Guest column: Why China's bad banks are a bad idea

14 October 2013

At the end of the 1990s, China's banks faced a rising tide of bad debts, and Beijing came to the rescue. Financial insiders still see that move as necessary, wise and courageous. On the contrary, bailing out the banks was a bad idea. It would be a mistake to repeat the trick.

Then, as now, China's lenders had lent too much. Between 1984 and 1997, their loans grew 24 percent per annum. It couldn't continue forever. In 1998, as non-performing loans started to increase, the growth rate fell to 15 percent, and then 8 percent and 6 percent in the next two years. By that point, bad loans in the banking system were close to 30 percent of total lending.

If Beijing had done nothing, this credit slowdown could have forced a loan contraction, or even a recession. That would have been a blessing in disguise: it would have ushered in much-needed improvement in the quality of credit allocation.

Sadly, the necessary adjustment never happened. China's authorities instead set up four asset management companies - Cinda, Orient, Huarong and Great Wall - to take over the "toxic" loans, and between 1999 and 2005, they took out around 2 trillion yuan (roughly $300 billion at today's exchange rate) of bad assets. They did this at 100 cents on the dollar, without forcing the banks to take a haircut.

This had two side-effects. First, it gave everyone false hope that the banks had suddenly become solid and that there would be future bailouts if the bad debts ever piled up again. Second, it left the banks with masses of liquidity. The resulting equity injection was equivalent to 20 percent of their loan balance. The banks had received massive inflationary power with a few strokes of the pen.

Print away the pain

What came next was inflation, and more lending. The government was already running a deficit in 1999-2000 equivalent to 15 percent to 19 percent of its budget. So to fund the bailout, the Ministry of Finance let the monetary printing press do the work. Rates were aggressively cut too.

That drove annual loan growth as high as 21 percent in the following three years. The resulting spending and investing generated huge sales taxes and dividends for the Ministry of Finance, which then helped recapitalise the banks again in subsequent years.

Banks are now hooked on rapid loan growth. Even when the central bank forced them to keep 20 percent of their deposits in reserve, it was not enough to neutralise the power of the additional "high-powered" money in the banks. Subsequent IPOs and fund-raisings have given them even more firepower, keeping average loan growth since 2000 up to a 16.6 percent annual rate.

But sensible lending opportunities have not grown, and cannot

Context News

Joe Zhang, the author of "Inside China's Shadow Banking: The Next Subprime crisis?", is a corporate adviser in Hong Kong.

possibly grow, that fast. That means that bankers have competed to find new customers and lowered their credit standards, both knowingly and unknowingly. That is a surefire recipe for a crisis.

Repeat and repent

Were the AMCs really necessary? It's unlikely. There are two misconceptions. First of all, depositors were never at risk. There was absolutely no erosion of public confidence in the banks in the 1990s, despite the government's public admission that all the banks were technically bankrupt. Some financial institutions went bust, but no individual depositor lost money.

Second, banks never faced a capital crisis. In order to accommodate the double-digit loan growth of the past three decades, lenders certainly needed more capital. But it would have been better for the economy if much of that lending had never happened. Besides, borrowers wouldn't all have failed to repay at once, so credit growth would have slowed, not collapsed entirely.

Today, the world is worried about China's bad debts again. There are loud calls for another round of recapitalisation. But that would be a grave mistake.

Instead, the best thing for China's financial system would be to downsize the banks via special dividend payouts, and allow their lending capacity to gradually decline. That should force discipline into their lending processes, and reduce the risks of badly allocated credit.

Some pessimists estimate that China's bad debts are more than 10 percent of the total, enough to wipe out the sector's capital. But as long as depositors' confidence in the banks remains high, and loans don't all fail to pay back at once, that needn't matter very much. Bailing out the banks at a stroke will only leave them emboldened to make the same mistakes again.

Chinese euro leanings both financial and strategic

14 October 2013

Chinese issuers are returning to the euro bond market after a long absence. State-owned oil refiner Sinopec and oil producer CNOOC recently raised about half a billion euros each in the first Chinese euro offerings in nearly a decade. It makes financial sense: interest rates currently reflect the diverging monetary policy of the Federal Reserve and the European Central Bank. It also furthers Beijing's long-term plan to become less dollar-centric. With the two goals aligned, such issuances could become a little more common.

Market conditions are ripe for more borrowing in euros. Yields on U.S. Treasuries, the benchmark for dollar-denominated bonds, have risen since May because the Federal Reserve is expected to scale back its quantitative easing programme. But those on German government bonds, the touchstone for euro issuance, are being contained by the European Central Bank's plan to keep policy accommodative for an extended period. The yield premium which 10-year Treasuries offer over Bunds has doubled so far this year. Spreads have also widened at other maturities.

Chinese firms will, of course, continue to tap the liquid dollar bond market. However, they may want to take advantage of more attractive euro funding conditions to diversify their funding and investor base. That sits well with China's intention to reduce a reliance on the dollar that leaves its economy too dependent on the vagaries of U.S. monetary and fiscal policy. While the shift can't and won't happen overnight, Beijing has slowly been preparing the ground in recent years.

China has gradually diversified its foreign exchange reserves, though the lion's share is still held in dollars. It has also promoted the international use of its currency, notably by establishing a series of bilateral currency swaps with other central banks. The latest, concluded last week – and the second largest to date - is with the European Central Bank.

The budget showdown in Washington, and the threat of a U.S. debt default, were a reminder of why Beijing wants its economy freer from the dollar's vagaries. Chinese firms' bond issues can only help. By a happy coincidence, they also present an attractive proposition.

Context News

Sinopec and CNOOC issued a combined total of 1.05 billion euros of bonds between Sept. 26 and Oct. 9, according to Dealogic, which said these were the first Chinese euro bond offering since 2004.

Ten-year U.S. Treasuries yield 80 basis points more than comparable German Bunds. The yield spread was 39 basis points at the beginning of the year.

The ECB and the People's Bank of China announced the establishment of a bilateral currency swap agreement on Oct. 10.

Waffling G20 still best hope for global economy

14 October 2013

Despite its waffling, the G20 is still the best hope for the global economy. The gathering of top 20 nations proved its worth during the financial crisis, helping to coordinate an international response. But finance ministers at the latest Washington meeting worry the group has succumbed to mission creep and verbosity. A functional G20 is vital for a smooth transition as economic power shifts from rich to emerging nations.

With no immediate crisis to discuss, the G20 finance chiefs sought to address the shortcomings of the group itself. South Korea's delegation was most forthright, saying reforms were needed. Among the complaints voiced by officials was that the coterie had lost its focus, with countries inserting pet topics onto the agenda. Talks have recently ambled from climate change to youth unemployment. One result has been unnecessarily prolix communiqués, which topped 4,000 words at the July meeting in Moscow.

In an ideal world, the streamlining called for by Korea could be aided by shedding a few superfluous members – notably Argentina. Diplomatic etiquette makes this impossible. Still, much can be done to keep the G20 from losing clout.

