emerging markets index. The abolition of the aggregated quota system for both Shanghai and Shenzhen creates room for policy liberalisation.

Investors can access around 1,480 stocks through this pair of programmes without needing to apply for a license or quota and without being subject to capital mobility restrictions.

With combined inflows of around Rmb370bn ($54bn) as of June 2017, the Connect schemes have reshaped the market access model. The implementation of new suspension policies by local exchanges has lowered the number of voluntary trading suspensions to pre-crisis levels. When MSCI drafted a new review, the stock markets struck companies in trading suspension for more than 50 days from the proposed list of stocks.

Investment implications

The number of trading suspensions in the China A-shares market remains the highest in the world. That figure stabilised at 250, representing over Rmb2tn in market capitalisation. For some investors, this may still be a reason to hesitate on China.

Offshore A-share derivatives talks are yet to reach a conclusion. MSCI is in discussions with China exchanges to draft a resolution on the removal of pre-approval requirements on new and pre-existing financial products linked to China A-shares. The latest consultation proposal from MSCI varies greatly from previous versions. The 448 constituents of the MSCI China A Index were filtered by market capitalisation, trading suspensions, stock connect eligibility and whether they overlap with shares already listed on Hong Kong's exchange to create a leaner list of 169 companies.

> ***"With combined inflows of around Rmb370bn ($54bn), the Connect schemes have reshaped the market access model.***

These changes focus on investability and liquidity, key concerns for the index provider's clients. Each of the 169 names is accessible via Stock Connect, making them available to investors who have not yet acquired qualified foreign institutional investor quotas.

The new proposal is gaining traction among MSCI's most prominent customers. BlackRock, the world's biggest asset manager, said for the first time it favours the inclusion of China's domestic shares in MSCI global benchmarks. The proposal is more large-cap orientated, as small- to mid-cap names were removed from the original proposal. The large banks and oil majors are no longer included, making state-owned conglomerate Kweichow Moutai the largest constituent in the proposal. Sector allocation is streamlined compared with the original proposal.

Financial institutions and industrial companies have been trimmed down by 4% and 1.6% respectively, while enterprises specialising in consumer staples received a 3% boost. This partially reflects the increasing significance of domestic consumption as China's new growth engine.

Trend for Chinese equities

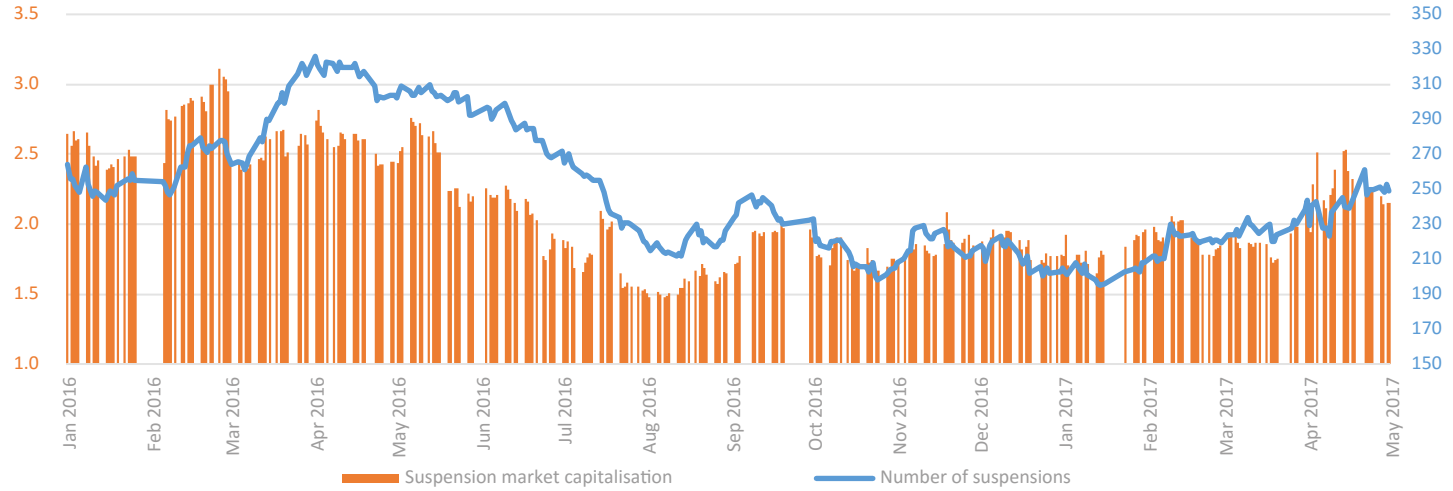
The impact of MSCI's inclusion of China A-shares on market behaviour may take years to emerge. The experience of Taiwanese and South Korean shares highlights the probable trend for Chinese equities. Retail turnover declined for what appear to be structural reasons over the two to three years after their inclusion. Market internationalisation and capital mobility resulted in increased correlation with developed markets.

A second observation from Taiwan and South Korea is the shift in their domestic market valuation frameworks. After their inclusion, Taiwanese and Korean domestic markets saw their price-earnings levels decline and trail MSCI developed market indices. A similar shift towards value and fundamentals is emerging in the China A-shares market. Industry leaders with the prospects and ability successfully to consolidate their business are likely to do well. ■

Nan Bai is Vice President of International Business at ChinaAMC.

China A-market fluctuations, 2016-17

Trading suspension and market capitalisation in the A-shares market, Rmb tn



Source: Wind, ChinaAMC

Boosting China's economic transition

Bringing together government, industry, financial sector

Qi Bin, China Investment Corporation

President Xi Jinping's defence of globalisation at the annual meeting of the World Economic Forum in Davos and China's Belt and Road infrastructure initiative have opened a new phase in the country's embrace of internationalism.

To facilitate overseas investment, Chinese industries are seeking to implement strategic improvements, such as upgrading organisational structures and operational systems.

To speed up this process, China has launched an initiative that brings together government, industry and the financial sector so they can work together to support this transformation. Mergers and acquisitions can act as a vehicle for China to benefit from other countries' expertise and accelerate its economic transition.

Supply side structural reforms

Three decades after the opening-up of China, its society is undergoing profound changes. A prominent source of conflict is that, while demand is increasing rapidly, the supply side is relatively less developed. In particular, a significant lack of high quality products and services is a problem. There are two ways of undertaking supply side structural reform. The first is through innovation within a country, which requires improvements in economic and social systems, with the key being the reform and development of capital markets. The second is through overseas M&A, which opens opportunities for learning from other countries. There are four key components to successful M&A: synergies with the Chinese market, integration after the merger, improving how investment products work in the context of the Chinese market and ensuring the countries involved benefit from M&A.

> *"A prominent source of conflict is that the supply side is underdeveloped. In particular, a significant lack of high quality products and services is a problem.*

Accelerating economic modernisation

The top three Chinese industries involved in overseas M&A in 2015 were technology, manufacturing and consumer goods. This represents a shift from the energy sector, and reflects the stronger performance of China's new industries as its economy transitions. It is becoming less export-orientated and more driven by domestic demand.

Central Huijin Investment, a subsidiary of China Investment Corporation, holds the equity of many financial institutions and participates in their decision-making on investments.

The aim of CIC is to speed up the fund's reform, strengthen internal and external synergies and exploit Chinese wealth fund management to provide strong support to China's overseas investment. ■

Qi Bin is Executive Vice President of China Investment Corporation.

Institutional investors' private equity

Alternative investments for long-term returns

Chao Chen, China Investment Corporation

Asset allocation refers to the strategy of balancing risk and reward by adjusting portfolio holdings relative to risk tolerance and investment horizons. The concept first arose in the 1930s. The associated mean-variance analysis model proposed by US economist Harry Markovitz is a common analysis framework used by institutional investors.

A preferred alternative to the mean-variance model is the endowment model of investing, which supports three assets: value-maintained or valued-added portfolio assets, macro hedge assets and diversified assets. Under this methodology, the endowment model would first allocate a considerable portion of a portfolio to less liquid assets. Next, investors would increase allocation in hedge funds, which are less correlated to traditional stocks and bonds, and then move from domestic allocation to global asset allocation. The final focus would be on investment outsourcing.

Large institutional investors, including pension funds and sovereign funds, have low liquidity requirements and must work to a long-term investment horizon. Private equity investment, meanwhile, offers high potential returns on the one hand, and low asset liquidity, a long income cycle and high management costs on the other.

> *"Holdings of private equity assets increased to offset the impact of low interest rates on returns.*

Private equity realignment

In the last five years, large institutional investors adapted their strategies to investing in private equity. First, holdings of private equity assets increased to offset the impact of low interest rates on returns. Second, they placed more emphasis on long-term investments and explored opportunities in differentiated investments. Third, more attention was paid to post-investment management and value creation.

The criteria for fund selection can be summarised under the 'five-P' guidelines: people, plan, performance, procedure and policy. There are significant strategic differences when investing in leveraged buy-out funds, venture capital funds and growth funds. The core principle of leveraged buy-out funds is to realise value creation. This means they look to invest in industry leading companies and in defensive markets.

Companies with high growth potential, excellent management and a wide range of exit possibilities are much sought after. Reasonable prices and controlling ownership in corporate governance are similarly attractive qualities. Private equity investment offers a lucrative alternative for large institutional investors searching for suitably long-term and illiquid assets. ■

Chao Chen is Deputy Head of the Research Institute and PhD Research Fellow at China Investment Corporation.

Prudent approach to shadow banking

Deleveraging helped by regulatory coordination

Le Xia, BBVA

Chinese regulators are intensifying their efforts to curb shadow banking activities and lower the leverage of the country's financial sector. The People's Bank of China shifted its policy stance to 'prudent' and implemented a new regulatory framework of 'macroprudential assessment'. The aim is to make banks include many previously off-balance sheet activities on their books.

Wealth management products and bank-issued certificates of deposit in the interbank market are the main targets of this regulatory tightening. These are the instruments through which many small and medium-sized banks and non-banking financial institutions raise funds to support risky lending both off and on their balance sheets.

Chinese banks' aggregate exposure to shadow banking activities amounted to Rmb58.5tn ($850bn) at end-2016, or 11.3% of banks' total assets. These activities are increasing the indebtedness of the corporate sector, making the formal banking sector more vulnerable to potential external shocks.

