Issue

18

OCTOBER 2012

Eighteenth Issue

INTERNATIONAL ASSOCIATION OF FINANCIAL EXECUTIVES INSTITUTES

IAFEI Quarterly

The electronic professional journal of IAFEI
(International Association of Financial Executives Institutes)

October 24, 2012, www.iafei.org

Table of Contents

Please turn over

The Philippines, Article: **Hall of shame: D. Kozlowski**
By Billy Cortez, Commentator Market Monitor, Business World, Monday, October 15, 2012, Philippines, article provided by Finex, the Philippines IAFEI member institute

The Philippines, Article: **Building Networks for Finance Professionals**
By Dr. Conchita L. Manabat, Finex, the Philippines IAFEI member institute, October 2012

UK, Article: **Fancy a Spin with a Convertible ?**
It is essential to get your timing right when you issue this type of bond.
By Mark Dalton, founder of Conv-Ex, an independent advisory firm specializing in convertibles and equity derivatives, from The Treasurer**,** October 2012**,** ACT, UK

UK, Article: **When Business Cycles Go Awol**
The politicization of risk may be damaging investor confidence.
By David Bowers, director at Absolute Research Strategy, from The Treasurer, September 2012, ACT, UK

UK, Article: **Beware the Investment Desert**
It is not the assets that you think are risky, but the ones you believe are Safe.
By David Bowers, director at Absolute Research Strategy, from The Treasurer**,** October 2012**,** ACT, UK

USA, Interview: **“ The Central Banks Make Me Afraid “**
Interview with Mohamed El – Erian, head of the world`s largest bond investor **Pimco**. He regards Europe as a barrel of shooting powder. Investors are in great danger. By **Dennis Kremer,** from Frankfurter Allgemeine Sonntagszeitung, September 23, 2012

USA, article: **US Fiscal Cliff**
The winner of the next month`s presidential election has to prevent huge fiscal contraction in the US
By Jeremy Warner, assistant editor of The Daily Telegraph and one Of Britain`s leading business and economics commentators, from The Treasurer**,** October 2012**,** ACT, UK

IAFEI News

Letter of the Editor **October 24, 2012**

Dear Financial Executive,

You receive the **IAFEI Quarterly XVIII th Issue**.

This is another issue of the electronic professional journal of IAFEI, the International Association of Financial Executives Institutes. This journal, other than the IAFEI Website, is the internal ongoing information tool of our association, destined to reach the desk of each financial executive, or reach him, her otherwise, at the discretion of the national IAFEI member institutes.

This issue again offers a broad range of articles on financial subjects.

China, more than ever, is the growth engine of the world economy, and thus we include an article on the China growth prospects.

Mexico, is where IAFEI is going to have its World Congress next month, November 14 to 17, 2012. We include an article on the present state of Mexico and its economy.

The **Euro**, is a most complex and unprecedented currency. We include an article on how the Eurosystem is functioning.

And **all other articles** of this issue have their distinct merits as well. Enjoy the reading.

Once again:

I repeat our ongoing invitation to IAFEI member institutes, and to their members, to send us articles for inclusion in future IAFEI Quarterlies, and to also send to us your suggestions for improvements.

With best personal regards Helmut Schnabel

Helmut Schnabel

Belgium, Article: Why Eurobonds are Un-American

By Daniel Gros, director of the Center for European Policy Studies, Brussels, Belgium, August 2012

The emerging consensus in Europe nowadays is that only “debt mutualization” in the form of Eurobonds can resolve the euro crisis. But a closer look reveals that this early US experience provides neither a useful analogy nor an encouraging precedent for Eurobonds.

Advocates of Eurobonds frequently cite the early United States, when Alexander Hamilton, President George Washington’s treasury secretary, successfully pressed the new federal government to assume the Revolutionary War debts of America’s states. But there are several reasons why this comparison has shortcomings.

First, taking over a stock of existing state debt at the federal level is very different from allowing individual member states to issue bonds with “joint and several” liability underwritten by all member states collectively. Hamilton did not have to worry about moral hazard, because the federal government did not guarantee any new debt incurred by the states.

Second, it is seldom mentioned that US federal debt at the time (around $40 million) was much larger than that of the states (about $18 million). Thus, state debt was not central to the success of post-war financial stabilization in the new country; rather, it was a natural corollary of the fact that most of the debt had been incurred fighting for a common cause.

Moreover, the most efficient sources of government revenues at the time were tariffs and taxes collected at the external border. Even from an efficiency point of view, it made sense to have the federal government service public debt.

Federal assumption of the states’ war debts also yielded an advantage in terms of economic development: once states no longer had any debt, they had no need to raise any revenues through direct taxation, which might have impeded the growth of America’s internal market. Indeed, after the federal government assumed the states’ debt (already a small part of the total), state revenues fell by 80-90%. The states then became for some time fiscally irrelevant.

Finally, the key to the success of financial stabilization was a profound restructuring. Hamilton estimated that the federal government could raise enough revenues to pay approximately 4% interest on the total amount of debt to be serviced – significantly less than the 6% yield on the existing obligations.

Holders of both state and federal bonds were thus offered a basket of long-dated bonds, some with an interest rate of 3%, and others with 6 % (with a ten-year grace period). The basket was designed in such a way as to result in an average debt-service cost of 4%. In modern terms, the “net present value” of the total debt (federal and state) was reduced by about one-half if one were to apply the usual exit yield of 9%.

Moreover, the very long maturities of the new federal bonds meant that there was no rollover risk. It would have been very dangerous to expose the federal government to this danger, given that the operation was rightly perceived at the outset as extremely risky.

For the country’s first few years, debt service swallowed more than 80% of all federal revenues. The slightest negative shock could have bankrupted the new federal government. Fortunately, the opposite happened: federal revenues tripled under the impact of a rapid post-war reconstruction boom, and continued to grow rapidly, aided by the country’s ability to remain neutral while wars ravaged the European continent.

By contrast, growth prospects in Europe today are rather dim, and interest payments, even for Greece or Italy, account for less than 20% of total revenues. The real problem is the rollover of existing debt in a stagnating economy. For example, Italy will soon have a balanced budget in structural terms, but must still face the problem of refinancing old debt as it matures each year.