Already in Washington there was an effort to tighten up, starting with an unusually brief communiqué. More can be done to create a leaner G20. The gathering has a potentially valuable role to play in easing tensions as the world adjusts to the increasing heft of China, India and others. To be effective the G20 could focus its talks more narrowly on questions of global monetary policy, capital flows, trade and intellectual property.

Despite a couple of aimless years, the G20 is still the best forum for collaboration on such issues. Unlike the more elitist G7, it encompasses two-thirds of the global population and the fastest growing nations like China. At the same time it is still far easier to reach consensus than at full meetings of the International Monetary Fund, which has 188 members with which to contend.

Even if the G20 is allowed to drift, it is still capable of being shocked back into life by a full-blown financial crisis. With plenty of chronic global problems to resolve, though, it would be a shame to see the considerable potential of the G20 go to waste.

Context News

Finance officials and central bankers from the Group of Twenty top economies met in Washington on Oct. 11.

The gathering, which became the main forum for collaboration between global policymakers during the 2008 financial crisis, was in need of reform, according to a statement from South Korea's finance ministry. Australia, the next chair of the gathering, also indicated that it would focus on making the meetings more productive.

Split Nobel prize shows bubbles are worth watching

14 October 2013

Economics is the only field in which two people can share a Nobel prize for saying opposing things. This old joke, provoked by the 1974 prize that went to ideological antagonists Friedrich August von Hayek and Gunnar Myrdal, is proving relevant again. Eugene Fama, Lars Peter Hansen and Robert Shiller all worked on financial markets' efficiency and drew separate, if not opposing, conclusions. This is a welcome reminder that the dismal science has few absolute truths to offer - mostly questions to explore.

Hansen's merits are methodological. His key innovation, the Generalized Method of Moments (GMM), is a popular econometric technique with applications in micro- and macro-economics, used to uncover relationships between variables in uncertain, complex economic environments - such as asset markets.

Unlike Hansen, Fama and Shiller are mostly known for the conclusions they - or often, others - draw from their academic work. Fama is one of the founding fathers of the "efficient market hypothesis", which roughly holds that financial markets always send the right price signals. Shiller, on the other hand, seems to have spent decades debunking the EMH, collecting empirical evidence that markets are prone to bubbles and irrational exuberance.

An important practical insight of Fama's research is that it is difficult - if not impossible - to beat the wider stock market over a sustained period of time. Empirical research supports this finding, and triggered the rise of passive investment funds that track stock market indices.

Overall, however, Fama's influence on practical policy has been stronger than it should have. EMH nurtured an excessive faith in the wonders of unregulated financial markets, which led economists to ignore speculative excesses. That partly explains the general passivity during the dot.com hype, and later the housing bubble, which triggered the biggest financial and economic crisis since the Great Depression.

Robert Shiller is one of the few economists who warned against those bubbles. His was at times a lonely voice, which explained stock market movements by "animal spirits". More recently, especially after the crisis, his approach has become more mainstream.

Rewarding both Shiller and Fama the same year shows that economics remains a healthy chorus of loud, conflicting voices. But Hansen's work in particular shows that a technical framework remains key to better understanding of complex questions, or at least framing the debate.

Context News

Americans Eugene Fama, Lars Peter Hansen and Robert Shiller won the 2013 Sveriges Riksbank Prize in Economic Sciences in Memory of Alfred Nobel (commonly known as the Nobel Prize for Economics) on Oct. 14 "for their empirical analysis of asset prices".

The Royal Swedish Academy of Sciences, which awards the 8 million crown ($1.2 million) prize, said the Laureate's research has improved the forecasting of asset prices in the long term and helped the emergence of index funds in stock markets.

The award citation said Eugene Fama and several collaborators demonstrated that stock prices are extremely difficult to predict in the short run, and that new information is very quickly incorporated into prices; Robert Shiller found that stock prices fluctuate much more than corporate dividends, and that the ratio of prices to dividends tends to fall when it is high, and to increase when it is low; and Lars Peter Hansen developed a statistical method, the Generalized Method of Moments, that is particularly well suited to testing rational theories of asset pricing.

U.S. debt default disaster isn't up for debate

14 October 2013

A U.S. debt default would "ripple through the global economy in a way you couldn't possibly understand," says Jamie Dimon, chief executive of JPMorgan. Lawmakers in Washington resisting an increase in the federal borrowing limit suggest otherwise. But they're wrong.

The Treasury has said it will start running short of cash on Thursday if frantic efforts by the White House and Congress don't resolve the political impasse soon. That doesn't mean it will stop servicing America's $16.7 trillion of debt immediately. But that's not really the point. The market reaction will come whenever investors switch from incredulity to believing American leaders might actually allow that to happen.

Immediate consequences will probably echo the situation when the Reserve Primary money market fund broke the buck in 2008, marking its net asset value down from the traditionally unquestioned $1 a unit after being stuck holding Lehman Brothers debt. Broader short-term funding markets worth trillions of dollars, which rely on Treasury bills as a kind of currency, will start seizing up as cautious participants worry they aren't worth their face value – the article of faith that keeps these markets liquid.

In the highly interconnected world of finance, that will spark fears about financial institutions' liquidity, further freezing funding markets and bringing crippling margin calls, which is what occurred after Lehman's collapse five years ago. Meanwhile, instead of a downward spiral centered on dodgy bonds in one segment of the mortgage market, investors everywhere will be forced to assume all U.S. government debt obligations are in question. They will sell off dollar assets and seek relatively safe alternatives like yen, Swiss franc and euro-denominated paper.

Members of Congress might react to the first signs of meltdown. After all, lawmakers passed the Troubled Asset Relief Program bank bailout in October 2008 after first rejecting it and seeing stocks decline by 7 percent in an instant. But by then, borrowing costs will be higher across the board and they may not fully settle back. Higher debt costs could dent the fragile improvement in the housing market and slow economic recovery in general.

Lawmakers may reach a last-minute deal, and anyway what would follow a default isn't exactly predictable. But events wouldn't be as hard to understand as Dimon suggests. He could easily have explained: financial markets are a confidence game, and there's solid recent evidence of what happens when that confidence collapses.

Context News

U.S. Senate leaders are "making progress" in their bid to resolve Washington's latest fiscal crisis but still seek agreement on two key points - length of an increase in the debt limit and a funding bill to reopen the government, a Democratic aide with knowledge of the talks said on Oct. 14.

The Treasury says it cannot guarantee that the U.S. government will be able to pay its bills past Oct. 17 if Congress does not raise the $16.7 trillion debt ceiling by then.

"The United States cannot default and, in my opinion, will not default," JPMorgan Chief Executive Jamie Dimon said during a panel discussion at a financial industry conference in Washington on Oct. 12, according to Bloomberg. "It would ripple through the global economy in a way you couldn't possibly understand."

India in depth: Changing recipe of monetary sauce

15 October 2013

The Reserve Bank of India's in-house rule for setting interest rates is a secret sauce in desperate need of a new recipe.

The ingredients for the rate-setting formula are not known. But a Breakingviews examination of India's call-money rates, inflation and GDP over the past 13 years shows that the central bank has historically placed a rather low emphasis on taming inflation, while fretting more about output slumps and currency swings.