Excessive risk transfer

As the bulk of these shadow activities are not reflected on institutions' balance sheets, existing supervisory requirements of liquidity or capital adequacy cannot effectively limit their expansion.

Moreover, the rampant growth of these activities could lead to excessive transfer of risk within the financial sector. Financial institutions may become less incentivised to monitor and manage risks associated with shadow banking, since they believe other parties are taking on those risks through complex deal structures.

Since the start of this year, the volatility of China's interbank seven-day repo rate (a widely accepted gauge of market interest rates) has significantly increased. Institutions' reluctance to lend in the money market spilled over to the bond market and raised the financing costs of bond issuance. Up to April, high interest rates led to the delay or cancellation of the issuance of several bonds worth around Rmb260bn.

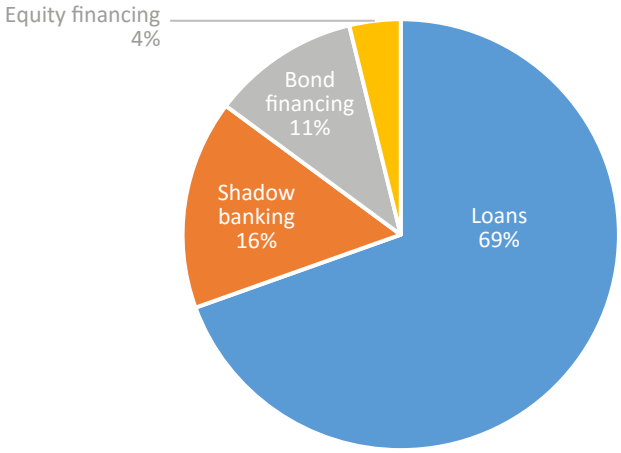
> *"Market regulators are seeking to implement initiatives in a coordinated way, and are fine-tuning the pace of regulation.*

Furthermore, the liquidity decline is restraining Chinese stock markets. The Shanghai composite index is below the 2016 high recorded in November despite the economy showing stronger than expected momentum in the first four months of 2017.

The shares of small and medium-sized banks and non-banking financial institutions with greater exposure to wealth management products and interbank businesses are under particular pressure.

How off-balance sheet financing compares with banks' loan portfolios

Share of total Chinese financing, %, March 2017



Source: People's Bank of China, OMFIF analysis

Coordinated and measured approach

Successfully deleveraging the financial sector while avoiding a systemic debacle is an arduous task. However, a confluence of factors could help the Chinese authorities to do so in a smoother way.

The regulators are paying more attention to communications to avoid unnecessary market upheaval, and authorities are seeking to implement initiatives in a coordinated way. In response to market reactions, they are fine-tuning their pace of regulatory tightening. This measured approach can help them avoid serious policy miscues.

Another buffer the authorities can rely on is the high reserve requirement ratio of China's banking sector. For large banks, that ratio stands at 17% of total deposits. Even for small and medium-sized banks, the reserve-requirement ratio is 15%. Nonetheless, the authorities can still release a large amount of liquidity to the banking sector when they deem necessary. With such a high reserve-requirement ratio, the authorities have room to manoeuvre along the deleveraging path.

Preserving confidence

Moreover, almost all important Chinese financial institutions are state-owned. That structure might not be good for efficiency, but it could help sustain public confidence in the event of market turmoil. Banks benefit greatly from the ability to take deposits from households and firms during difficult times. The state-owned nature of financial institutions could help to preserve confidence and avert a run on banks.

The deleveraging process may last several years and could be accompanied by heightened volatility in domestic financial markets. There is a risk of declining liquidity and small-scale sell-offs before the authorities achieve their goal.

Although China is exercising tight control of its capital account, the turbulence in domestic financial markets could still spill over to the currency market and put downward pressure on the renminbi.

Worries about a possible renminbi decline could become a key binding constraint for the authorities in pressing ahead with their deleveraging campaign. Regulatory changes may damp the economy by raising funding costs. All this may lead to China experiencing a few years of growth below its potential. ■

Le Xia is Chief Economist for Asia at BBVA Research and a Senior Research Fellow with the International Monetary Institute at Renmin University of China.

Rise of Asian currencies

China, India and Thailand show reserve strength

Narodowy Bank Polski analysis

The central banks of advanced economies responded to the financial crisis by expanding their balance sheets at an extraordinary pace. Nine years on, some are assessing the risks and benefits of exiting such policies and reversing this balance sheet expansion. In the latest part of this Bulletin series, Narodowy Bank Polski experts focus on Asia, highlighting trends in China, India, Korea and Thailand.

China allows renminbi appreciation while boosting liquidity

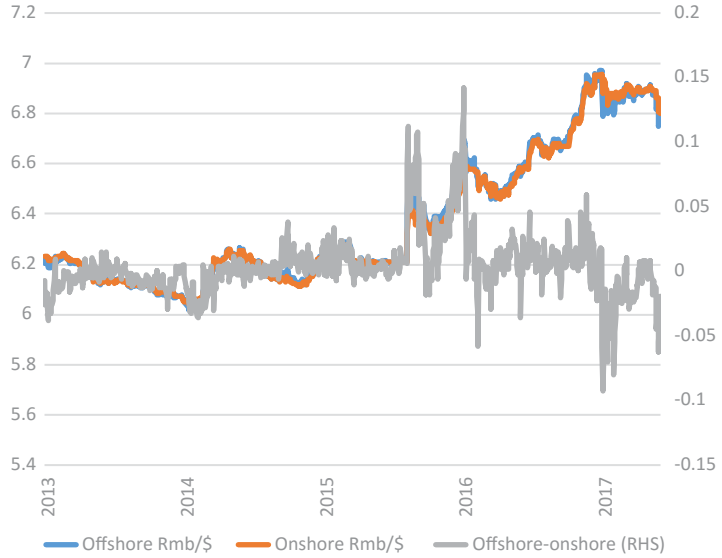
The offshore renminbi's exchange rate appreciated for five days in mid-May, the longest uninterrupted rise since February 2016. This trend seems to stem more from the weakness of the dollar than the strength of the Chinese currency. The People's Bank of China let the domestic currency appreciate for four days in a row, and set its level at Rmb6.879 to the dollar (See Chart 1). The PBoC has been attempting to increase liquidity. According to Reuters estimates, on 16 May the PBoC completed an exercise to expand the money supply by a net Rmb170bn ($25bn), the largest such exercise since January.

It is not clear whether the reversal of the renminbi's trend will affect the size of the currency's offshore market. According to Standard Chartered's renminbi globalisation index, this market contracted at a slower pace in March but still reached a three-year low at the end of Q1 2017. China's holdings of US Treasury bills saw their highest increase in two years, rising by $27bn in March to $1.09tn from $1.05tn in November. This highlights the effect that capital controls have had in slowing capital outflows.

Following the renminbi's inclusion in the International Monetary Fund's special drawing right basket last October, other central banks appear inclined to increase the currency's share in their foreign reserves. On 13 June the European Central Bank announced it had completed a €500m investment denominated in the renminbi.

Chart 1: Renminbi appreciates

Renminbi exchange rate, offshore and onshore markets



Source: Thomson Reuters, Narodowy Bank Polski analysis

India's reserves hit high as Reserve Bank intervenes

India's annual inflation rate fell to 2.99% in April, its lowest level since the series was first recorded in January 2012. The drop came from disinflationary pressures from weak food prices, and resulted in high demand for rupee assets such as equities and bonds. In response, the Reserve Bank of India intervened in the foreign exchange market by purchasing dollars to maintain the low value of the currency, a policy that brought the country's foreign reserves to an all-time high of $372.2bn by the end of April (see Chart 3). At this level, investors believe that India is well-equipped to withstand further monetary tightening by the US Federal Reserve, avoiding a 'taper tantrum' of the sort seen during a previous tightening spell in 2013.

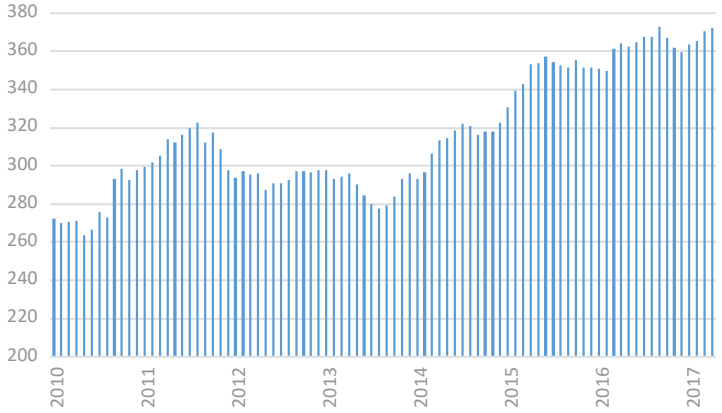
Chart 2: Rupee appreciates following bond demand

Indian rupees per dollar

Source: Thomson Reuters, Narodowy Bank Polski analysis

Chart 3: Indian reserves increase

Reserve Bank of India, foreign reserves, $bn



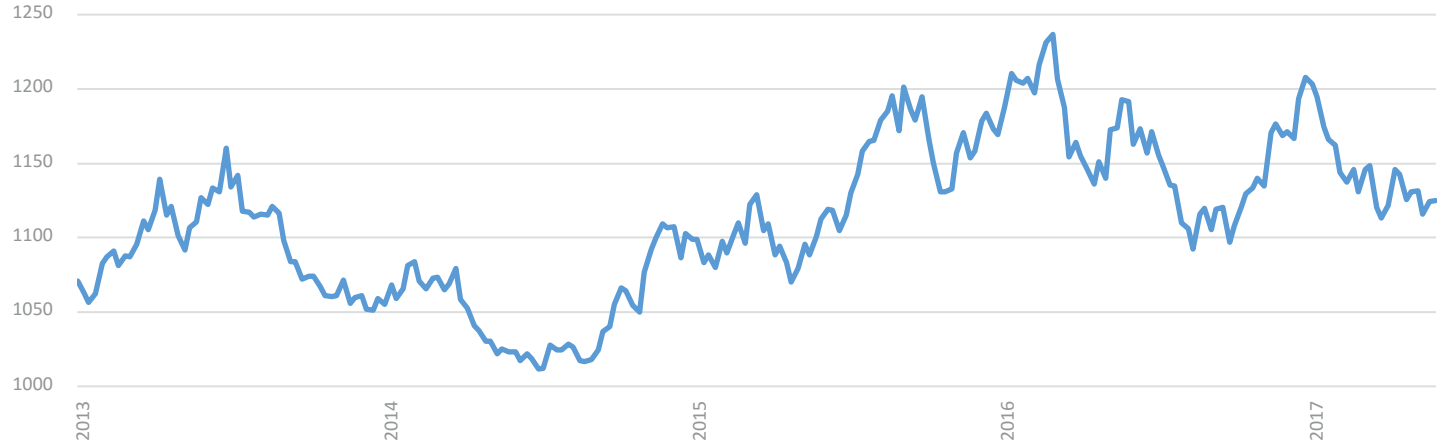
Source: Reserve Bank of India, Narodowy Bank Polski analysis

President Moon's stimulus plans boost stock market

The initial market reaction to the result of the presidential elections in May – when President Moon Jae-in of the Democratic Party of Korea gained power – was somewhat muted. The won was fairly stable. Then, in his first speech after he was sworn in on 10 May, Moon promised to increase spending to stimulate the economy and create jobs. This pushed the Kospi Index higher and the currency reversed its initial losses (see Chart 4). Prospects for South Korean asset prices are, however, likely to be affected by political tensions on the Korean peninsula.