Assuaging doubt about the sustainability of public debt in the eurozone would thus probably require a deep restructuring as well. The eurozone crisis could certainly be resolved if all existing public debt were transformed into 20-year Eurobonds with a yield of 3%, and a five-year grace period on debt service. One can easily anticipate the impact that this would have on financial markets.

More interesting for the current situation in the eurozone is what followed about a half-century after Hamilton acted. In the 1830's and 1840's, a number of states had over-invested in the leading transport technology of the time – canals. When the canal-building boom ended, eight states and the Territory of Florida (accounting for about 10% of the entire US population at the time) were unable to service their debt and defaulted on their mostly British loans.

British bankers threatened that they would never again invest in these untrustworthy Americans. They could point to the precedent set by Hamilton, and had probably invested on the implicit understanding that, if necessary, the federal government would bail out the states again.

But, despite foreign creditors' threats, the federal government did not come to the rescue. The bailout request did not succeed because it could not muster a simple majority of the states (represented by the Senate) and the population (represented by the House of Representatives) under the normal decision-making procedure (the "Community method," in European Union jargon).

The defaults proved to be costly. The 1840s were a period of slow growth, and continued pressure from foreign creditors forced most of the official debtors to resume payments after a while. Default was not an easy way out, and all US states (with the exception of Vermont) have since embraced balanced-budget amendments to their constitutions as a way to shore up their fiscal credibility. Are EU members prepared to take a similar step?

China, Country Report: Support of Growth has Priority

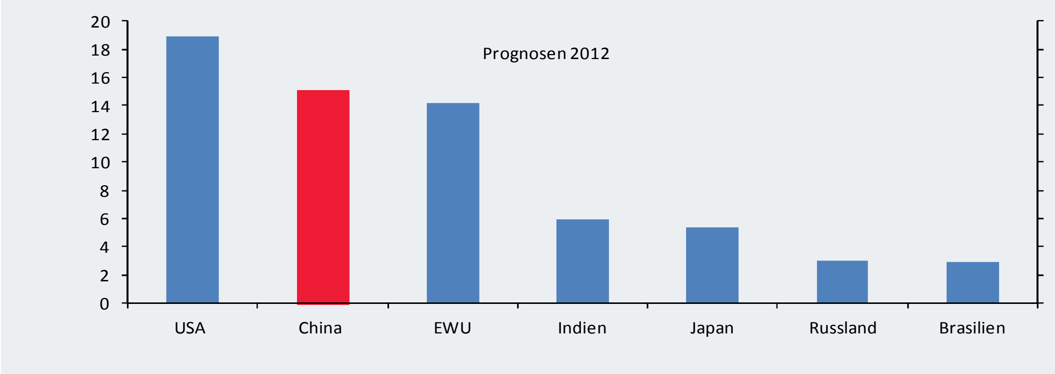
By Viola Julien, Macroeconomic Research Helaba, October 24, 2012, Landesbank Hessen Thüringen, Germany

The global growth weakness is weighing since the autumn 2011 on China´s export industry, and therefore the Chinese political leadership is acting on supporting the economic activity and the business cycle. Although the monetary and fiscal political stimulus measures might not reach the same degree like at the times of the global financial crisis 2008/2009, first successes are visible in the meantime. For China, though, the present phase is also a possibility, to steer towards the objectives of the newest Five Year Plan. A controlled cooling down of growth and a more sustainable economic model are thereby being pursued. Also the wories about a renewed increase of the inflation are working for a level headed policy.

China has gone, during the past decades, through an impressive development. Annual growth rates significantly above the 10 % mark have not been an exception .Since long, China has overtaken Japan as the second largest world economy, and in the present year the Chinese share of the global GDP (as measured by purchasing power parity) shall probably be greater than that of the Euro area. Because of the strong international trade interrelationships, China has advanced to be the motor of the global business cycle. If this motor is stuttering, then the world economy is feeling the effects. For this reason, China is increasingly looked at with worry, because the economic growth has weakened continuously in the past quarters. In the first six months of the current year, the GDP growth sank to 7,9 % versus the preceding year, and for the third quarter with a growth rate of the GDP of 7,4 % the lowest rate since three years is in the books. The decreasing annual growth rate is, however, distorting the view on the latest dynamics of growth. Here is to be seen, that the bottom point has already been reached in the first quarter 2012, and that the growth rate on a quarterly comparison has since advanced from revised 1,5 % to 2,2 % in the third quarter.

Share of World GDP, Forecast 2012

% %



Source: EIU, Helaba, Macroeconomic Research

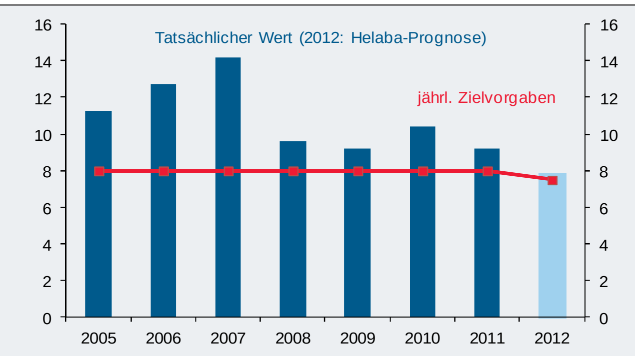
With a view to the objectives in the present five year plan (2011 to 2015), lower growth rates have indeed to be viewed as a step into the right direction. The government is aiming at creating a more sustainable growth model. The earlier strategy, which provided to the country, in the past years and again and again, growth rates in the double digit range, is founded essentially on exports and on investments. This has proven to be utmost effective, but at the same time it embodies the risk of an economic overheating.