The danger of such an algorithm is plain to see. While the government's fiscal recklessness deservedly shares the blame for India's stagflation, monetary ineptitude is equally responsible for hobbling the once fast-growing economy.

That is about to change. Raghuram Rajan, the RBI's new governor, unexpectedly raised the policy rate in September, giving a strong hint that the central bank is turning into an inflation hawk. He also set up a panel to recommend a fresh monetary strategy that is more "predictable and transparent."

The central bank needn't become a completely open book. But a more robust response to inflation is a welcome break from the past. A monetary policy rule that targets several variables risks falling between stools. That's the case now. Inflation is almost at double-digit levels but the economy, which grew just 4.4 percent in the June quarter, is operating below capacity. The paradox is partly explained by the RBI's actions. The central bank's target short-term interest rate has in the past responded three times more forcefully to an output shortfall than to higher inflation.

Such a policy rule can work without any major hiccups for a long time, but it has a corrosive effect on behaviour. Even in the event of hyperinflation, savers can't expect the central bank to come to their rescue. Fearing erosion of their savings, they add gold and real estate to their portfolios. Fiscal overreach makes things worse. Elevated government deficits absorb a bulk of dwindling financial savings, pushing interest rates higher than they would otherwise have been. That blunts the impact of monetary policy. Growth plummets, but inflation stays high. A stagflation-type crisis erupts.

That's not all. In the past, the RBI has also demonstrated an unhealthy obsession with the exchange rate. When the rupee was appreciating against the U.S. dollar before the 2008 financial crisis, the central bank had a tendency to set short-term rates lower than they should have been. Its motivation was to prevent the economy from being swamped by yield-chasing capital inflows.

The concern now is the opposite. The rupee has tanked because of investors' misgivings about India's bloated trade deficit. In July, the RBI raised short-term interest rates by 3 percentage points to prevent capital outflows, showing once again that it cared less about the currency's domestic purchasing power than its value in overseas transactions.

Rajan is now dismantling his predecessor's ill-conceived defence of the currency. In this, he has been lucky. The rupee is stable at about 62 to the dollar. But danger lurks. Nobody quite knows how the central bank will respond if expectations that the U.S. Federal Reserve will soon start withdrawing excess dollar liquidity resurface, putting the rupee under renewed selling pressure.

Yet Rajan's goal must be to tone down the importance monetary policy assigns to variables other than inflation. Exporters become complacent because they know that the monetary authority tends to fight currency appreciation. A good example is the Indian software industry. It has been wildly successful because of the country's cheap labour, but has underinvested in research, and is struggling now to develop its own intellectual property. Similarly, knowing that the central bank will cut interest rates to keep output at an even keel absolves the government of its responsibility to boost the capacity of the economy.

India's hotchpotch monetary rule has also failed to anchor inflation expectations. Even with GDP growth at a 10-year low, surveys show people expect prices to keep galloping. If citizens were confident that the central bank would bring inflation down because that's what it always does, then some of that faith would show up as lower inflation today.

Looking at inflation, Breakingviews' analysis of past RBI behaviour suggests overnight rates should be around 8.4 percent. The central bank's determination to shore up the currency would add 0.9 percentage point to the theoretical number, while its desire to reduce the output gap would reduce it by 0.6 percentage points. Combine the three ingredients, and the final rate - based on historical trends - should be 8.7 percent for the third quarter of 2013.

But following Rajan's intervention, the actual rate was 9.5 percent on Sept. 25. Since Rajan's actions suggest he cares less about the value of the rupee and lost output, the higher observed rate points to one explanation: banks believe the new governor is putting a greater emphasis on controlling inflation than before.

This new rule, if Rajan can make it credible, could lead India to embrace a formal inflation-targeting regime. But it shouldn't be in a hurry to go down that route. Since the 1997 financial crisis, most developing countries in Asia have adopted arrangements whereby the central bank is given an inflation goal by the government or parliament, and told to focus its efforts on achieving it. By and large, inflation targeting has worked — but not everywhere, and not always. For example, the Bank of Thailand steadily raised interest rates in 2006 in an attempt to rein in inflation. The hot money that poured eventually prompted the country to impose capital controls. Thai assets were subsequently walloped.

Before India can migrate to inflation targeting, the government must first prune its permanently elevated budget deficit, so that it's able to use fiscal policy to dial economic output up and down. Still, there is no doubt that too many ingredients are spoiling the consistency of India's monetary broth. Even if Rajan can't adopt a simpler recipe overnight, he can enhance the anti-inflation flavour of his interest-rate concoction.

Silicon Valley storms into Washington data void

15 October 2013

Silicon Valley is storming into the Washington data void. Startup venture Premise is reporting a U.S. inflation gauge, helping to fill a gap left by the government shutdown. The firm uses modern technology to gather more prices more frequently than the official consumer price figures. Once hooked on Big Data, economists may find there's no going back.

Traders, investors and other macro crunchers normally would be keeping an eye out on Wednesday morning for the September CPI bulletin. As it happens, though, the U.S. Bureau of Labor Statistics is on hiatus while Congress and President Barack Obama spar over the budget. Instead, price watchers will have Premise claiming a 0.2 percent rise in the cost of American food staples in September - and a continuing rise so far in October.

CPI is broader, but Premise provides more current information. The BLS dispatches staff to retailers and other establishments on a monthly basis. Premise uses computers to track up-to-the-minute online prices and combines the information with thousands of daily photos submitted by paid smartphone users. In food, where Premise is focused, its index is based on 240,000 product prices against 5,000 in the CPI.

The real-time nature of Premise's data - not to mention the added attraction that it is culling comparable prices for 29 cities around the world - makes it different. In June, for example, Premise says it spotted a noticeable rise in the prices of onions, an important staple in Indian diets, in the streets of Mumbai and Chennai. By the time policymakers noticed and responded weeks later, food inflation had already soared and the rupee had weakened.

The firm reckons stockpiles of snapshots from shops around the world may themselves prove valuable if, say, they reveal a shortage of supply of certain products when shelves are consistently found to be half empty.

Of course, Premise isn't alone trying to find new value in the oceans of data now accessible online. In another example, Monsanto agreed earlier this month to pay over $900 million for Climate, a firm started in 2007 by former Google engineers to aggregate information on weather and create a self-service insurance market that didn't exist before. As firms extract useful trends, governments may find their own measurements become obsolete. It may take a while for the likes of Premise to build credibility, but a federal closure that enforces official silence can only accelerate that process.

Context News

The co-founder of San Francisco-based Premise said in an Oct. 14 blog post that the firm was introducing its first three commercial applications - a global inflation monitor, industry price intelligence and a food security tracker.

"We founded Premise in 2012 because existing mechanisms of econometric data gathering are insufficient to meet the policy, trading, relief or business strategy challenges posed by an era of unprecedented economic and social volatility," Premise Chief Executive David Soloff wrote.
He said Premise captures between 40,000 and 50,000 discrete data points every hour.