Chart 4: Won gains against dollar as spending plan boosts market confidence

South Korean won per dollar



Source: Thomson Reuters, Narodowy Bank Polski analysis

Solid export performance supports Thai baht

The Bank of Thailand signed its fourth bilateral swap agreement with the Bank of Japan in May. The arrangement will enable the authorities in Japan to swap their local currencies against the US dollar. The size of the facility has risen to $3bn. The banks believe the agreement reinforces financial market stability and fosters economic and trade ties between the two countries. The value of the baht has continued to rise. It reached a 21-month high against the dollar in April, and has since stayed at around that level (see Chart 5).

The Thai currency is supported by solid export performance and stronger than expected GDP growth. Commentators speculate that the Bank of Thailand is intervening in the foreign exchange market to slow the baht's upward trend. Foreign reserves have risen close to the record high of 2011, confirming such assessments (see Chart 6).

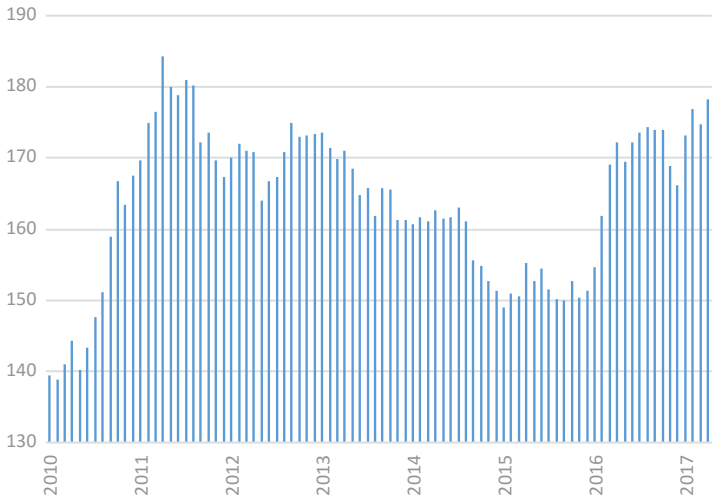
Chart 5: Stronger than expected baht appreciation

Thai baht per dollar

Source: Thomson Reuters, Narodowy Bank Polski analysis

Chart 6: Thailand's foreign reserves continue to rise

Bank of Thailand, foreign reserves, $bn



Source: Bank of Thailand, Narodowy Bank Polski analysis

This analysis was led by Paweł Kowalewski, Economic Adviser in the Bureau of Monetary Policy Strategy at Narodowy Bank Polski, with contributions from Patrycja Beniak, of the bank's Economic Analysis Department.

Limits of a cashless society

Cash and digital: co-existing for inclusion

Ruth Euling, De La Rue

Reports of the end of cash are greatly exaggerated. With qualities including portability, divisibility and durability, cash is forecast to continue expanding.

A 'cashless society' is about as probable as the 'paperless office' that some insisted was within reach 20-30 years ago. Just as technologies like email and cloud computing came to co-exist alongside paper, innovations including credit cards, digital wallets and cryptocurrencies are complementing cash rather than replacing it.

> *While the proportion of transactions carried out in cash will decline, the total volume of cash in circulation globally is expected to rise by 3%-4% a year over the next 10 years.*

Although countries are right to welcome technologies that promote diversity of choice and social inclusion, one cannot lose sight of the facts. Around the world, 38% of the population do not have bank accounts–although the proportion of global wealth this represents is tiny. The demand for ATMs continues to grow globally, with numbers set to increase by around 5% per year. December 2016 saw more cash withdrawn from ATMs in the UK than any month in history. Sweden, which many consider to be the economy least dependent on cash worldwide, is reviewing its policy of removing ATMs as a result of public feedback.

While the proportion of transactions carried out in cash will decline, the total volume of cash in circulation globally is expected to rise by 3%-4% a year over the next 10 years (see Chart).

Cash and digital innovation can co-exist

Access to financial services is key to achieving the United Nations' sustainable development goals by 2030. However, the infrastructure needed to support cashless transactions is unavailable in much of the world. High costs, geography and political priorities are among the reasons inhibiting the expansion of this infrastructure.

Where the infrastructure does exist, even temporary breakdowns can cause major problems. In October 2016 Asda, the UK supermarket chain, incurred the wrath of customers when a loss of internet connection prevented electronic payments from being processed.

The Office of the UN High Commissioner for Refugees reports that 1m children per week are born without their births being registered. No birth certificate means no proof of identity and therefore no bank account or access to financial tools.

Changing demographics further complicate the issue. Aging populations are less digitally savvy than younger ones.

In addition, there is a risk any pronounced shift to a cashless society would further exacerbate the differences between the wealthiest and poorest parts of society.

> *Global paper production shows growth, despite email and other technologies, an indication that the digital and physical can co-exist.*

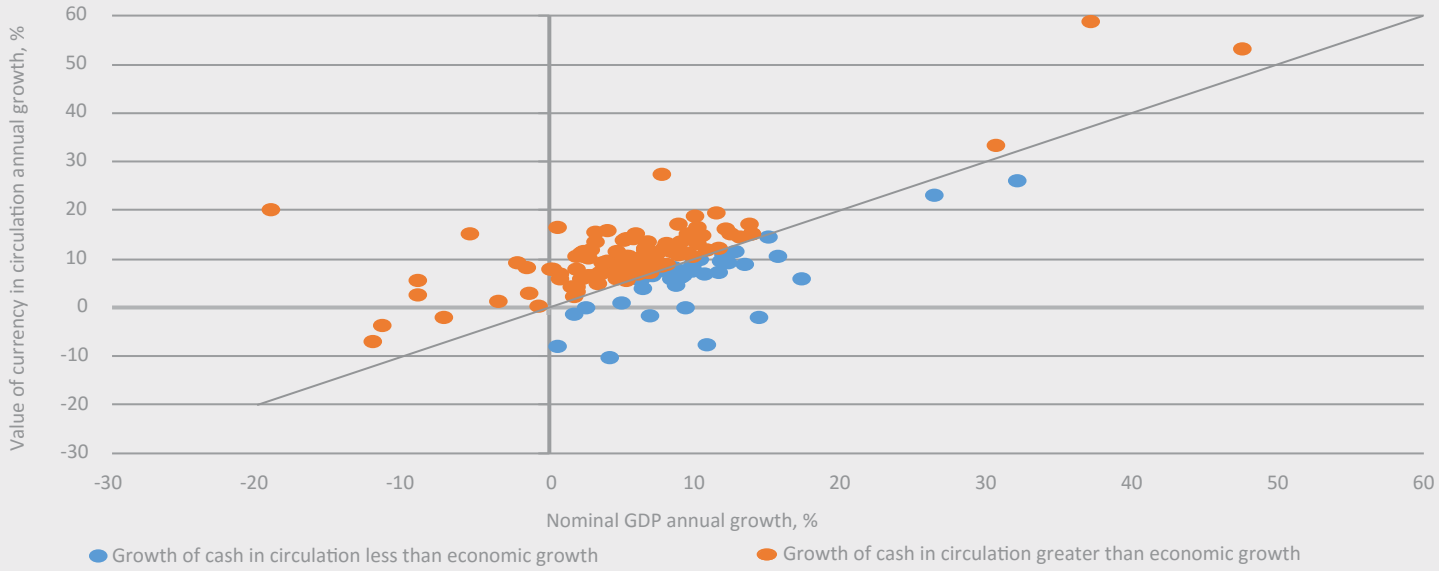
Global paper production still shows growth, despite the impact of email and other technologies, a clear indication that the digital and the physical can co-exist.

No fully accessible and reliable infrastructure for a cashless society is yet on offer. Digital opportunities are certainly growing. But cash will continue to co-exist with digital offerings, and as a key component of an open and inclusive society. ■

Ruth Euling is Global Sales Director at De La Rue.

Value of money in circulation increases faster than GDP in 70% of countries

Value of currency in circulation annual growth, %, v. annual nominal GDP growth, %



Source: International Monetary Fund, De La Rue analysis

Fanciful ideas on EU integration

Member states outside EMU in no rush to adopt euro

Adam Glapiński, Narodowy Bank Polski

Many europhiles believed, shortly after the UK voted last June to leave the European Union, that getting rid of Britain would pave the way to deeper integration of the remaining states. One year on, even after the ascent of Emmanuel Macron as a pro-European French president, it is time for a more sober view.

The EU has made progress in areas such as banking supervision. Yet no major member state is willing to give up decision-making power over vital issues like taxation and spending. Further development of European economic and monetary union is being deferred. All the ideas, including those from Paris, about accelerating integration are little more than a fantasy.

The member states outside EMU are in no rush to adopt the euro. Some are behaving conspicuously like the British. Their antipathy seems not to bother those running the monetary union. They have enough problems with current members.