Domestic Consumption Should Boost Growth

Of this problem The Chinese government is well aware of this problem. Prime Minister Wen Jiabao called the growth speed of previous years, lately, as unbalanced, and not able to be maintained. Private consumption, the share of which of GDP has decreased in the past years, shall have more emphasis and become an important pillar of growth.. A more equal distribution of welfare is said to be indispensable for this. The increase of the wages level, already to be observed, but also the loosening of making loans to small and medium sized corporations as well as private individuals, are in our view important steps, in order to attain the goal of a growth which is more driven by the internal domestic economy. At the same time, in the present five year plan, the average growth rate for the years 2011 to 2015 has been set at 7 %. The target rate, set at the beginning of the year for 2012, is 7.5 %. In the past it was evident, however, that the yearly growth targets had to be mostly viewed as absolute low end limits, and that the effective growth rates of GDP have often been significantly higher.

Targets in Previous Years Always Exceeded , red line yearly targets, blue line effective data

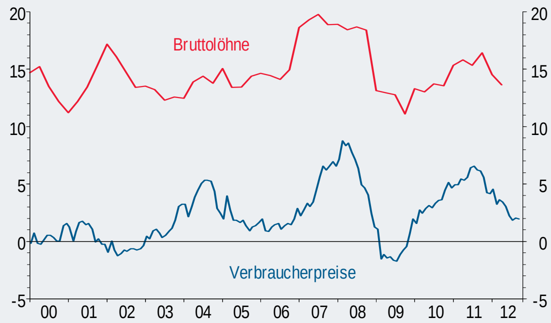
Reales   Real GDP, % versus Previous Year



Quellen: Bloomberg, Helaba Volkswirtschaft/Research

Impressive Wage Increases, red line gross wages, blue line consumer prices

% versus Previous Year



Quellen: Datastream, Helaba Volkswirtschaft/Research

The present situation of the business cycle is characterized by stabilizing business climate and early economic indicators. At first position here have to be named the purchasing manager indices (PMI) in the manufacturing business, which already in the last year sank significantly from the high levels, and which have fallen in the meantime under the 50ies mark. Dramatic declines like in 2008 have so far not been seen, however, and the light increase of the Markit/ HSBC-PMIs in September from 47,6 to 47,9 points allows for hope, that the valley bottom has been left behind. In the services industry, the purchasing manager indices continue to show a widespread not uniform business climate, but they continue to hold up above the expansion threshold. Also at the real economical data like the industrial production or the consumer store sales a bottoming can be recognized. Moderate increases for the Chinese economy in the coming months are indicated in addition the OECD early indicator for China.

People`s Bank of China (PBC, the Chinese Central Bank) and Government: In the meantime more than only a Fine Tuning

Against the background of a slowing dynamic of the business cycle, in the last months a rethinking has taken place at the political leadership, towards supporting and easing measures. A broad stimulus like three years ago - for the fighting against the global economic crisis 2008/ 2009 - is this time, however, not to be expected, because the strong increase of making new loans and the high growth rates of GDP at the time effectuated an increase of the inflation rate, which in the summer of 2011 reached its maximum at 6.5 %.

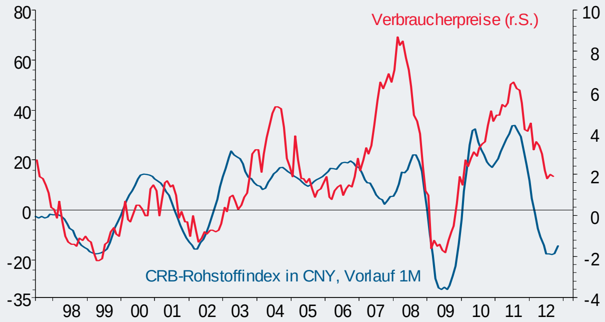
Since the middle of 2011, the support of the economy by the government was limited - also against the background of the development of inflation - to a fiscal policy fine tuning. Since the end of the last year, the Chinese central bank (PBC) has then in addition lowered the minimum reserve requirements. After two key interest rate lowering measures in June and July of this year, the central bank, for the purpose of providing liquidity, has recently only made use of monetary operations - probably also because the fear is great that the inflation may rise again. The latest significant price increases of grain show, though, that this fear is not really unjustified. However, the consumer price inflation at presently 1,9 % is visibly below the tolerance rate of the PBC of 4 % , and also at the preceding business sectors the price pressure has lately decreased. So, the producer prices in September with - 3,6 % showed for the seventh time in a series a negative annual change rate.

In addition to monetary policy steps, projects in the industrial, transport and construction sector as well as capital expenditure for infrastructure should in addition support the economy. The State Commission for Development and Reform authorized, in the first months of the year, significantly more projects than in the previous year period. Obviously, especially investment projects, which had been planned originally for 2013, are now being advanced. Positively to be noted, is however, that the projects shall concentrate more on regions in Western and Central China. So far the economic power of the country is concentrated along the east coast.

First successes of the monetary easing are to be recognized. So the robust development of the personal car sales volume is an indication for a stabilization of the economic dynamics. In addition, in recent months the downside dynamics of the exports to Europe have slowed down, and the exports to the USA, with fluctuations, are increasing further. In the meantime, the trend towards lower growth rates at capital expenditure has ended. This, as well, is an indication for a sustained expansion - and it shows, that the government, in view of the difficult global situation, is setting the focus, presently, clearly on the support of the business cycle, instead of pushing at the new orientation of the growth model,. We expect in the next months further monetary and fiscal measures. The credit expansion in the meantime has to be considered as moderate and not comparable with the year 2009, so that inflationary dangers are being contained. Also the minimum reserve requirements are expected to be further lowered repeatedly in the second half of the year.