The U.S. Bureau of Labor Statistics was scheduled to report the September Consumer Price Index at 8:30 a.m. on Oct. 16. The agency says its website is not being updated because of the federal government shutdown. "During the shutdown period BLS will not collect data, issue reports, or respond to public inquiries," according to the site.

Japan ageing blues give generic drugmakers a high

18 October 2013

A rapidly ageing population is ruining Japan's fiscal health, but it's also giving the country's generic drugmakers a high.

Only half of Japan's population will be in the workforce by 2050. Their taxes and insurance premiums won't be enough to pay the bills of the elderly. Medical costs are the biggest burden: the healthcare bill for a person aged 82 is six times higher than for a 34-year-old civil servant.

Without raising tax rates, hiking co-payment charges, or diluting Japan's cherished universal health care system, the only course open to the government is to rein in costs, which galloped 5.3 percent in 2010, more than double the rate in the United States.

This is where generic drugs can play a role. While 76 percent of all prescription drugs in the United States are cheaper copies, according to consulting firm Capgemini, unpatented medicines account for less than 25 percent of sales volumes in Japan, KPMG says.

Fiscal realities are pushing Japan to close the gap with the United States. The government has approved 367 generic products for inclusion on the National Health Insurance price list in December. The list is a policy tool - what's not on it is not covered by insurance. By tweaking listing prices, Japan has been able to cut the cost of existing drugs by two-thirds in 20 years, according to health policy researcher Naoki Ikegami.

Even with low margins, a bigger share of the world's second-biggest pharmaceuticals market will be an enticing opportunity for copycat producers. At least that's what investors are betting on. Shares of Japanese generic drugmakers Sawai Pharmaceutical and Towa Pharmaceutical have surged between 30 and 40 percent since Prime Minister Shinzo Abe announced his intention to make health care a key element of his growth strategy in June. Sawai hopes to double its revenue between 2014 and 2020.

Global drug companies, stung by adverse court rulings in India, are pushing for a stronger patent regime under the Trans-Pacific Partnership (TPP) trade treaty. Although Japan is now part of TPP negotiations, it's unlikely to radically enhance its already generous protection for innovators. Another lucrative market is sipping out of Big Pharma's grip, and there isn't much it can do about it.

Context News

Shares of Japanese generic drugmakers Sawai Pharmaceutical and Towa Pharmaceutical have risen between 30 and 40 percent since Prime Minister Shinzo Abe's growth strategy, unveiled in June, set the goal for expanding the market for drugs and medical devices to 16 trillion yen by 2020, from 12 trillion yen now.

Japan's Ministry of Health, Labour and Welfare has approved 367 generic products for inclusion on the National Health Insurance price listings in December, IHS Global Insight reported on Aug. 19, citing Pharma Japan.

Unpatented drugs accounted for less than 25 percent of pharmaceutical sales by volume, according to Japan Generic Medicines Association. That compares with a generic prescription rate of 76 percent in the United States, according to Capgemini.

UK risks double standards in wooing China banks

15 October 2013

George Osborne is risking regulatory double standards as he seeks to court Chinese banks. The UK Chancellor of the Exchequer hopes that smoothing their path to Britain will in turn help London become the global centre for offshore trading in the renminbi. But the plan creates a worrying inconsistency.

Since the financial crisis, regulators have tried to restructure banks so regional operations function as separately capitalised subsidiaries. Osborne's idea is to let Chinese wholesale banks operate only as branches in the UK. It's an important technicality: branches rely on capital located elsewhere in their parent group. The failure of a systemically important foreign bank branch without a separate capital cushion could cause damage to the UK economy. Beijing could repatriate assets, leaving creditors with nothing.

This drive for so-called subsidiarisation originates from Lehman Brothers' collapse, when funds leaked from London to the bank's New York headquarters. While the Bank of England can't force foreign banks to set up separately capitalised subsidiaries, most systemically significant institutions would find it hard to operate in the UK otherwise.

Fortunately, China's five biggest state-owned banks - Agricultural Bank of China, Bank of Communications, Bank of China, China Construction Bank and ICBC - already all have UK subsidiaries. But although not all Chinese lenders are systemically risky, UK regulators need to remain vigilant. The few UK-based Chinese banks without separately capitalised subsidiaries may be smaller than the big five, but could grow. What's more, Beijing's oversight is notoriously opaque. The Prudential Regulatory Authority, the Bank of England division that regulates wholesale banking, may only be able to make limited assessments of Chinese banks via its counterpart. The China Banking Regulatory Commission is unproven - it was only set up in 2003.

Osborne's efforts to woo Chinese lenders look a lot like the light-touch regulation that undermined London's reputation as the crisis broke. In the short-term, the renminbi trading pact may benefit London's finance industry and boost Beijing's share of foreign direct investment. But if a UK-based Chinese bank got into difficulties, and British regulators couldn't stop a badly managed failure, the move would be a costly mistake.

Context News

UK Chancellor George Osborne and Chinese counterpart Vice Premier Ma Kai agreed on Oct. 15 to support trading of the renminbi in London.

As part of the accord, Chinese banks can apply to operate wholesale branches in the UK, rather than separately capitalised subsidiaries.

The agreement also seeks to increase foreign direct investment into China by allowing licenced London-based institutions to plough renminbi back into China.

Britain can gain from China's empire builders

15 October 2013

Britain once had nothing to offer China but silver and opium. Now it has holidays, banks and building sites. George Osborne, the UK Chancellor of the Exchequer, and London's mayor Boris Johnson are using visits to Beijing to say just how welcoming the UK is likely to be. It's a triumph of openness, and provided the UK chooses its partners carefully and the Chinese are tactful, both sides will benefit.

Simpler visa rules, and Chinese funding for landmark building projects, are easy to like. Overall Chinese tourist spending, according to Barclays, grew an annual 22 percent in the second quarter of 2013. Meanwhile, property developers are putting their ambition, and their access to credit, behind redevelopment of Royal Albert Dock and the Crystal Palace in London and the Manchester Airport complex. It is hard to see how these initiatives pose threats to sovereignty, or security. They will help Britain fund its trade and budget deficits, however, and may lead to more useful investments, say in high-speed rail.

Banks are more contentious. China's lenders want to set up branches rather than the subsidiaries most of them run today. This would let them take their parent banks' capital into account. In return, the UK may win a bigger role trading China's currency. London may get more finance jobs. Yet questions remain about how Chinese banks would behave in a crisis. State lenders and regulators answer to the ruling Communist Party. In the pecking order, foreigners come close to the bottom.

China is unlikely to reciprocate on pure banking activity. Foreign banks have just 2 percent market share in China by assets. As with coveted sectors such as cars and pharmaceuticals, banking in China is still restricted. But precise reciprocity is less important than net financial advantage. Britain needs investment. In principle and in practice, openness is the way forward. The United Kingdom is already welcoming: the country took in foreign investment equivalent to 2.6 percent of GDP in 2012, double the aggregate figure for the OECD countries.