Britain's monetary union lesson

It's hard to imagine a landmark event that would reverse this reluctance for greater economic integration. Immediately after Macron's victory, many German politicians were quick to offer him support, provided he forgot any idea of EMU becoming a system for transferring funds from creditor to debtor countries.

Britain offers Europe valuable lessons about what is needed for deeper integration. It is a long process requiring many checks and balances. Over more than three centuries, after Scotland and England unified in 1707, the British created a successful monetary union. Yet England, Scotland, Wales and Northern Ireland retain separate national football teams to this day. Beyond the UK, it will be a long time before European states are willing to give up their places at the G7 or the International Monetary Fund.

The British were sceptical about the single currency from the beginning. For years this was seen as another sign of the UK's European backwardness. However, in the past couple of years, more EU countries outside the euro have started to share British doubts, showing unmistakable fondness for preserving domestic currencies. Many policy-makers in these countries behave as if they were under the influence of Alan Walters, the notoriously eurosceptic economic adviser of former Prime Minister Margaret Thatcher.

> ***"Mild currency fluctuations are a small price to pay for preserving autonomous monetary policy. For relatively small economies, such policies are efficient.***

The British were the first to secure the right to stay outside the single currency with the 1991 opt-out clause. Denmark followed in 1993. Sweden is acting similarly, despite not having an opt-out. Central and eastern European states that joined the EU in the 2000s initially saw euro membership as a badge of honour. Then the sovereign debt crisis destroyed any belief that the euro area is a new promised land. Most new members wrote the single currency out of the monetary script.

The treaty obligation to join EMU was invented to prevent competitive devaluations seen after the break-up of fixed exchange rates. Yet double-digit inflation – and the threat of competitive devaluations – belong to the history books. Exchange rates may be volatile but they are relatively stable. In Poland, the złoty has hovered around current levels since the start of the century. In the Czech Republic, the koruna has appreciated.

Preserving autonomous monetary policy

Mild currency fluctuations are a small price to pay for preserving autonomous monetary policy. For relatively small economies, such policies are efficient. Sweden has used the exchange rate as a major tool to combat deflation (see Chart). The same is true for the Czech National Bank, which intervened in the exchange markets to prevent the currency from rising, although it has since adjusted the policy.

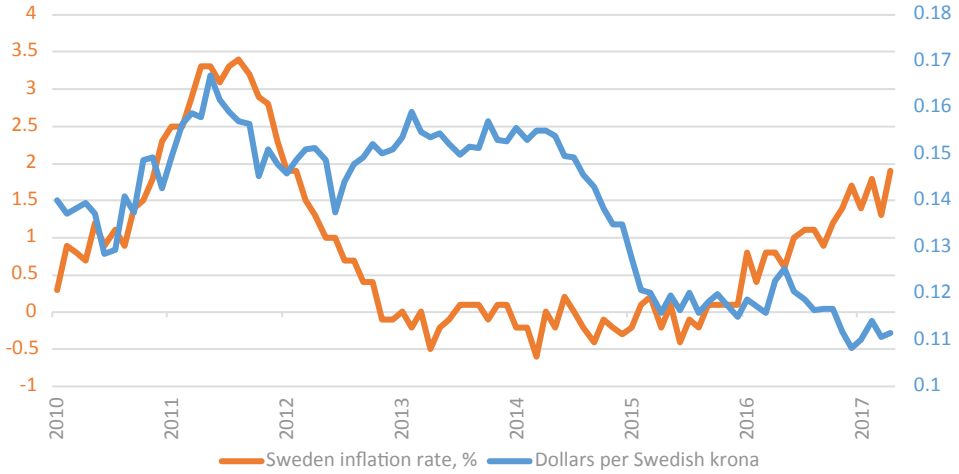
Polish authorities quickly realised how EMU imbalances were the key reason behind the euro area sovereign debt crisis. Warsaw has signalled that in the next 10 years it has no interest in joining. The country needs time to bring Polish living standards more in line with the rest of the continent.

Some purists say that remaining outside EMU without an opt-out breaches the European treaty. However, neither Sweden nor the new members were part of the then-European Community when the clause was introduced. The EU leadership must know it would be foolish to force a country to meet treaty obligations against the will of its people.

Overcoming the challenges of monetary unification appears an insuperable hurdle for the European establishment. The Treaty of Rome is 60 years old, far too short a period to allow the European nations to forget the benefits of national policies. EU citizens still behave the way Thatcher once described. Conquering Mount Everest, they plant not the EU emblem but their national flag. We'll need a long time before an EU football team takes the field in union colours. ■

Depreciation of Swedish krona subdues deflationary pressures

Swedish consumer price index, %, and exchange rate to the dollar



Source: Thomson Reuters, Statistics Sweden, OMFIF analysis

Adam Glapiński is President of Narodowy Bank Polski, Poland's central bank.

May's meticulous train-wreck

How Labour's 'zen master' became crowd-puller

Meghnad Desai, Advisory Council

Two earthquakes have hit British politics. The first was Prime Minister Theresa May's gamble of calling a general election three years earlier than necessary. She mistimed it badly, given she had already invoked Article 50 of the Treaty of Lisbon, which started the two-year period for negotiations on Britain's exit from the European Union.

May wasted seven weeks over the needless poll and lost the meagre Conservative majority bequeathed by David Cameron, her predecessor. The episode came across as a meticulously planned train-wreck. May's position is precarious. Her power is drained. Both parliament and the EU's negotiators understand this. The result will be neither a 'soft' nor 'hard' Brexit – it will be a mangled Brexit.

The second earthquake is in the opposition Labour party. Many expected a massive defeat and a subsequent attempt to oust Jeremy Corbyn, who took over the party's leadership in 2015, with a view to reconstructing Labour for elections in 2022. But Corbyn proved to be a crowd-puller. He obviously loved every moment. The leaking of the Labour manifesto was a great help. For a week, newspapers had no other topic to discuss. Every proposal was analysed, shock and horror expressed. And then the shocks were dismissed. Labour got a lot of free publicity.

> *"The debate between left and right had disappeared from British politics under Tony Blair's 'Third Way'.*

Corbyn means to carry on in uncompromising socialist style. The media attacked him but there was little new to say – Corbyn has not changed his views for 35 years. His critics' ripostes no longer impress older voters, and being hated by the tabloids makes Corbyn a hero to younger voters.

The Conservative manifesto was an unmitigated disaster. From then on, May's lead over Corbyn began to slip. She was nervous and stilted, and the phrase 'Maybot', coined by journalist John Crace, became her moniker. Corbyn, in comparison, was described as a zen master.

Corbyn is reviving right-wing v. left-wing ideological politics in Britain. That debate had disappeared under former Labour Prime Minister Tony Blair's centrist 'third way'. This election, too, was a return to two-party politics in the UK. Around 82% of all votes went to either the Labour party or the Conservatives, compared to 67% in 2015.

The reconstruction of the Labour party is postponed. Rebuilding the Conservative party has become the more urgent task – but it is impossible. Meanwhile, the EU deadline looms. Come March 2019, Brexit negotiations must be concluded. It is not outside the realm of possibility that, by then, the zen master will be prime minister. ■

Lord (Meghnad) Desai is Emeritus Professor of Economics at the London School of Economics and Political Science, and Chair of the OMFIF Advisers Network. Between 1982-92, Desai was Labour party Chair for the constituency of Islington South and Finsbury.

UK net creditor for first time since 2008

Sterling depreciation drives shift

Ben Robinson

OMFIF's research into countries' net international investment positions as part of the fourth edition of the annual *Global Public Investor* publication highlights the UK's shift from a net debtor to a net creditor in 2016.

This is the first time the UK has been a creditor since the sharp decline in sterling following the 2008 financial crisis.

> *"Large depreciation of sterling was the main factor behind the shift for the UK into a net creditor position.*

Traditionally, the UK has had a large negative net position and runs a persistent current account deficit.

The large depreciation of sterling that followed the referendum decision to leave the European Union was the main factor behind the shift for the UK into a net creditor position. At end-2016 the UK's net foreign assets reached 22% of GDP, the largest positive position since 1985-86 when the creditor position was aided by sterling's sharp fall against the dollar to as low as $1.05.

This represented the prelude to several years of severe currency swings punctuated by the Plaza and Louvre accords in 1985 and 1987 marking the dollar's high and low points.

These international agreements in turn led to Britain's luckless 'shadowing' of the D-mark in 1987-88 and sterling's ill-timed entry into (and subsequent departure from) the European exchange rate mechanism in 1990-92.

UK foreign assets fluctuated significantly in the 1990s with sales of foreign holdings resulting in a fall in the net creditor position to only 1.2% of GDP in 1992. The UK has built up international assets extensively since.

At the same time, the country has become one of the key global destinations for investment, with total stocks of foreign direct investment in the UK standing at over £1.3tn in 2015. The large build-up of the UK's gross assets and liabilities has been accompanied by sharp exchange rate-induced swings in net returns on the balance of Britain's foreign currency-denominated international assets and its mainly sterling-denominated liabilities.

> *"The UK has become one of the key global destinations for investment.*

These fluctuations have had a major impact on Britain's current account position in recent years, in some cases swamping the traditional effect of changes in the trade account. ■

Ben Robinson is Economist at OMFIF. These findings form part of OMFIF's Global Public Investor 2017 *research publication. For more information visit www.omfif.org.*

Macron relies on cross-party co-operation

Presidential victory backed by parliamentary success

Philippe Dauba-Pantanacce, Standard Chartered Bank

President Emmanuel Macron has consolidated his power in France. His nascent party, La République En Marche! (REM), and the Democratic Movement (MoDem), his centrist ally, performed much more strongly than expected in the first round of legislative elections on 11 June, winning almost one-third of votes.

This is expected to translate into more than 400 seats in the 577-seat National Assembly following the second round on 18 June. A negative outcome, however, was the poor turnout, with only half of voters casting ballots, a record low.

Macron's renewed victory follows his sweeping win in the presidential election in May. He secured 66.1% of the vote against 33.9% for right-wing leader Marine Le Pen, a result exceeding all predictions.

That election had the lowest turnout (75%) since 1969, and 9% of eligible voters cast invalid ballots. That stands for more than 4m people frustrated by the available choices.