Inflation Outlook Leaves Room for Further Interest Rate Lowering Measures, red line consum, prices

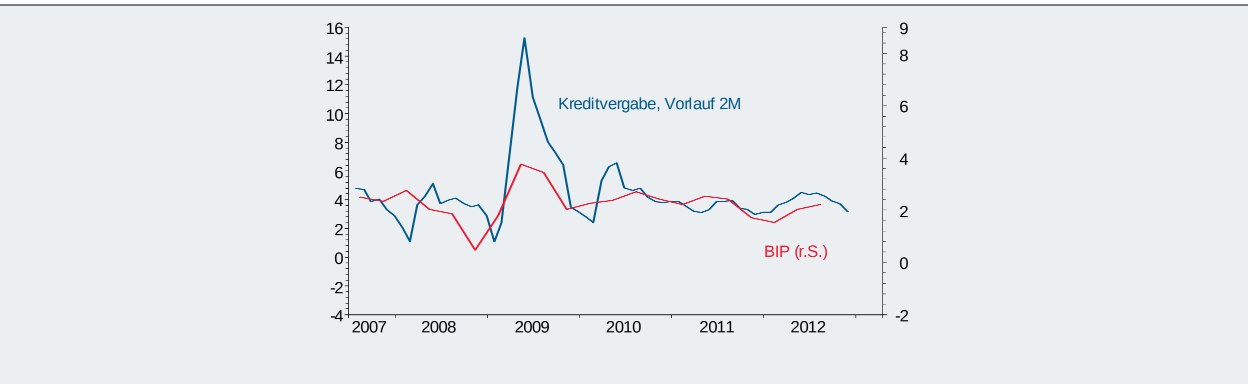
% versus Previous Year, Moving6 Months Average   % versus Previous Year



Quellen: Datastream, Helaba Volkswirtschaft/Research

No Excessive Credit Expansion , blue line, loans made, 2 months anticipated. Red line GDP

% versus Previous Year



Quellen: Datastream, Helaba Volkswirtschaft/Research

Real Estate Market: Normalisation is Starting

China´s real estate market has an extended phase of strength behind itself. In the past years, the house prices have partly increased significantly, especially because of the demand as a consequence of the urbanization process. The billion heavy expansion and stimulating programs, in the fight against the worldwide financial crisis, have additionally pushed the real estate boom. Countless building construction projects have been executed, speculations for value increases pushed the prices further up, the quota of unused real estate increased. For the middle class a home property in the cities became practically unaffordable.

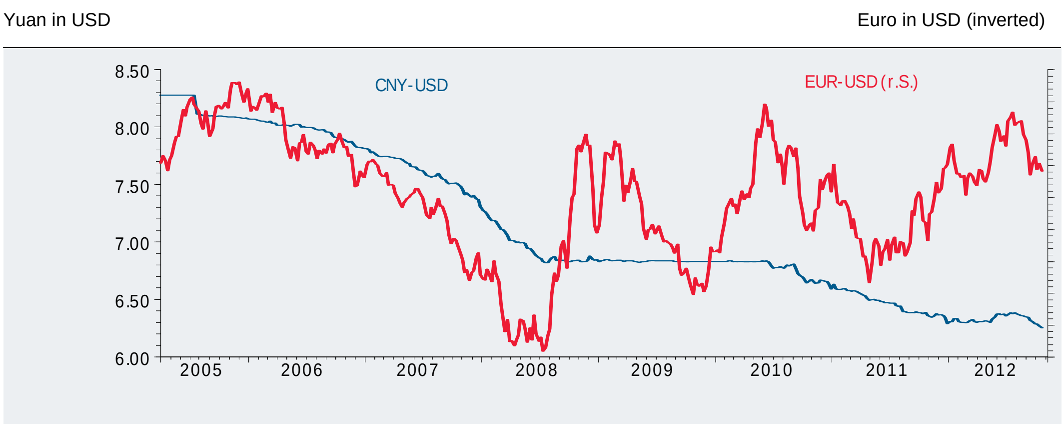
In order to prevent an overheating, the government has introduced various measures in 2010. Among others, the equity requirements for the purchase of homes have been increased up to 50 %, subsidies have been cancelled and tight restrictions relating to the purchase of second homes have been introduced. Also the monetary tightening measures 2010/ 2011 showed effects, by way of making it more difficult to give loans. Since one year, in addition, special taxes for luxury real estate in the cities Shanghai and Chongqing are being levied. At the same time, the government is pushing the construction of affordable homes further - 36 million affordable homes shall be created until 2015.

The restrictive measures have finally shown effects - at the end of 2011 the trend has turned around in the real estate market and the prices started to decrease. Other than the dampening effects of the government measures, it seems to be especially also a correction of the preceding overheating. The price decrease is going on in an orderly way, and signs are on the rise, that the valley bottom will soon have been reached. So the prices for new homes have increased slightly again in June for the first time since ten months. Also the latest key interest rate lowering measures should here contribute to the stabilization. Should this be confirmed in the coming months, then it will have been achieved, to soften the real estate bubble, without taking away an important support of the economy. In order that price speculation remain contained continuously, real estate specific restrictions - as for instance the purchase of second and third homes - might though not be loosened too quickly.

Yuan Reform in Small Steps

As China is having an ever more important role in world trade, there is also the need for reform in the monetary policy. An undervalued currency of the country has brought to China, in the past, high current account surpluses and supported the economic growth. International trade partners - among all especially the USA - are criticizing these export and competitive advantages since long and are requesting a revaluation of the Yuan. The fixed connection with the US Dollar has though been discontinued, since 2005, but especially in crisis times still exchange rate interventions are still being executed, in order to support the economy through export enhancements. So the Chinese central bank kept the USD-CNY-exchange rate stable at 6,80 during the worldwide financial crisis. Since June 2010 then the gradual appreciation continued, and until yearend 2011 the Yuan then advanced by almost 8 %. Since the beginning of the year the USD-CNY has again, with fluctuations, revalued further from 6,30 to presently 6,25.

Yuan-Revaluation at last again somewhat more dynamic



Sources: Datastream, Helaba Volkswirtschaft/Research

Still though, China has made the Yuan more flexible lately, by way of allowing it to fluctuate instead of + / - 0.5 % now in a range of + / - 1.0 % around a basket of currencies. However the reference rate is still being set daily by the PBC vis a vis the US dollar. Hence despite the latest measures, the Yuan remains not freely convertible. To expose it further to the market forces, though, will be for China a further step towards the self-set target, to have a freely convertible currency until 2015, and to establish it as a reserve currency. The way to there is still far, though. For the reform of the growth model, part of which is the stimulus for domestic consumption, a strong home currency is indispensable. The trend for a revaluation of the Yuan will therefore probably continue in the medium term, although in a less dynamic way than in 2011. At the yearend we regard an exchange rate of 6.20 to 6.25 USD-CNY as possible.