If there's a risk, it's that the new investors are unknown quantities. ABP and Zhongrong, the developers behind the Royal Albert Dock and Crystal Palace, have brief and patchy track records. ABP has completed only one development in its decade-long history. Chinese developers also rely on political patronage, which can prove fickle. China may be putting up the cash, but Osborne and Johnson are investing their reputations.

Context News

George Osborne, the UK Chancellor of the Exchequer currently on an official visit to China, said he is hoping Britain can forge closer ties with the Asian giant. He has pledged to simplify visa rules for Chinese tourists visiting the United Kingdom. He added that there is "no limit" to the number of Chinese students and tourists Britain can accommodate.

Osborne also said he would make it easier for Chinese banks to open branches in the United Kingdom. Currently they must operate through subsidiaries, which can require more capital and are primarily regulated by the UK's Prudential Regulation Authority and Financial Conduct Authority, rather than by the bank's home regulator. The exception is Bank of China, which set up a UK branch in 1929.

Osborne is visiting China for five days, alongside Boris Johnson, mayor of London.

Who could be the trillionaire among us?

15 October 2013

The first trillionaire could very well be among us. In its world wealth report, Credit Suisse envisions a scenario where 11 of them are walking the Earth in two generations, implying that the first person worth a thousand billion dollars turns up even sooner. Economic trends will determine if it's a tech wunderkind, hedge fund whiz or resources czar. Globalization gives an African a shot, but other data mean a Russian is more likely.

In the study's entertaining "what if" synopsis, the world's 11 richest individuals would reach $1 trillion of net worth by 2073. Assuming the mega-wealthy remain as they are today, a compounded economic growth rate of 6.13 percent would put everyone on the Forbes rich list up to No. 11 Wal-Mart heir Christy Walton and her family there. Distributions, such as they are, mean Carlos Slim and his $70 billion should cross the finish line by 2058.

Of course, it is worth imagining how economic cycles and trajectories might change. The world's monetary situation favors a financier who can take advantage of surplus liquidity. If policies moderate, though, and rapid, non-inflationary growth is powered by technological innovation without massive global redistribution, then Silicon Valley could be the place to look. Heck, it might even be Facebook founder Mark Zuckerberg, who would be 74 years old four-and-a-half decades from now.

If global inequality can be reduced, continuing to lead poorer countries to grow faster than rich ones, then the first trillionaire might very well arise from an emerging market. Mexico's Slim isn't the only possibility. It could be an Ambani or Mittal from India or someone like Chinese beverage magnate Zong Qinghou, or one of their peers building businesses across the continent. Depending on how things break in Africa, Nigeria's Aliko Dangote, currently worth some $16 billion, stands an outside chance, though he'd need to live to 101.

A long stretch of above-trend inflation would mean even more than the billion millionaires Credit Suisse projects 60 years hence, and would favor an oil or mining tycoon as the world's inaugural trillionaire. Russia, of course, has its fair share of them. What's more, no big country's super-wealthy have shown stronger staying power. Of Russia's 26 billionaires in 2005, 25 of them retained the status in 2010. For now, plan the 12-zero party for Moscow.

Context News

In an exercise included in its annual "Global Wealth Report," Credit Suisse attempts to chart shifts in wealth mobility and finds that in two generations, there could be nearly a billion millionaires, or 20 percent of the adult population, and "there is likely to be a few trillionaires too – eleven according to our best estimate." The report was released on Oct. 9.

Tax-and-spend Bloomberg leaves Big Apple fragile

15 October 2013

The first candidates' debate in the run-up to New York City's Nov. 5 mayoral election is set for Tuesday evening. Democrat Bill de Blasio is polling far ahead of Republican Joe Lhota in the race to succeed Michael Bloomberg. In his 12 years as mayor, Bloomberg increased the city's annual outlays by 75 percent to $73 billion, far outstripping growth in the local or national economy. With tax rates and spending already high, whoever takes over won't be able to afford handouts.

Bloomberg's expansion of New York's budget equates to a 33 percent increase after inflation. He noted in a recent speech that the World Trade Center attacks of Sept. 11, 2001 – just weeks before he was first elected – spawned concern about a return to the dark days New York experienced in the 1970s. Instead, he is largely justified in claiming that the city has weathered that tragedy, seen off the 2008 financial crisis and more than recovered.

Yet New York is spending approximately $8,700 per head of population every year, more than double Chicago's outlay per person and about 50 percent more than Los Angeles shells out.

A huge tourism market may merit more spending than the norm, and the desirability of living in the city that never sleeps also means high real estate prices and hefty property tax revenue. Streeteasy's Manhattan Condo Market Index, for example, is up 74 percent since Bloomberg took office in January 2002 – almost exactly in line with the rise in the city's budget. However, in the larger metropolitan area, the S&P/Case-Shiller home price index has risen only 37 percent.

New York City charges its own income tax and with state and federal levies has one of the highest aggregate top rates in the United States. And on a range of metrics assessing tax systems and rates, the Tax Foundation recently ranked New York dead last among the 50 states in its Business Tax Climate Index. That suggests there isn't much room to raise taxes.

Moreover, public spending may be due for a further rise, as renegotiating expired contracts with public employees could result in a one-time cost of more than $7 billion in retroactive wage increases, according to the Citizens Budget Commission. Whether the next New York City mayor leans toward higher spending or lower taxes, he will be hamstrung by Bloomberg's legacy of fragile finances.

Context News

Republican Joe Lhota and Democrat Bill de Blasio, both candidates to become mayor of New York City, will participate in three debates before the Nov. 5 election, with the first event set to take place on Oct. 15.

New York's budgeted spending for the fiscal year ended June 30, 2014 (netting out transfers from other years) is $72.7 billion. That's up 75.3 percent from the year ending June 2002, the last full year before outgoing Mayor Michael Bloomberg took office. In real terms, that equates to a 33.4 percent increase in annual spending.

By way of comparison, nominal U.S. GDP increased 56.6 percent from the second quarter of 2001 to the second quarter of 2013, while nominal output for the New York region increased approximately 49.7 percent. New York City's population rose 4.1 percent between July 2000 and July 2012 to reach 8.3 million.

Chicago's 2013 budgeted spending, between its local fund, corporate fund and capital improvement budgets, totals $11.2 billion, or $4,100 per head of 2012 population. Los Angeles, meanwhile, expects to spend $21.3 billion in 2013 to 2014, or about $5,600 per head of 2012 population.

Merkel can build coalition with minor left turn

16 October 2013

Germany's Green party has abandoned coalition talks with Angela Merkel, so the German chancellor is back to square one - and to the most credible option from the beginning: an alliance with the Social Democrats of the SPD party. Two-thirds of Germans favour such a "grand coalition", which would control more than 80 percent of the seats in the Bundestag, the lower house of parliament.

But the SPD isn't overly excited about forming a coalition with Merkel, and it has pledged to consult its members on any potential agreement.

If Merkel wants to govern with the Social Democrats, she will have to make concessions. She will have to compromise on a national minimum wage, which was one of the SPD's core campaign themes. Given that Merkel has herself suggested a softened version of the measure, finding an agreement on this is doable.