Macron set himself a difficult objective by promising to overcome the ideological divisions which often hamper French policy-making. In addition, he will find it difficult to heal a divided country while executing his legislative programme.

In the presidential election, millions of people voted not necessarily for him but against Le Pen. Especially on the left, many say they voted for Macron to save democracy and to be able to oppose him the following day.

> ***"Especially on the left, many say they voted for Macron to save democracy and to be able to oppose him the following day. Several unions are planning demonstrations.***

Several unions, after supporting Macron, are planning demonstrations against his proposed reforms. These especially concern liberalisation of the labour market, much touted by Macron before the election, an aim which is traditionally fiercely opposed by trade unionists.

The focus will quickly turn to Macron's ability to implement his agenda. Macron is doing his best to widen his appeal to right-wing voters.

He appointed Edouard Philippe, a member of the centre-right Republican party (LR), as his prime minister. Macron gave major ministries in his cabinet to people on both sides of the political divide and others from civil society. On 18 June, he faces two possible scenarios.

If, as expected, REM wins an absolute majority in the National Assembly, Macron could retain Philippe as prime minister and pursue his campaign promises. The prime minister answers to the president, and most policy impulse would originate with Macron. This is the classic constitutional framework of the French presidential regime.

One alternative is that REM secures a strong bloc with a relative majority. Groups on the right may grant some support. Macron could vary his cabinet by appointing additional ministers from both sides.

Without majority, compromise

France is breathing a sigh of relief that it is avoiding the possibility of cohabitation, where LR won an outright majority over REM – an outcome that some were tipping before the parliamentary elections. This would have led to a damaging fight over choice of prime minister, slowing down reform implementation.

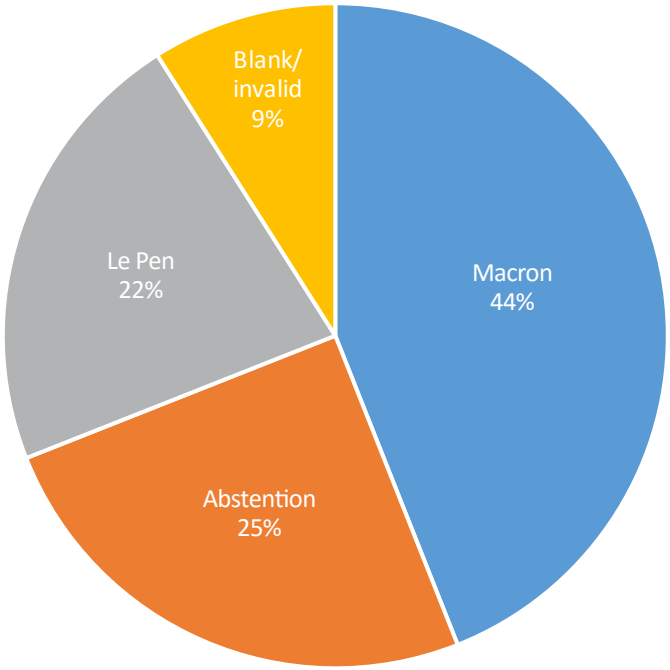
Even though France has had relatively well functioning periods of cohabitation in the past, the inevitable contentiousness of such arrangements often proves disturbing for foreign investors.

Macron's success, against all the odds, in building further his power base gives him and Philippe important powers of initiation and implementation, considerably aiding his policy effectiveness.

Macron's incorporation of cabinet ministers from both the left and right speaks to his desire to overcome France's political divide. His task now is to make the best of what has been a highly successful start to his presidency. ■

Macron needs to widen his support base

Presidential election votes, percentage share of 47m eligible voters



Source: Ministère de l'Intérieur, Standard Chartered analysis

Philippe Dauba-Pantanacce is Senior Economist, Global Geopolitical Strategist at Standard Chartered Bank. This article is produced with the permission of Standard Chartered Bank and is updated based on a Global Research Report originally published on 8 May. It is subject to its General Disclaimer.

Emerging markets' risk-reward attraction

IFC aims to match investors with opportunities

Georgina Baker, Advisory Board

At a time of low returns from traditional asset classes, fund managers are under pressure to increase their holdings of less traditional assets that offer higher yields, such as infrastructure, non-tradable assets and private equity.

The International Finance Corporation, a member of the World Bank Group, is demonstrating that investments in emerging markets are an attractive risk-reward proposition to add to a diversified portfolio.

The needs of people in emerging markets remain a significant development challenge: 700m citizens lack adequate water services, 2.4bn need better sanitation and 1.2bn do not have access to electricity.

The infrastructure investment gap in emerging markets is estimated at $1.5tn a year. To bridge this gap between limited public funding and pressing development needs, private sector support is crucial.

Finding bankable projects

The global community has agreed upon 17 targets by to be reached by 2030 – the Sustainable Development Goals. Reaching these will require trillions of dollars annually in increased investments.

The money is out there. Globally, pension funds hold assets worth more than $35tn, sovereign funds have $6tn and the world's biggest companies $160tn. So it's not about finding capital, it's about finding bankable projects with the right risk-return profile for investors.

The private sector often won't get involved if it believes there are high risks from poor governance, poor infrastructure and lack of skills. The IFC's mission is to establish the conditions that enable the private sector to invest in emerging markets, creating jobs and growth. Over the past 60 years the IFC has invested $250bn, a combination of its own funds and those raised from other investors, but given the scale of the needs, private investment on a much larger scale is required.

To tap into private funding, the IFC created the Managed Co-Lending Portfolio Programme. It allows institutional fund managers to access a diversified pool of investments in emerging markets. Investors joining MCPP benefit from the IFC's experience of investing in emerging markets and in a range of industries. They do not have to worry about identifying bankable projects or monitoring as the IFC does that.

The first MCPP agreement, in 2013, was a $3bn commitment from the People's Bank of China. In less than two years, the IFC invested that money to support private-sector development across all regions and sectors.

The IFC has followed up with MCPP Infrastructure, which seeks to raise $2bn for infrastructure investment from insurance companies. It offers investors access to the IFC's emerging market projects with the IFC managing the portfolio on behalf of investors.

Minimising the public debt burden

MCPP reflects the vision of World Bank president Jim Yong Kim, who has set out a new way for development institutions to look at finance , known as 'the cascade'. The idea is to work through the options for financing development challenges while minimising the public debt burden.

> *"One way to unlock private investments is to focus on 'creating markets'. This means enabling the development of new markets or pushing for systemic changes to markets.*

The starting point is to consider whether private-sector financing is available for a project. If not – whether due to perceived risks or market failures – public resources are considered to reform the business environment. Only if reforms do not bring about sufficient change quickly enough will official development assistance be used to try to lower the cost of bringing in private capital for a project.

This approach means that public resources are the 'last resort' and used only when market solutions are not possible. It was applied to the development of the Queen Alia airport in Jordan. The Jordanian government asked the World Bank, which invests in public sector projects, for a loan to build the airport, but the team working on the project suggested a private sector solution.

Ultimately the airport was built with private sector funds, and the government now receives concession payments from the developer. Careful structuring of the project created an investment opportunity for the private sector and a better solution for the Jordanian economy.

There are many projects like the Queen Alia airport that could be turned into opportunities for investors. One way to unlock private investments is to focus on what the IFC calls 'creating markets'. This means enabling the development of new markets or pushing for systemic changes to markets. In the 1980s the IFC created emerging market bonds as an asset class. In the 1990s it helped create private markets in the former Soviet Union. More recently the IFC has been involved in developing green bonds and in strengthening markets for power and mobile telecommunications.

Colombia infrastructure PPPs

The benefits of creating markets are being seen in Colombia, where congested and crumbling roads have stunted economic growth for decades. The country needs 7,000km of new roads at a cost of around $24bn, which the government can ill afford.

The Colombian government approved a framework for public-private partnerships targeting infrastructure. With IFC advisory input, Colombia designed a PPP programme that includes around $25bn in projects and will produce more than 8,000km of roads, making it one of the most ambitious such programmes worldwide.

The World Bank Group provided technical advisory services to help strengthen the Colombian bond market to encourage investment. New regulations were developed for issuing and investing in infrastructure bonds, including the legislative framework of debt funds that facilitates investments by pension funds in infrastructure. The IFC invested in a $400m infrastructure fund, which is expected to play a critical role in financing large-scale projects by mobilising pension funds.

The end result was that the IFC helped the government create a capital market for infrastructure financing and Colombia will get thousands of kilometres of new roads – without the expansion of government debt. The national economy will get a boost while investors get a new market.

Institutional investors, when partnering an entity such as the IFC, can achieve diversification in their portfolio, along with a better yield. Beyond this, they can be confident that their investment strategy is having a positive impact in countries where there is considerable need. ■

Georgina Baker is Deputy Treasurer at the International Finance Corporation.

Catalyst for private sector investment

Raising commercial viability of developing country finance

Jonathan Hutchins

In the campaign before the 8 June general election, Prime Minister Theresa May promised to maintain Britain's commitment to spend 0.7% of its gross national income on overseas aid. Some members of her Conservative party and parts of the press question the policy of a fixed target.

This sort of criticism fed the political narrative of last year's campaign to leave the European Union. May has since embraced the decision to leave, and people speculated that she might take the opportunity to free herself from this inherited commitment. Doing so might help the UK's ongoing deficit reduction efforts or create more fiscal space for domestic spending.

GDP commitment 'right thing to do'

But the announcement maintaining the 0.7% commitment was unsurprising. The UK has met the target each year since 2013, and the International Development (Official Development Assistance Target) Act 2015 entrenched the policy in law. To repeal it would be complex and could undermine May's stated vision of a 'truly global Britain'.

High-profile speeches by Microsoft founder Bill Gates and World Bank President Jim Yong Kim in support of UK aid policy preceded May's decision. International pressure may have played a part, but the policy is viewed in government as the right thing to do.

Behind the headlines, changes in international official approaches to overseas aid support the arguments for UK policy continuity. These changes include a greater recognition of the role to be played by private sector development in meeting the United Nations' sustainable development goals. This signals a shift in the way some of the UK's overseas aid may be deployed.

The World Council of Churches first proposed the concept of a fixed target of overseas aid in the 1950s. International bodies like the Organisation for Economic Co-operation and Development, which has defined and monitored official development assistance for nearly 50 years, advanced the idea. Simply put, a transaction can be considered official development assistance if it promotes the economic advancement and welfare of developing countries and is concessional in character.