New Dynamic in the Coming Months

It has to be taken note of, that China has already taken important steps, to executing a new economic orientation. The difficult economic environment, though, has slowed down this process and has turned the focus of the government towards supporting the business cycle. We expect, that in the coming months further growth stimulating measures shall be taken. The Chinese business cycle should therefore gain more steam and dynamics. In order to achieve the ambitious targets of the Five Year Plan, and in order to opening up a sustainable path for growth, from which a broad spectrum of the population shall benefit, further structural reforms are necessary. To continue on this way will be the job of the new political leadership, which will take office in the spring of the coming year.

Economic Data China

		2010	2011	2012p	2013p
Gross Domestic Product Growth	%. real	10,4	9,2	7,9	8,4
Population	Mio.	1.341,0	1.348,0	1.354,0	1.360,0
Unemployment Rate	%	6,1	6,5	6,6	6,5
Government Budget Balance	%GDP	-1,6	-1,8	-3,1	-2,6
Inflations Rate	%	3,3	5,3	3,0	3,5
Current Account Balance	%GDP	5,2	4,0	3,3	2,8

Sources:EIU,OECD,Helaba Macroecon./Research

Europe, Article: Scrambled Eggs and the Eurosystem

By Payden&Rygel, Los Angeles, California, USA, Second Quarter 2012 Point of View, Our Perspective on Issues Affecting Global Financial Markets

The euro is like a plate of scrambled eggs. Let us explain.

Once scrambled, we find it impossible to unscramble eggs. Physicists call this process entropy. It is the idea that some processes are irreversible. The euro zone's common currency, the euro, is a bit like that.

And for this reason—despite all the headlines about emergency summits, bank runs, capital flight and rumored country exits from the currency union—the eurosystem remains together. A brief tour of the monetary system blueprint may help elucidate the true nature of the problems faced by the euro area.

IMAGINE THERE IS NO EURO (IT IS EASY IF YOU TRY)

To begin, let us pose a counterfactual situation: imagine the euro never existed. Now, in our world without the euro, imagine that concerns regarding the solvency of Greek banks boil to the surface. Greek depositors and foreign investors alike "jog" to the banks to withdraw funds or initiate electronic transfers across borders.

At first, this process is smooth and orderly. The central bank of Greece maintains a stock of foreign exchange (FX) reserves to facilitate cross-border transfers because depositors and investors want deutschmarks or dollars, not drachmas. But, say the "jog" turns into a "run." What then?

In that case, one of two things occurs. First, if Greece maintains a currency peg to the German deutschmark, a bank run will deplete the central bank's FX reserves (the central bank of Greece can not "print deutschmarks"). Instead of honoring the hypothetical 5:1 official exchange rate (drachmas to deutschmarks), the central bank can now manage only a 10:1 exchange rate. In market jargon, the central bank "devalues" or "depreciates" or "depegs" the domestic currency. In reality, market forces overwhelm the currency regime and the central bank faces up to actual market levels.

Or, in the second case, if Greece already maintains a floating rate currency regime, the drachma weakens on the foreign exchange market as everyone sells drachmas to buy deutschmarks. It is important to note that in this arrangement, both sides (e.g. Greece and Germany) lose—foreign investors take a hit as the value of the currency in which they have invested declines.

Here is the problem: if depositors and investors want to sell the drachma for dollars or deutschmarks, the Greek central bank needs a stock of FX reserves—and it may run out or revalue its own currency.

Did you know?
The TARGET2 system replaced its predecessor system, Target, in 2007. The original system debuted in 1999.

Facts:

Handles 91% of all large-value euro payments

Nearly 350,000 average daily transactions in 2011, with average daily volume of EUR2.4 trillion, which is approximately 25% of euro area gross domestic product (GDP)

ECB acts as the central counterparty to each transaction (i.e. the ECB is the buyer for every seller and the seller for every buyer)

At the end of each day, each NBC has a net position vis-à-vis the ECB, not against other national central banks across Europe