Reaching consensus on a higher tax rate for top earners may be more difficult. The SPD wants to raise the top marginal tax rate from 42 percent to 49 percent. The CDU promised not to touch it. A compromise could entail lower taxes for low-income earners, and a symbolic increase of the top rate.

In all likelihood, Merkel will also have to hand over the finance ministry to the SPD. That would mean that Wolfgang Schaeuble, a Merkel confident who has become a key figure on the international scene for his role in the euro crisis, would lose his job. Joerg Asmussen, currently a member of the European Central Bank's executive board, could replace him, with Schaeuble becoming foreign minister.

The negotiations will be tricky, but possible divergences on the ways to deal with the euro crisis shouldn't be more than a side show. Both parties are pro-European and committed to keeping the monetary union together. The SPD backed Merkel's major moves during crisis. And whatever its reservations, it cannot force Merkel to backtrack on Europe's banking union compromise.

Neither side has an alternative to a grand coalition. Merkel ruled out a minority government and the SPD has rejected a coalition with the radical Left and the Greens. If a deal falls through, new elections would be needed - which everyone wants to avoid. Merkel and the SPD are in this together. They will eventually face up to that fact.

Context News

Germany's Greens decided against any further coalition talks with Angela Merkel's CDU early on Oct. 16. The Conservatives are just five seats short of an absolute majority but lost their preferred coalition partner, the free-market FDP. The chancellor will now have to focus on talks with the centre-left Social Democrats (SPD).

Foreign exchange offers few trends to befriend

16 October 2013

Foreign exchange specialists face challenging times. FX Concepts, once billed as the world's largest currency hedge fund, is winding down its investment management operations. It isn't the only one struggling, and the troubles aren't over yet.

Currency hedge funds have returned only 1.8 percent between January and August, according to Eurekahedge data. That's half as much as those with a wider asset focus, and puts them on track for a second year of underperformance. Such FX funds typically latch on to clear trends, pick up on deviations from what is considered fair value, or enter carry trades which involve borrowing low-yielding currencies to invest in higher-yielding ones.

The difficulty is that there are few big trends on which to hitch a ride. Most major exchange rates are stuck in well-worn ranges. The yen's slide lasted little more than a quarter and sterling's rise lost momentum after a few months. FX funds have sometimes jumped on a move only to find they bought close to the top of the market.

Monetary policy isn't divergent enough to generate big FX swings given interest rates are low across the developed world. And the U.S. government shutdown and debt default risks may delay even the tapering of the Federal Reserve's quantitative easing programme that was expected to buoy the dollar. The prevalence of low rates also reduces the scope for lucrative carry trades between major currencies. Higher interest rates are offered in emerging markets but recent turmoil there has made investors pickier.

Compounding the problem is the absence of an overarching theory of what is driving FX now that markets have become less driven by varying degrees of fear. Correlations are breaking down as quickly as they are established. Moreover, FX volatility has fallen in the past two years. That hobbles more nimble funds that might have been able to profit from big gyrations, and makes life harder for options strategies.

Of course, FX funds aren't the only one feeling the pain. Some of the banks they deal with are also eking out currency trading profits amid fierce competition. A tough environment is likely to mean a greater concentration of market share - and fewer success stories in both camps.

Context News

FX Concepts, once the largest currency hedge fund in the world, said on Oct. 9 that it was winding down its investment management operations because of a flood of withdrawals and poor performance.

Daily turnover in the foreign exchange market averaged $5.3 trillion a day in April 2013, up from $4.0 trillion three years earlier, according to the Bank for International Settlement's triennial survey published on Sept. 5.

Hedge funds specialising in foreign exchange reported returns of 1.8 percent between January and August and 4.87 percent in 2012, according to Eurekahedge data. The return from the broader global hedge funds index was 3.06 percent and 6.59 percent respectively.

Debt deal may encourage Asia's dollar craving

17 October 2013

Washington's last-minute deal on raising the U.S. government's debt ceiling made grim viewing for Asian central banks. It's the second time in two years they have faced anguish over the safety of their enormous U.S. government bond holdings. But even with an agreement to raise the ceiling until Feb. 7, and default averted, the harrowing experience is unlikely to turn America's largest creditor group into a bunch of angry sellers. They may in fact do the opposite, and buy more.

There is precedent for such behaviour. China and Japan, the two biggest holders of U.S. government debt, now own 16 percent more Treasuries than they did during the previous round of sparring over the debt limit during the summer of 2011. A 95 percent jump in the same period in the Treasury ownership of the Caribbean banking centres, where Asian central banks often buy to mask their purchases, suggests financial fragility has only tightened the embrace of the dollar. Asia's biggest eleven economies officially held over $3 trillion of U.S. government securities at the end of July, according to Treasury data.

Asia has a strong motivation for self-insurance. The region's markets still rely on U.S. debt as collateral for trades, and a crisis - say, a missed interest payment - that pushed down the value of government bonds would only increase the volumes needed to back everyday transactions. Although the region's central banks have stitched up an array of currency swaps, they remain small, and would be next to useless if all participants became desperate for dollars at once.

There is still no viable substitute for the dollar. Asia doesn't have a large pool of "safe" assets of its own that are close to cash. Blame it on fiscal rectitude. The region's governments have run conservative budgets since the 1997 financial crisis, so they don't produce enough debt to serve as collateral in private loan contracts. Cross-border trades are especially dollar-dependent. Even highly liquid Japanese government bonds are generally not used to post security.

Asia has cause to grumble again about Republicans and Democrats playing dangerous games of chicken. Chinese politicians have been doing so already, and it must be tempting to sell Treasuries out of sheer indignation. But Uncle Sam's Asian creditors still can't afford to rebel, even if they do have a cause.

Context News

The U.S. Senate and House of Representatives approved a temporary fix to the debt ceiling crisis on Oct. 16, avoiding a possible default on government borrowings.

The deal will enable the government to fund itself until Jan. 15, and raise the debt ceiling - a legislative device limiting the U.S. Treasury's ability to issue national debt - until Feb. 7. It does not resolve fundamental disagreements over spending and deficits that divide Republicans and Democrats.

China's vice finance minister, Zhu Guangyao, urged Washington to "ensure safety of Chinese investments in the United States and the global economic recovery", Reuters reported on Oct. 7. China held $1.3 trillion in U.S. Treasury bonds in July 2013, up from $1.1 trillion three years ago, according to official U.S. estimates.

Japan's Finance Minister Taro Aso warned of a "large international impact" from a potential default of U.S. government debts, Reuters reported on Oct. 8. Japan's holdings have risen to $1.1 trillion, from $817.3 billion in July 2010.

Fitch warned on Oct. 15 that it could cut the sovereign credit rating of the United States from AAA, citing the political brinkmanship over raising the federal debt ceiling. The ratings agency gave itself until the end of the first quarter of 2014 to decide whether it will actually cut the rating.

When will US stop acting like a fat spoiled brat?

17 October 2013

Imagine future historians looking back at the 113th Congress of the United States. They will not judge it kindly. One day when the dollar is no longer the currency of choice for financial transactions around the world, the fictional chroniclers will ask, perhaps as Romans did in the fifth century: how did a nation that had so much going for it manage to squander everything?