> *"The UK's aid policy will continue and much of its funding will be channelled to the private sectors of emerging economies. But donors cannot meet goals through official development assistance alone.*

The OECD has fine-tuned the definition of official development assistance to reflect the effort of the official sector to catalyse private sector investment. This validates the UK's view that investment through the private sector is an appropriate channel by which to meet part of its development targets.

Direct investment and private capital

London-based CDC Group is the world's oldest development finance institution and wholly owned by the UK government.

In 2015 the government injected new capital into CDC for the first time in 20 years, and this year parliament approved an increase in the statutory limit on contributions to £6bn from £1.5bn. In addition, it gave authority to the secretary of state for international development to increase this to £12bn.

In 2016 the OECD decided to classify net equity investment in development finance institutions as a 'sunk cost', initially counted in official development assistance at face value. Taken together, these decisions provide additional tools for the effective deployment of the government's overseas aid budget, and pave the way for CDC to become more prominent in deploying UK aid.

Private capital in essential investments

Direct investment of the UK's overseas aid budget is only part of the story. While official development assistance comprises more than two-thirds of external finance for less economically developed countries, donor countries are known to use it as a lever to generate private investment and domestic tax revenues.

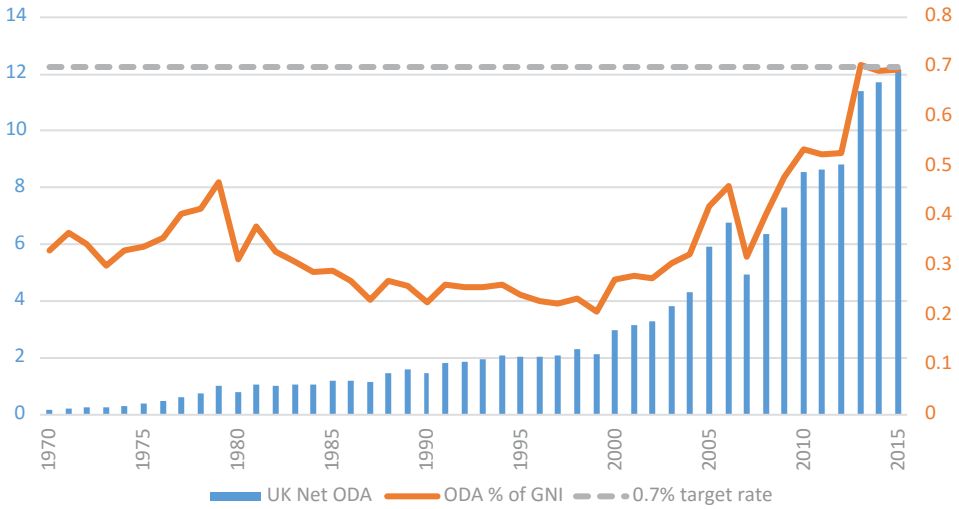
CDC is trying to introduce private capital into essential investments and demonstrate the commercial viability of investing in developing economies. In 2015, CDC reported it had committed $350m to investment funds, which helped bring in a further $832m of private sector investment.

The UK's aid policy will continue and much of its funding will be channelled to the private sector of emerging economies. But donors like the UK cannot meet the UN's sustainable development goals through official development assistance alone. Development finance institutions like CDC will continue to marshal other sources of private sector funding with greater resources.

With $2tn in assets held by the world's 10 largest pension funds, $5tn in the world's largest sovereign funds, and an estimated $100tn still earning historically low returns on global bond markets, even partial success will have a notable impact. ■

UK has met its aid commitment since 2013

Official development assistance contributions, £bn and % of GNI



Source: Office of National Statistics, OMFIF analysis

Jonathan Hutchins is a lawyer and independent consultant.

Fed raises rates but turns dovish

Economic softening casts doubt on further increases

Darrell Delamaide, US editor

The Federal Reserve, as expected, increased interest rates by 0.25 percentage points on 14 June, but many analysts are beginning to question whether there will be any more this year.

Commentators had been expecting two further quarter-point rises after Federal Reserve policy-makers increased rates in March. This seemed to be the consensus in statements made by panel members and remained the dominant stance in the 'dot-plot' of interest-rate forecasts.

Since then Washington has been almost paralysed by political crisis and the market has rethought its optimism about President Donald Trump's agenda. Policy-makers have subsequently become more ambivalent, causing analysts to rethink their projections.

Concerns over inflation and labour market

James Bullard, the St. Louis Fed chief, dampened expectations in the light of softening economic outlook. 'Longer-term yields have declined, inflation expectations have weakened, and market expectations of the policy rate path have declined,' he said at a Washington University event in St. Louis. 'This may suggest that the FOMC's contemplated policy-rate path is overly aggressive relative to actual incoming data on US macroeconomic performance.'

Speaking afterwards, Bullard, who is not a voting member of the FOMC this year, indicated that he would not oppose one quarter-point increase this year.

Lael Brainard, a Fed governor and permanent voter on the panel, sounded dovish when she urged caution about interpreting the unemployment rate of 4.3% as 'maximum employment'. As the labour market evolves, there may be greater slack than is apparent. 'The recognition that maximum employment evolves over time to reflect changes in the economic landscape serves us well,' Brainard said at a Minneapolis Fed event. 'It puts the onus on members of the FOMC to analyse the changing features of the labour market and develop a nuanced understanding of the different margins of slack.'

Neel Kashkari, president of the Minneapolis Fed and a voting member of the FOMC this year, echoed those remarks, and expressed his worries over inflation: 'Right now inflation is going in the wrong direction, and that is concerning to me.' Kashkari was the lone dissenter in the March vote to raise rates and he doubled down on his resistance by dissenting again on the 14 June hike.

> ***"Analysts are struggling to interpret the outflow of information from the Fed but this transparency is viewed as a healthy development for financial markets.***

Robert Kaplan, the Dallas Fed chief, said before the 14 June decision he still expects rates to rise three times in 2017 but noted that weak inflation readings in March and April could make it less of a foregone conclusion. 'I intend to be patient in critically assessing upcoming data,' he said.

Evaluating persistence

In general, Fed policy-makers see the slowdown in economic growth in the first quarter as 'transitory', and will be watching to see if the downturn in inflation is temporary too. Inflation, as measured by the personal consumption expenditure index preferred by the Fed, was up 0.2% in April, with 'core' inflation, taking out food and energy prices, also up 0.2%. Both measures had shown monthly declines in March. The year-on-year increase in PCE was 1.7% in April and only 1.5% for core inflation, both well below the Fed's 2% target. Further dovish inflation data for May have added to the sense of caution.

Some policy-makers are showing less doubt. Patrick Harker, head of the Philadelphia Fed and a voter this year, said the Fed was on track to make the planned rate increases this year. 'We're looking at a labour market more or less at full health, with very little slack,' he said at Drexel University in Philadelphia.

Fed chair Janet Yellen seemed to share this prognosis in her remarks after the June meeting, predicting a steady improvement in the labour market and a slow march to 2% inflation. She made clear, with the usual caveats, that the Fed intends to start trimming its balance sheet this year, if slowly.

It seems that FOMC members are working harder than ever to provide the public with a transparent view of their monetary policy debates. Committee members are on track to give a record 14 speeches each this year, compared with only four each in 1996.

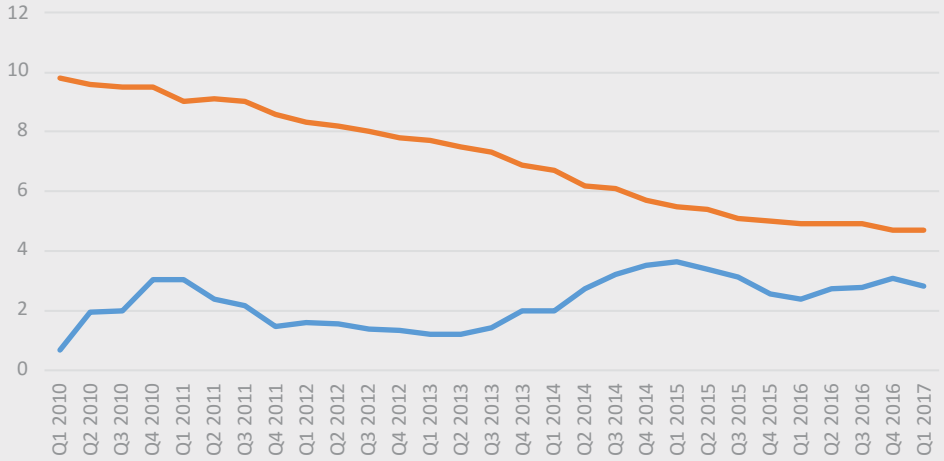
Analysts are struggling to interpret the outflow of information from the Fed but this transparency is viewed as a healthy development for financial markets.

Meanwhile, the nominations for the three vacancies on the Fed's Board of Governors, which were considered imminent, may be delayed for weeks or even months as vetting continues, according to agency reports.

However, Treasury Secretary Steve Mnuchin said in early May that the administration would not necessarily wait to present all three as a package – the board is down to just four members. The Fed nominations are among hundreds of top-level government appointments the administration has been slow to act on. ■

Slowing inflation in Q1 2017 challenges US monetary policy plans

Inflation rate, US personal consumption expenditure, %, and US unemployment rate, %



Source: Bureau of Economic Analysis, Bureau of Labor Statistics, OMFIF analysis

Darrell Delamaide is OMFIF's US editor.

US won't derail green finance market

Withdrawal from Paris agreement could spur consolidation

Ben Robinson, OMFIF

Despite the US decision to withdraw from the Paris climate agreement, investor appetite for green assets is likely to continue growing. Global Public Investors, including central banks, sovereign funds and public pension funds, have been a leading force in the growth of the green investments market over the last decade. Their support is key to its continuing development.

In the last six months public investors from Europe and the US signed more than $2bn of green investment deals, mostly in green bonds and renewable energy. In January, Fonds de Réserve pour les Retraites, the French pension fund, committed an additional €5bn to managers investing in green and sustainable assets and in companies adhering to strict environmental and social responsibility criteria.