Source: European Central Bank

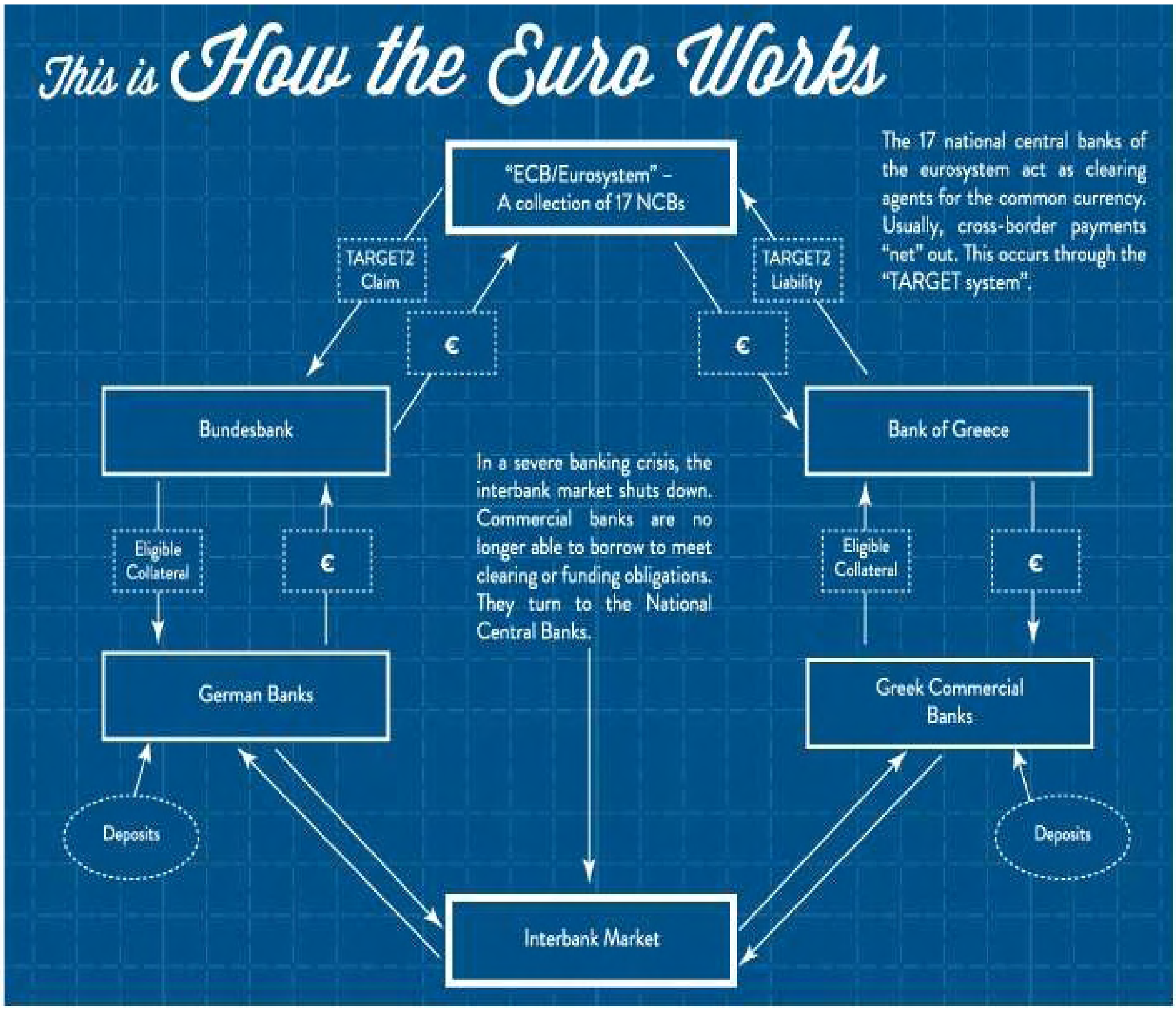
THE BLUEPRINT OF THE EUROSYSTEM

A monetary union solves the foreign exchange reserves "problem." How? In short, by eliminating the need for FX reserves.

In effect, the "euro" is not just the pretty piece of paper we hold in our wallets; it is an agreement among 17 national central banks (NCBs) to clear payments at par in euros. The eurosystem stands ready to honor any money or deposit in any eurozone country as if it were one country.

How does it work? On any given day, money is flowing two-ways, facilitated in real-time by the **T**rans-**E**uropean **A**utomated **R**eal-time **G**ross **S**ettlement **E**xpress **T**ransfer System – TARGET2. If a Greek consumer writes a check for a German BMW, the check deposited in a German bank is cleared through the eurosystem. Then, the car dealer's account is credited by the German central bank and funds are deducted from the Greek banks balance at the Greek central bank (**See "This Is How the Euro Works" on the previous page**).

What if the Greek bank has insufficient funds? As illustrated above, banks meet any shortfalls by holding a stock of settlement balances at the ECB, borrowing settlement balances in the private interbank market or borrowing directly from the ECB. Banks within each country access funding from their respective national central banks (NCBs) in the form of the longer-term refinancing operations (LTROs) and the Main Refinancing Operations (MROs).



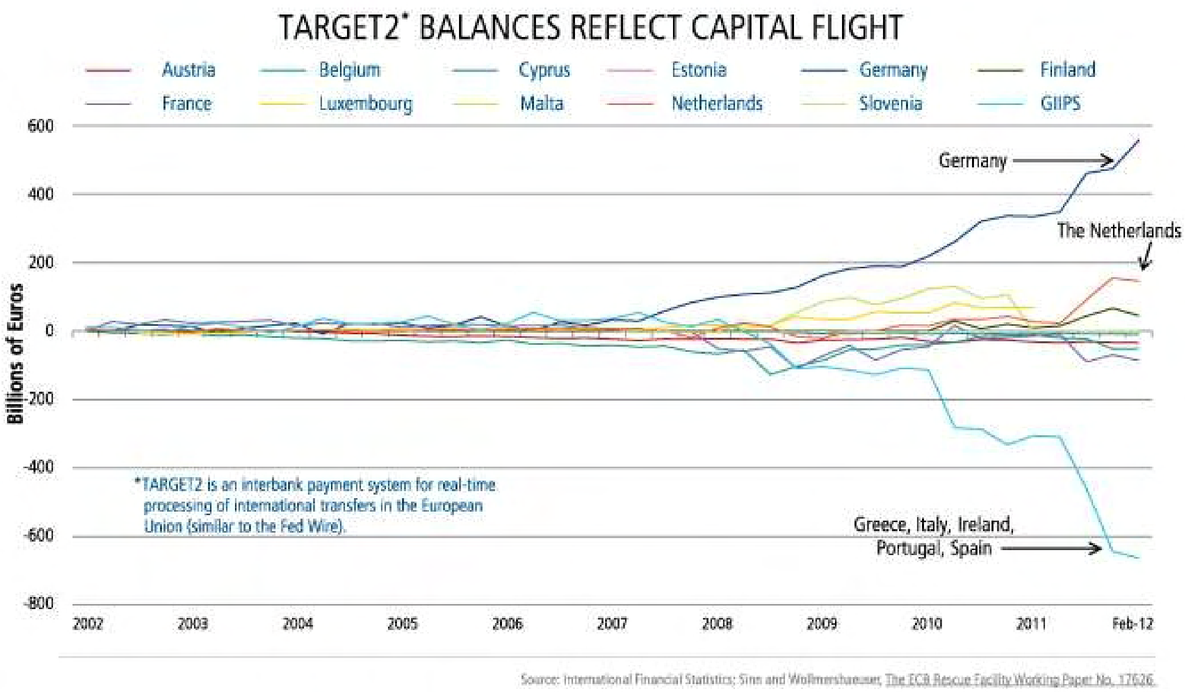
EUROSYSTEM AS THE "MARKET MAKER OF LAST RESORT"

This hypothetical is reality today. By mid-2012, banks were borrowing EUR 1.4 trillion from the ECB in MRO & LTRO. In short, the crisis is a breakdown in the cross border interbank market.

Despite the best intentions of the eurosystem architects to eliminate the need to worry about balance of payments and FX problems, capital flight has followed the bust anyway. The pressures simply show up in different ways.