The debt ceiling deal of Oct. 16 2013 was when it all began to unravel, the historians will conclude. On this day, Congress temporarily postponed a self-induced battle over whether to pay the creditors of the profligate nation that for decades spent more than it produced. Democrats and Republicans agreed to disagree and end a 16-day shutdown of critical functions of the state, in the hopes they could come to some sort of agreement four months down the road. Naturally, that didn't happen.

America had every reason to resolve its relatively mild fiscal problems back in 2013. The capacity to consolidate financially, with a tiny sacrifice from old folks here, an oversized military complex there and the foregoing of a Ferrari or two amongst the very rich could have balanced the numbers.

After all, the country was experiencing an historic return to energy self-sufficiency, as new deposits of shale gas and oil were unlocked. Its technological innovation was the envy of the world, and U.S. universities the destination of choice for the global elite. Thanks to a pliant central bank and the perceived safety of Washington's IOUs, money was cheap and plentiful. Relative to other rich nations, the American people were young, procreating and willing to accept new immigrants into their communities.

It was the perfect recipe for prosperity, the future historians will sigh. And somehow, it all went wrong. Extremists on either side of every debate created a battle royale. Not just budgets and money, but public health and safety, human rights and freedoms, even whether to help the poor and infirm. Compromise emerged as a dirty word. And Oct. 16 will go down as that disappointing turning point.

Context News

The U.S. Congress on Oct. 16 approved an 11th-hour deal to end a partial government shutdown and pull the world's biggest economy back from the brink of a historic debt default that could have threatened financial calamity.

Capping weeks of political brinkmanship that had unnerved global markets, the Senate and House of Representatives each passed the spending measure after Republicans dropped efforts to link the legislation to changes in President Barack Obama's signature healthcare law.

Obama vowed to sign the bill and begin reopening the government "immediately."

The deal, however, offers only a temporary fix and does not resolve the fundamental issues of spending and deficits that divide Republicans and Democrats. It funds the government until Jan. 15 and raises the debt ceiling until Feb. 7, so Americans face the possibility of another government shutdown early next year.

New ECB liquidity splurge couldn't please them all

17 October 2013

In the crisis of late 2011 and 2012, the European Central Bank pumped over a trillion euros of three-year loans into the zone's banks. Now rumours are rife of a new liquidity injection. But opinions vary over why and when it would be needed – and what form it would take.

There is a reason for the talk. As the old loans draw closer to maturity, banks repay the ECB and borrow in money markets. That will push up rates in the euro zone, crimping a fragile recovery. Excess liquidity (the surplus of funds that banks draw from the ECB on top of reserve requirements) has fallen from nearly 800 billion euros in March 2012 to just above 200 billion euros. Markets become more volatile as excess liquidity shrinks, with a crunch point likely at the 100-billion-euro level.

A move similar to the 2011 and 2012 "longer-term refinancing operations" is unlikely to have the same bazooka effect. It wouldn't need to be as long or as big. Moreover, the "asset quality review" and stress tests next year are supposed to mean lenders don't need central bank funding. There are simpler ways of tackling falling liquidity, like lowering reserves.

Another idea is doing the rounds: a measure targeting borrowers starved of credit, like small companies in southern Europe. That would address the problem of fragmentation in euro zone borrowing rates, and deflect criticism that banks use LTROs to speculate on government debt. It would probably need to be long-dated, matching the new loans. The snag is that, with stress tests looming, weaker banks may not lend.

The ECB could also want to use the liquidity weapon to reinforce its "forward guidance", the communication tool it started using to counter the effects of rising U.S. rates. That would probably require a fixed-rate, very large injection; a bold move for a central bank that favours ambiguity, and controversial if used again to buy sovereign debt. It's probably a last resort if the euro zone faced deflation.

Any ECB move would involve a tricky balance of timing, structure and collateral. Small wonder its President Mario Draghi isn't saying much. He may be hoping that with the economy in slow recovery, the days of crisis intervention are over.

Context News

Mario Draghi, the president of the European Central Bank, reiterated on Oct. 2 his readiness to use longer-term refinancing operations to counter the threat of rising money market rates.

"We are ready to use all available instruments, including an LTRO (longer-term refinancing operation), to ensure that developments in short-term money market rates are in line with our medium-term assessment of price stability," Draghi said at the ECB's monthly press conference.

"We have a vast array of instruments to this end and we do not rule out any options in order to do what is needed in the most appropriate way."

LTROs are the longer-dated repurchase operation through which the ECB conducts monetary policy, typically one or three months. In 2011 and 2012 it used two three-year LTROs for the first time.

Europe starts to see the light on “dark pools”

17 October 2013

Europe is starting to see the light on dark pools. These shadowy sounding entities, which allow investors to conduct trades away from the exposure of mainstream exchanges, have tended to be viewed with suspicion by policymakers who equate opacity with market risk. But there are signs regulators are wising up.

Dark pools can save investors money. Consider a global pension fund that needs to buy a large slug of stock. The fund could execute that order on a stock exchange, or via a dark pool operated by a bank or marketplace like Liquidnet or Turquoise. On an exchange, a high-frequency trader might spot the order and skew the price by bidding up the stock. In a dark pool, outsiders only find out afterwards, and pension fund members get a better deal.

The snag is that too much dark-pool trading means less liquidity on the traditional stock exchanges. In the United States, dark pools account for roughly a third of all equity trades by volume, according to brokerage Rosenblatt Securities. At that level, though the evidence is patchy, trading on conventional exchanges could become more volatile, and less safe.

That doesn’t seem a near-term risk in Europe: although dark pool trading has doubled in two years, it’s still only 6 percent of the total, Thomson Reuters and Markit data show. It’s also why a crude cap on the volume of dark pool trades, as some have proposed, sounds excessive. A better proposal from the European parliament would prevent dark pool operators from transacting unless they offer a superior price to that on an exchange.

This new “price improvement” rule has been road-tested in Australia and Canada, with some success. And a system overhaul is in any case overdue. The current rules often allow stock exchange users to avoid disclosing some details of high-volume transactions at all, market participants say.

It would be better if dark pools were also limited in their ability to offer smaller sized trades: academic research suggests that prices on traditional stock exchanges suffer as the average size of transactions executed in dark pools falls. Still, the current reforms suggest regulators aren’t groping around blindly.

Context News

The volume of equities trading in Europe conducted on private platforms known as “dark pools” rose for the fifth consecutive month in September, and accounted for 6 percent of all share trades in the region, Thomson Reuters and Markit data show.

Dark pool trading constituted 3 percent of European share volume two years ago.

The European parliament has proposed a rule prohibiting dark pool trading unless it can be done at a better price than that available on traditional exchanges, Financial News reported on Oct. 15, citing a draft parliament paper published on Oct. 11.

This so-called price improvement rule has been backed by a coalition of 16 firms and trade associations, including the London Stock Exchange, the Association for Financial Markets in Europe and several asset managers.