These deals expanded the large stock of existing green investments by public sector funds. The growing prominence of green assets in GPIs' balance sheets has led several funds to separate their green investments from their regular equity and bond portfolios, and to report them as a separate asset class.

Divestment from fossil fuels and carbon-emitting industries is becoming increasingly popular among pension funds and sovereign funds. This is being propelled by environmental concerns and, in the case of sovereign funds, the need to hedge against falling oil and commodity prices.

Strong performance of green assets

The US withdrawal from the Paris climate agreement cannot derail the logic behind this increased allocation to green assets. Long-term investors like public pension funds must take note of environmental, social and governance issues in the companies and projects in which they invest.

The impact of climate change on long-term portfolio values is a key concern. Investors are aware of the financial risks facing carbon-intensive companies, including stranded assets, tightening regulations, higher insurance costs and potential fines. Reputational risk, too, can impact long-term performance.

Public investors stress that their green assets are evaluated according to the same investment criteria as regular assets and must offer risk-adjusted returns which satisfy funds' mandates. They want to avoid the perception that they are failing to fulfil their fiduciary duty or are being profligate with public money in the pursuit of green investments. The evidence so far is positive.

Demand has outstripped supply as investors from both the public and private sector have moved into green assets. Green bonds are backed by the strength of the issuing party so they are no more risky than regular bonds. More than 80% of all green bonds are investment grade, and companies issuing them cover a wide range of industries and sectors. This means investors can achieve portfolio diversity and maintain their desired risk level while increasing their allocation to green assets.

> *"Around 34% of Chinese green bond issuance did not meet international standards in 2016.*

Green equity investments have performed similarly well. At end-2016 Norges Bank Investment Management, the $925bn sovereign fund of Norway, had almost Nok60bn ($7bn) invested in 'environmental' equities. These assets returned 12.4% last year, against 8.7% for NBIM's total equity investments.

A growing market

The issuance of green bonds, one of the key green assets for institutional investors, grew to $95bn in 2016 from around $800m in 2007, according to the Organisation for Economic Co-operation and Development. The OECD estimates green bond issuance could reach $620bn-$720bn a year by 2035, with a total outstanding figure of $4.7tn-$5.6tn.

Institutional investor demand for companies that fulfil ESG criteria is encouraging further green bond issuance by corporates. Many public investors, in particular public pension funds, which have $13.8tn assets under management globally, include clauses in their mandates to 'encourage the development of green and responsible business practices and models'. Companies which fail to comply with ESG principles risk being shut out.

Asset managers face losing the business of large institutional investors if they fail to pursue strict ESG rules, as the chief investment officer of Japan's GPIF, the world's largest public pension fund, pointed out in early June.

Those that follow strict rules may attract assets from more investors. These factors are

FOCUS
GREEN FINANCE

helping to boost demand for and issuance of green assets.

The type of issuer has evolved from the initial dominance of multilateral development banks to include corporates, banks and sovereigns. Corporates and banks account for around 60% of all issuance.

This is being aided by regulators, notably the People's Bank of China and the Bank of England, which are attempting to standardise issuance and clarify regulatory issues. Lack of detail on exactly where the proceeds from green bonds are used by the issuer, and the projects which qualify as 'green' for these purposes, is one factor holding back the market. Standardisation is needed to facilitate growth.

US may lose market influence

China is the largest issuer of green bonds and the PBoC has established a comprehensive regulatory framework for these assets.

However, the companies and projects that qualify as green are not the same as those promoted in Europe and elsewhere. Around $12.6bn of Chinese green bonds, equivalent to 34% of total Chinese issuance, did not meet international standards in 2016.

Finding common agreement is difficult, not least because the disagreements over standards represent a struggle for influence over this growing market. By withdrawing from the Paris agreement, Washington may cede leadership in this field to Beijing, with consequences that could benefit Chinese companies ahead of their competitors in the US and Europe.

The decision to withdraw from the Paris agreement risks reducing the share of US companies in global green industries, threatens to lower regulatory standards around green investments, and challenges the ability of the US to play an active role in shaping this market.

It may, however, spur other countries – as well as individual US states – to work together more closely on developing the market and to meet the growing demand for green assets. ■

Ben Robinson is Economist at OMFIF.

Social reform 'next step' for China

IMF points to need for soft infrastructure

John Adams, Advisory Board

The scene-setting in *Modernizing China: Investing in Soft Infrastructure* is a reminder of China's economic power. The nation provides 20% of global GDP and within 30 years has become the major trading partner for 120 countries.

The authors of this book from the International Monetary Fund point out that the key question for China is how, after plucking more than 600m people out of poverty and creating a middle class of 150m, it can avoid the middle-income trap that many developing countries have fallen into.

The old system of heavy-infrastructure investment and government allocation of resources is becoming irrational and destructive of value. Alongside vast overcapacity in steel and coal production, zombie companies abound, transfused only by subsidised loans to maintain employment and social stability. Local authorities, buoyed in better times by land sales but now short of cash, have been banned from new borrowing since 2015 and are being pushed by central government into public-private partnerships.

Change in economic direction

The report's authors, W Raphael Lam, Markus Rodlauer and Alfred Schipke, are realistic when they say that any change in economic direction must achieve social as well as economic and policy goals. This, they point out, will depend on establishing a soft infrastructure, which means freeing up institutions that will guide and underpin the economy. It will involve equitable and environmentally friendly tax structures with price-based financial and monetary structures. Strong corporate governance is important too.

China has made good progress in fiscal and monetary reform and in urbanisation. But total debt in 2015 was 150% of GDP – a point at which financial shocks usually emerge. This is mainly corporate debt, but total government debt, including that of local authorities, is around 60% of GDP.

It is perhaps surprising to see the IMF calling for an increase in bureaucracy, but the People's Bank of China and the financial regulatory agencies are understaffed, as is the ministry of finance. This means that new policies may be hard to implement.

Major Chinese companies are now 'going global' as are individuals. This will place new demands on the tax authorities, involving taxation of both labour and capital income, with an increase in redistributive effects.

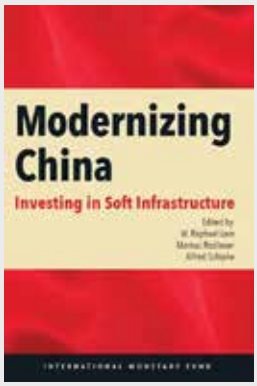
Pension reform is also pressing with public spending, at present just over 3% of GDP, rising to 10% by 2050. Over the same period, the number of active workers per retired pensioner will fall to under 2:1 by 2050, from 6.5:1 today. Unless addressed, this will mean a step back into poverty for many of the elderly.

Local authorities are the weak point in government finances, with responsibilities well in excess of their income. Better auditing is to be undertaken, and one proposal is the introduction of a resolution framework for financial distress in local governments.

Floating exchange rate

China, like many countries, has seen a weakening of the relationship between its money supply target and prices and growth. The PBoC is required to target monetary stability and the balance of payments. The IMF proposes that China moves towards price-based inflation targeting, with interest rates as the primary instrument. M2 targeting should be phased out. Here lies the rub: the interest rate transmission mechanism in China is weaker than in other economies for a variety of administrative reasons, including regulatory arbitrage into the informal lending sector. Interest rates would need to be liberalised (and zombie companies perhaps euthanised).

The IMF suggests a floating exchange rate within the next two years – in effect passing exchange rate risk management from the government to the private sector and individuals. These are tough decisions with unpredictable consequences. Confidence would need to be high to avoid the renminbi falling, and renewed US accusations of currency manipulation. China has spent



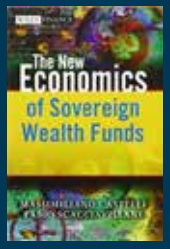
around $1tn since 2014 supporting its currency, which has fallen 16% against the dollar. This action and the uncertain prospects for US interest rates suggest that now may not be the moment for such a policy change.

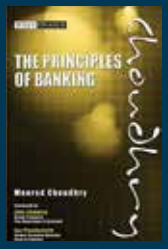
The inclusion of the renminbi in the IMF special drawing right basket of currencies since 2016 gives a slight edge to the Fund's comments. According to the IMF, at end-2016 countries reporting in its currency reserve data series held only $84.5bn of renminbi, less than 1% of total reserves. National reserve managers have seen the value of their newly acquired Chinese currency holdings shrink in dollar terms, with perhaps little prospect of a recovery in 2017.

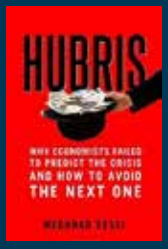
The report is somewhat restrained in its comments on the prospects for the renminbi moving from a vehicle for trade and investment settlements to an international reserve and funding currency. The markets will decide. Renminbi offshore deposits were about Rmb2.5tn ($370bn) at end 2014, but had halved by mid-2016.

Everyone agrees that China's reforms have entered a critical stage. With an unilateralist US, the UK leaving the EU and a resurgent Russia, China' economic and political future is of greater than ever importance. *Modernizing China* underlines the weight of expectations on the Middle Kingdom. ■

John Adams is Chief Executive of China Financial Services.







Tackling Japan's deflationary mindset

A rigorous account of monetary policy's limits

John Plender, OMFIF

Conventional wisdom among economists before the 2008 financial crisis was that a repeat of the deflationary disaster of the 1930s was improbable and avoidable.

All that was required was for central banks to turn on the monetary tap and the price level would meekly respond while the real economy could be relied on to recuperate quickly. The application of unconventional monetary measures since 2008 makes this a more complicated picture.

Monetary accommodation accompanied by fiscal easing ensured the financial crisis did not lead to economic depression. But any subsequent recovery has been anaemic, characterised by weak investment, poor productivity growth, persistent negative output gaps and limited credit demand despite ample provision of liquidity by central banks.

This, then, is a story not of policy failure but of policy shortfall. The best clue to understanding what is wrong lies in demographically-challenged Japan, where experimentation in monetary policy has been taken to further extremes than in the US and Europe. As Sayuri Shirai sets out in her authoritative account of Japanese monetary policy since 1999, *Mission Incomplete: Reflating Japan's Economy*, the Bank of Japan has explored the gamut of unconventional measures in confronting mild but enduring deflation.