That means that instead of running down foreign exchange reserves to finance cross border capital flight, the central bank experiencing outflows accrues liabilities to the rest of eurosystem. Instead of seeing a depreciation of the exchange rate between, say, the Greek drachma and the German deutschmark, we see a rise in TARGET2 imbalances (**See Figure 1**). The eurosystem shoulders the liquidity problem.

Figure 1



Under the arrangement explained above, the linchpin in the entire system is the "collateral" posted by banks to their respective NCBs[1]. These much-talked about TARGET2 claims (think IOUs) are not collateralized but they do require payment at the refinance rate (currently 0.75%). The ECB collects the interest payment from the Greek central bank and passes it along to the German central bank. In effect, each deficit NCB has a claim or liability to the eurosystem as a whole.

HOW TO UNSCRAMBLE: THE CHALLENGES TO EXIT

It is important to note that both Greece and Germany benefit from this currency arrangement. How?

The eurosystem facilitates a transfer of credit risk from the private sector (interbank market) to the balance sheet of the eurosystem (the NCBs).

Instead of a German investor or bank facing losses on a Greek bank account, the eurosystem now stands in the middle accepting the credit risk and providing liquidity as the market maker of last resort. Because TARGET2 claims are ultimately backed by the eurosystem balance sheet, the collateral posted for MRO and LTRO is important. The willingness of the eurosystem to absorb this collateral is the "survival constraint" of the eurosystem itself.

This also helps answer the oft-asked question: why has not Greece already abandoned the euro or been ushered to the door? Despite the media hype, both sides benefit from the arrangement. Thinking back to our counterfactual example where there was no monetary union, Germans would have experienced losses on cross border investments and deposits, while Greek currency holders and depositors would have experienced a decline in the value of their holdings.

As a result, both parties are stuck, leaving no easy exit for Greece or any member of the currency union. None of this is to say that it can not happen—that Greece can not leave the euro. Of course, the technological or mechanical requirement of printing new drachmas (e.g., printing presses) is not the issue. The issue is acceptability. How does a newly-issued, fiat currency obtain purchasing power? Money does not attain value because the sovereign says it should be valued. Money is an evolutionary product. It evolved to have purchasing power over time. Historically, in order to launch a new fiat currency, three critical components were required[3] :

a) The new currency would be pegged at a fixed-rate to an existing, stable, widely held money (e.g., the dollar, the euro, gold or silver)

b) The State would demand payment of taxes in only that currency (creating artificial demand),

c) The State would attempt to curtail the use of competing currencies (eliminate competing options and in this case try to prevent the euro from circulating)

Further, the avenue of currency devaluation put forth by academic economists is far too simplistic, particularly for the case of Greece.[2] In the best case scenario for currency devaluation export activity rises (a devalued currency means foreigners can buy more of your goods and services). At the same time, though, the weaker currency results in a decline in purchasing power for currency holders, particularly in a small, more imported-oriented economy. A new drachma would likely be pegged to the euro—so everyone would know the euro-price of goods and services, wages and costs.

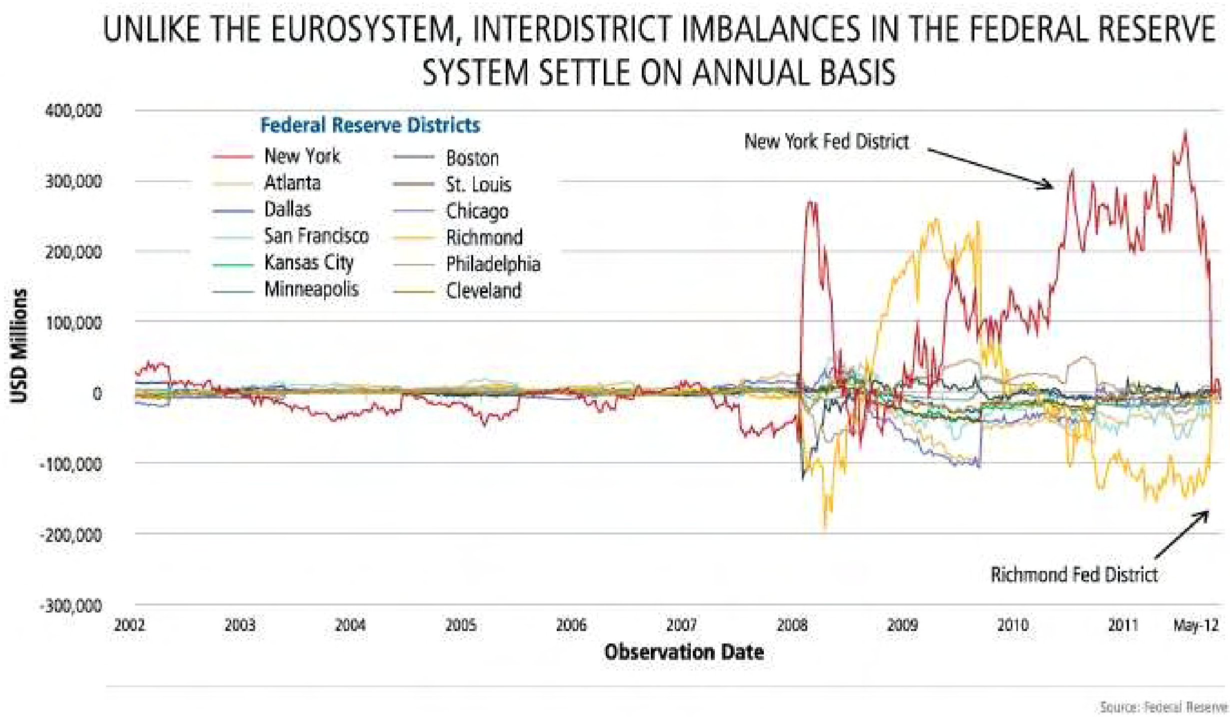
The incentives for Greece to leave are unclear, the challenges underestimated.

Did you know: Inter District Settlement Balances

An astute reader may wonder, does the US Federal Reserve System work in a similar fashion to the eurosystem (see Figure 2)? Do transfers between, say, the New York Federal Reserve District and the San Francisco Federal Reserve District net out. Yes, but with two key differences.