The draft paper also advocates combining that curb with another rule that would prioritise on-exchange orders over dark pool transactions.

Research by academics Carole Comerton-Forde and Talis Putnins shows that when the average size of transactions executed in dark pools falls, prices on traditional stock exchanges suffer.

OPEC's past 40 years suggest less powerful future

17 October 2013

It is four decades to the day since the Organization of the Petroleum Exporting Countries cut off supplies to Western nations. The resulting economic damage proved that the cartel of oil exporters was a force to be reckoned with in global politics. But 40 years later, the club's nations have failed to use their oil wealth to create diverse economies or solid democracies. Meanwhile profligate spending has left many member states reliant on high oil prices, inviting competition.

If judged solely by its ability to keep prices high, OPEC has had many successes. The cartel's willingness to lower output – led by kingpin Saudi Arabia - helped support crude prices in the early 1980s and after the 1997 Asian financial crisis. Even now, the 12-nation club can claim some credit for ensuring that a barrel of oil costs over $100, three times more than a decade ago.

Still, this is no great achievement considering that the group sits on some 80 percent of the world's oil reserves. The club's defects, by contrast, are far more notable. Indeed, the lack of popular legitimacy of many OPEC member governments has created a vicious cycle that is undermining the cartel's influence.

OPEC has most heft when its members can afford to act collectively by cutting production to buoy prices. That is no longer the case for the likes of Venezuela or Iran, which need every drop of oil to fund government spending aimed at placating domestic opponents. Even Saudi Arabia, which boosted state outlays by $130 billion in the wake of the 2011 Arab Spring protests, now gets uncomfortable when oil drops much below $100 a barrel.

Such elevated prices have fostered the development of shale drilling technology, tar sands development and deep-sea exploration, causing a surge of production in non-OPEC nations like the United States and Canada. That in turn weakens the ability of the cartel to throw its weight around in the market or global politics.

There seems little chance of OPEC pulling out of this spiral. The group has failed to produce a single success story like Norway or Chile, both of which used mineral wealth to build more diverse economies and stable democracies. Instead OPEC provides some of the scariest examples of the resource curse. Forty years after the embargo it seems clear that the cartel's members have misused their power along with their oil wealth.

Context News

On Oct. 17, 1973, the Arab oil exporters announced an embargo on Western countries.

The move by the Organization of the Petroleum Exporting Countries was in response to military support from the United States for Israel in the Yom Kippur war.

The 12 OPEC nations, now including Saudi Arabia, Iran and Venezuela, claim 81 percent of the world's crude oil reserves.

China loan to Argentina looks economically foolish

17 October 2013

China may lend $10 billion to Argentina. It's hard to see how it could justify doing so based on any strictly economic rationale. Argentina's price data have been screwy since 2007, and its GDP and payments figures look funny now as well. China may lend money to plug the gaps, but since collateral will be tough to find and economic information unreliable, it would have to be a mostly political gesture.

As previous lending to Ecuador has shown, China is quite prepared to lend to economically unsophisticated and often anti-American regimes as a means of gaining greater access to scarce natural resources. So long as the loans can be secured against commodity shipments, it may make good economic sense.

Argentina qualifies politically and as a major producer of commodities, but security for a $10 billion loan would be difficult to obtain. That's because the producers of grain and soybeans, Argentina's principal exports of interest to China, are in the private sector. Their output is not, at least without sacrificing the rule of law, available to the state. Given President Cristina Fernandez's political proclivities, nationalization is possible, but the inevitable economic chaos wouldn't help Argentina's cash flow issues.

Those problems are real, but puzzling. For instance, the unofficial "blue dollar" is selling at a 67 percent premium to the official rate, indicating a severe shortage of foreign exchange. These reserves have fallen 20 percent this year, according to preliminary data released on Oct. 11. At the same time, Argentina's current account balance, by official figures, was in modest surplus in 2013's second quarter, the latest data available.

That suggests that official balance of payments data may be in error, as official price data have been since 2007, with private estimates of inflation running around 25 percent annually compared to the official figure of 10.5 percent year-on-year in September.

Similarly on the GDP data front, the budget passed on Oct. 9 by Argentina's Congress assumed 6.2 percent growth in 2014 after 5.1 percent this year, but private forecasters suggest output growth is running at closer to 3 percent. This discrepancy could cost real money, since a higher reported economic growth rate would force higher payments on Argentina's substantial outstanding GDP-linked debt.

With no direct security to collateralize its loans, and questionable official statistics, writing a $10 billion check to Argentina seems economically foolish.

Context News

China is negotiating a $10 billion loan with the central bank of Argentina, according to Argentine newspaper reports.

While the official exchange rate on Oct. 17 was 5.82 pesos to the dollar, the unofficial "blue dollar" rate was 9.73, according to the Buenos Aires Herald.

Argentina's foreign exchange reserves have fallen by 20.3 percent this year to $34.5 billion, according to preliminary data released on Oct. 11.

Argentina's current account surplus was $650 million in the second quarter of 2013, according to official statistics.

De-Americanized world economy is a long way off

18 October 2013

Even a deeply dysfunctional United States will only marginally lessen its excessive global influence on its own. A fully "de-Americanized world," as demanded by China's official Xinhua news agency this week, would require international effort.

Political brinkmanship over U.S. borrowing, resolved only at the last moment and even then only temporarily, was the ostensible trigger for China's railing. In the background was another worry – the destabilizing global impact of Federal Reserve policy targeted largely at the domestic economy.

A de-Americanized world is a long way off. True, Washington's antics slightly diminish the aura surrounding the U.S. dollar and Treasury bonds. Recent military exploits, the financial crisis and heavy-handed actions in the name of national security have hurt America's image too. But the United States remains the world's biggest economy. Treasuries – some $5.6 trillion of which are held by foreign investors – are the most important debt securities. The dollar remains the world's reserve currency. For all the scorn heaped on Washington, America's freedoms and wealth – key elements in U.S. soft power – still serve as a beacon for migrants.

Officials elsewhere could act to speed de-Americanization. China's GDP, at $8.4 trillion last year, was more than half the size of America's output in 2012, against barely a quarter five years earlier. If the People's Republic, and other nations, can convert this changing balance into economic clout and greater soft power, things will start to change.

Keeping their economies healthy by avoiding big deficits would be a start. Efforts to promote other currencies will take time, especially as China wants to retain tight control over the renminbi. But hoarders of foreign reserves could focus more on cash and bonds denominated in yen, euros, Swiss francs and sterling. Longer-term initiatives should include building domestic capital markets and investing prudently in fellow developing economies.

Xinhua's wish list, although broadly a political attack, also justifiably includes giving emerging nations more say in supranationals like the World Bank and the International Monetary Fund. If the United States agreed, that would probably also show a willingness to engage more constructively with China in global affairs.

De-Americanization along these lines will be slow. The outcome – more evenly shared influence and economic heft – is worth the wait.

Context News

In a commentary dated Oct. 13 as U.S. lawmakers grappled with a government shutdown, official Chinese news agency Xinhua said: "… It is perhaps a good time for the befuddled world to start considering building a de-Americanized world."