Bold monetary measures

It started with zero interest rate policies and forward guidance in 1999-2000. Then came quantitative easing in 2001-06, with the BoJ buying substantial volumes of Japanese government bonds. The BoJ introduced comprehensive monetary easing in 2010 with a bolder asset purchase programme and a 2% price stability target.

Greater boldness followed under Governor Haruhiko Kuroda's quantitative and qualitative monetary easing that extended asset purchases across the yield curve and further into non-governmental paper. Finally, the BoJ adopted negative interest rates in January 2016 and switched to yield curve control in September that year.

Shirai is able to provide a unique insight because she spent five years as a policy board member of the BoJ, first under Governor Masaaki Shirakawa, then under Kuroda. This was a period when Japanese consensus broke down. Shirai herself voted against the negative interest rate policy in January 2016, a judgement that looks shrewd in the light of subsequent events.

Negative interest rates are a good example of what Shirai calls the growing complexity and ambiguity of unconventional measures. For a start, the BoJ has been operating a three-tier system of rates on financial institutions' reserves at the central bank, with negative rates applying only to a small proportion of total reserves. In fact, the weighted average of the three interest rates has remained positive since the policy was first introduced.

The purpose of this complicated system was to mitigate the adverse impact of negative rates on bank profits. The negative rate has, nonetheless, had unintended consequences. Some financial institutions have been reluctant to sell Japanese government bonds to the central bank because they do not want to add to their unremunerative current accounts at the BoJ.

Japan's disinflationary mindset

The big question, in the light of this monetary extremism, is why the BoJ has failed to meet its 2% inflation target. The only occasions since 1999 when inflation has picked up have been either the result of an increase in consumption tax, yen depreciation or external factors such as increases in energy and commodity prices.

Much of the explanation relates to public perception. The BoJ's opinion surveys show that the Japanese have a limited understanding of the 2% inflation target or quantitative and qualitative easing. And in the 10 years to 2016 the rate of inflation as perceived by households was always higher than the actual rate of inflation as measured

by the consumer price index. Above all, subdued household spending reflects an aging, risk-averse public's concern about current and future income. Yet it is in the corporate sector where the deflationary mindset has been most entrenched, leading to an accumulation of corporate savings.

Confronting an upward bias in inflation perceptions, firms have adopted cautious price-setting behaviour. A majority of corporate respondents to the BoJ's short-term economic surveys expect either zero inflation in output prices, or they simply do not know what to expect. Meanwhile, despite the upward bias in inflation perceptions, workers have been reluctant to demand increased pay.

Shirai hopes that a virtuous circle between corporate profit, incomes and prices will eventually emerge to eliminate deflation, but expects the BoJ's inflation target to be met only 'in the somewhat distant future'. With the central bank's credibility seriously tarnished, its continuing independence, already eroded since Prime Minister Shinzo Abe took office in 2012, must be in question. This book provides a remarkable insight into the limits of what monetary policy can achieve. ■

John Plender is Chairman of OMFIF and author of the OMFIF report 'At the edge of shock: Japan's problematic monetary future'. Contact editorial@omfif.org for details.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Merciless wit of a man of ideas

Businessman, internationalist, benefactor

David Marsh

Sir Paul Judge, businessman, academic benefactor, internationalist and man of ideas, who died last month aged 68, possessed a larger-than-life taste for the unusual, the unexpected and the successful. Judge served for five years on the OMFIF advisory board, which he regarded with consideration and affection.

Judge incubated projects and gathered board memberships as butterflies breed chrysalides. He made his name relatively young at Cadbury Schweppes, the British food and drinks company, in the 1980s leading a £97m management buyout of the company's UK, Irish and French food businesses.

He formed Premier Brands, with 6,000 employees and a turnover of £400m – an astute and profitable move. From this flowed an £8m donation in 1990 to the University of Cambridge, his alma mater, enabling the creation of the Judge Business School, now one of Europe's leaders in business education. Christoph Loch, Judge's dean, said the school would 'forever be grateful' to its founding supporter.

> *"Judge incubated projects and gathered board memberships as butterflies breed chrysalides.*

Meteoric rise to eclectic career

Judge was knighted in 1996 for his work in politics and public service. His list of jobs, paid and honorary, testified to his eclecticism in business and finance.

They ranged from chairmanship of Food from Britain, the Royal Society of Arts, the British-Serbian Chamber of Commerce, and the UK arm of the British-North American Committee to a seat on the Milk Marketing Board and Togo's International Advisory Council.

He was president of the Chartered Management Institute and advisory board member of the HEC management education institute in Paris, the Athens University of Economics and Business and the Russian Presidential Academy of National Economy and Public Administration.

His experience included roles as special adviser to the Royal Institute of International Affairs, chairman of Schroder Income Growth Fund, director of mining company ENRC, deputy chairman of the American Management Association, a director of South Africa's Standard Bank and master of the Worshipful Company of Marketors.

At various times he was on the main boards of Boddington brewers, the WPP advertising company and Grosvenor Development Capital. He dabbled in politics, becoming director-general of the Conservative party in 1992, joining the cabinet office as an adviser in 1995 and founding an independent political movement called the Jury Team in 2009.

> *"Judge was knighted in 1996 for his work in politics and public service. His list of jobs, paid and honorary, testified to his eclecticism in business and finance.*

OMFIF legacy

Judge presided with thespian aplomb over two memorable OMFIF occasions. In 2014, in his capacity as sheriff of the City of London, one of his many City posts, he hosted a dinner at the Old Bailey to launch the first edition of the *Global Public Investor* publication, which has become an annual assessment of investment management trends among central banks, sovereign funds and public pension funds around the world.

With relish he conducted denizens of the global sovereign wealth community on a ghoulish pre-dinner tour of the courtrooms and the notorious 'deadman's walk', reputedly taken by condemned prisoners on the way to the hangman.

The guests included Jin Liqun, then heading the supervisory board of China Investment Corporation, who regaled his hosts with tales of how he was to set up for the Chinese government an infrastructure bank linking countries from around the world – which has since blossomed into the Asian Infrastructure Investment Bank.

The second landmark came when Judge was prime speaker at a ribald dinner at the Reform Club in July 2015 to celebrate the 75th birthday of Meghnad Desai, chair of the OMFIF advisers network since its inception in 2010.

Judge's speech, containing trademark doses of barbed understatement and merciless wit, illuminated without lionising the many-sided features of Desai's career. Departed from the stage, Judge will now engender similar tributes. ■

David Marsh is Managing Director of OMFIF.

OMFIF advisers' confidence in French president

Next generation of leadership: 'ambition laced with high intelligence'

This month's advisers network poll deals with the outcome of the French parliamentary election. Members of the network were asked: 'Will Emmanuel Macron's La République En Marche! (REM) party secure an absolute majority, a majority relying on ad-hoc coalitions with smaller groupings, cohabitation or other outcomes in June's parliamentary elections?'

Of those polled, 46% forecast an REM majority with reliance on ad-hoc coalitions with smaller groupings. The remainder is split between an absolute majority outcome and one which involves cohabitation.

Confirmation of Macron's strength came as the OMFIF Bulletin was going to press, with the president's better than expected showing in the first round of elections on 11 June. Following his win in the presidential election, accruing two-thirds of the votes against Marine Le Pen, some commentators had predicted a weaker performance in June for his barely one-year-old party.

The nascent REM grouping is entering more than 400 contenders for the parliamentary elections, though less than half of them have experience in elected office. Macron's task now is to build on the solid base of the May and June elections and turn his apparent hold over the French populace into real economic results that will impress other EU countries and spur much needed growth and investment.

'The most probable result will be a solid position for the parliamentary representation of President Macron, but just short of an absolute majority. His list of proposed parliamentarians is a calculated risk, but at the same time a positive beacon in a world of negativity and pessimism. A new Franco-German pact is on the horizon. Populism is not dead, but now very much on the defensive in key parts of Europe.'
Laurens Jan Brinkhorst, University of Leiden

'One would expect a majority for REM only with the help of some sort of coalition, though of unknown composition.'
Consuelo Brooke

'Macron may eke out a small majority. He has improved his chances with confident displays on the global stage.'
Gary Smith, Barings

'Macron will be able to build a majority with coalition partners. He is letting us glimpse what the next generation of leadership brings, ambition laced with high intelligence.'
David Smith, formerly United Nations

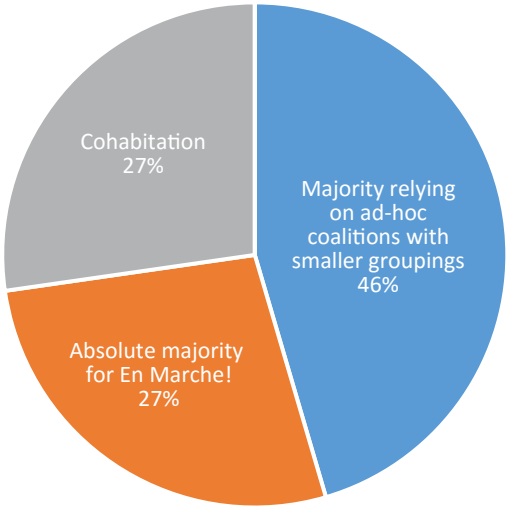
'In France, Emmanuel Macron is unlikely to win an absolute majority. He will almost certainly have to rely on candidates supporting a "presidential majority".'
Boyd McCleary, 39 Essex Chambers

'Macron looks like a phenomenon. An absolute majority is on the cards because of his charismatic performance since the presidential election.'
Stewart Fleming, St Antony's College, University of Oxford

These statements were received as part of the May poll, conducted between 12 May-5 June, with responses from 38 advisory network members.

REM majority to rely on smaller groupings

Percentage of responses



What will be the outcome of the French parliamentary elections?

'Macron will find his loose support disappears in the horse trading to get anything changed.'
Robin Poynder, FMR Advisory

'Macron's momentum should allow him to form a majority, but I doubt it will be an absolute one.'
Miroslav Singer, Generali

July's question

- **Will American withdrawal from leadership on international efforts to defeat climate change mean the world can no longer meet the goals set in Paris in December 2015?**
- **Which countries, or groups of countries, are best placed to assume global responsibility in this field? US states without the federal government, China, India, EU, Britain, Germany, France, other.**