First, every April the Federal Reserve System "settles" clearing balances with a transfer of US Treasury securities (in the "old days" it was conducted with a transfer of gold certificates). Second, the Federal Reserve System regional reserve banks are owned by banks with equity capital, NOT by, say, the State of California or the State of New York. This is a critical consideration, since the State of California's budget deficit is not a material economic issue for the banking system nor is the state of the banks in California a direct problem for the State of California's finances. Meanwhile, in Spain the sovereign is intertwined with the banking system.

Figure 2



STUCK—FOR NOW

The advent of the euro “solved” the foreign exchange reserves problem by creating a new one: the agreement to settle at par in a new, common currency. Now, instead of worries about depleting FX reserves during a run, the essential concern for the euro banking system (in particular the NCBs) is the availability and acceptance of euro-denominated collateral by the eurosystem. Unscrambling this system is difficult as banks in much of the euro area remain dependent on central bank borrowing to fund themselves. Further, re-launching a former domestic fiat currency is a challenge and may not provide the economic boost ascribed by many economic prophets.

In reality though, the eurosystem is not nearly as “irreversible” a process as a plate of scrambled eggs, but understanding the unique, intricate nature of the eurosystem goes a long way to explaining why it is still together in the face of unprecedented challenges.

SOURCES

1 Buiter, Willem F., Sibert, Anne C., “How the Eurosystem’s Treatment of Collateral in its Open Market Operations Weakens Fiscal Discipline in the Eurozone (And What To Do About It), Working Paper, 3 December 2005.

2 Worrell, DeLisle, “Small Open Economies Have to Be Managed Differently: Devaluation is Contractionary in Both the Short and Long Run,” VOX, 23 June 2012.

3 Selgin, George, “On Ensuring the Acceptability of a New Fiat Money,” Journal of Money, Credit, and Banking, Vol. 26, No. 4 (November 1994).

Germany, Article:

The Seed of Future Misfortune

A financial crisis-prophet warns of the side effects of the ultra-loose monetary policy

By Patrick Welter, The Sunday Economist, Frankfurter Allgemeine Sonntagszeitung

"In the long term we are all dead." This famous quote of John Maynard Keynes is presently guiding the monetary policy of the large central banks of the industrialized states which have introduced another round of monetary easing. The most aggressive one is the US Federal Reserve which is buying, once more and without setting a program expiry deadline, bonds, and with that it promises to adhere to de facto zero interest rate policy until at least mid 2015. But also the European central bank, the bank of England and Japan are easing their monetary policy.

In a short side distortion the focus of the central banks is directed towards the threatening weakening of their own countries and the world economy - and they neglect the long term risks. This supposition underlies to the warnings, with which William White, the former chief economist of the Bank for International Settlement in Basel, has flagellated the excess liquidity already more than a decade ago and warned of the creation of bubbles in the financial markets. The financial crisis has proven that he was right. Also today, White is warning of the "ultra-loose" monetary policy and its side effects.

In his present discussion paper he opposes a quote of Keynes to a quote of Ludwig von Mises: "It is the job of an economist to inform on effects that might occur much further out, so that we can avoid actions such as attempts to cure present evils by way of bringing out the seed for future even greater evils." With this, White is alluding to the controversy between Keynes and the Austrian economists such as von Mises and Friedrich von Hayek which developed around the world economic crisis in the Thirties of the last century.

Whereas Keynes analyzed the crisis at that time as a problem of the missing demand on a macro economic level, the Austrians emphasized as cause of the crises a credit bubble, failed investments and an overextended consumption based on buying on tick which then necessarily lead to an economic collapse. Does that sound familiar? Then also the warning of the Austrian economists applies that the efforts to boost demand with an ever looser monetary policy does lay the groundwork for the next crisis.

White describes the last 25 years since the crash on the stock market in 1987 as a series of monetary policy attempts to prevent economic downturns or to ease it. The series of the financial market bubbles reaches from the bursting of the Japanese house-price and stock market bubble 1991, over the Asian crisis 1997, the LTCM-collapse 1998 as well as the internet bubble 2000 up to the breakdown of the bloated house prices 2007.

The sequence of ever greater financial market bubbles is the most important one of many side effects of the ultra-loose monetary policy which is analyzed by White. Basically, a very loose monetary policy is thereby creating the prerequisites that in the future central banks must intervene with even stronger easing, whereby their instruments keep losing efficiency.

Other side effects are not less dangerous and they go far beyond inflation risks. A low interest policy for example favors imprudent lending. So banks are weakened. Insurance corporations are losing earnings power dramatically, with the concomitant harmful consequences for pension plans of many people. Possibly, the insurance companies are incentivized into risky speculative investment adventures. A low interest rate policy is alluring governments to build up ever greater debt mountains and to defer the consolidation of the state budget - see at Japan and increasingly the USA as well. The purchasing of government bonds in order to loosen the monetary policy at a border line of zero interest rates even further, is endangering the political independence of the central banks. The crisis caused focus of the monetary policy on the financial stability, complicates that in future the central banks are dealing again exclusively with price level stability. Moreover, low interest rate policy is exacerbating the disparity of incomes to the disadvantage of conservative savers. And so on.

The central banks are accepting these side effects and are hoping that the governments and corporations are winning time in order to heal the excesses of credit and indebtedness. White has doubts that this calculus will be successful. If the time is not be used it will be deduced as syllogism that the central banks must tighten the monetary policy - independently of the situation of the economy.

It is no coincidence that the paper of White has been published as a discussion paper of the Federal Reserve Bank of Dallas. The president of that regional Fed, Richard Fisher, is a monetary policy “hawk” and he is critical against the quantitative easing of the American central bank. Indeed, the central bank-internal discussion in the US is at least as controversial as in Europe, there the German federal central bank president Jens Weidmann stands isolated in the council of the European central bank.

In a biting speech Fisher has just drawn the attention to a disquieting historic observation. Worldwide, no central bank has achieved to free itself successfully from a situation of zero interest rate policy and meager growth that applies today in the US. The bank of Japan is holding the interest rate de facto at zero percent since 13 years. The American Federal Reserve started almost four years ago - and there is no end in sight.

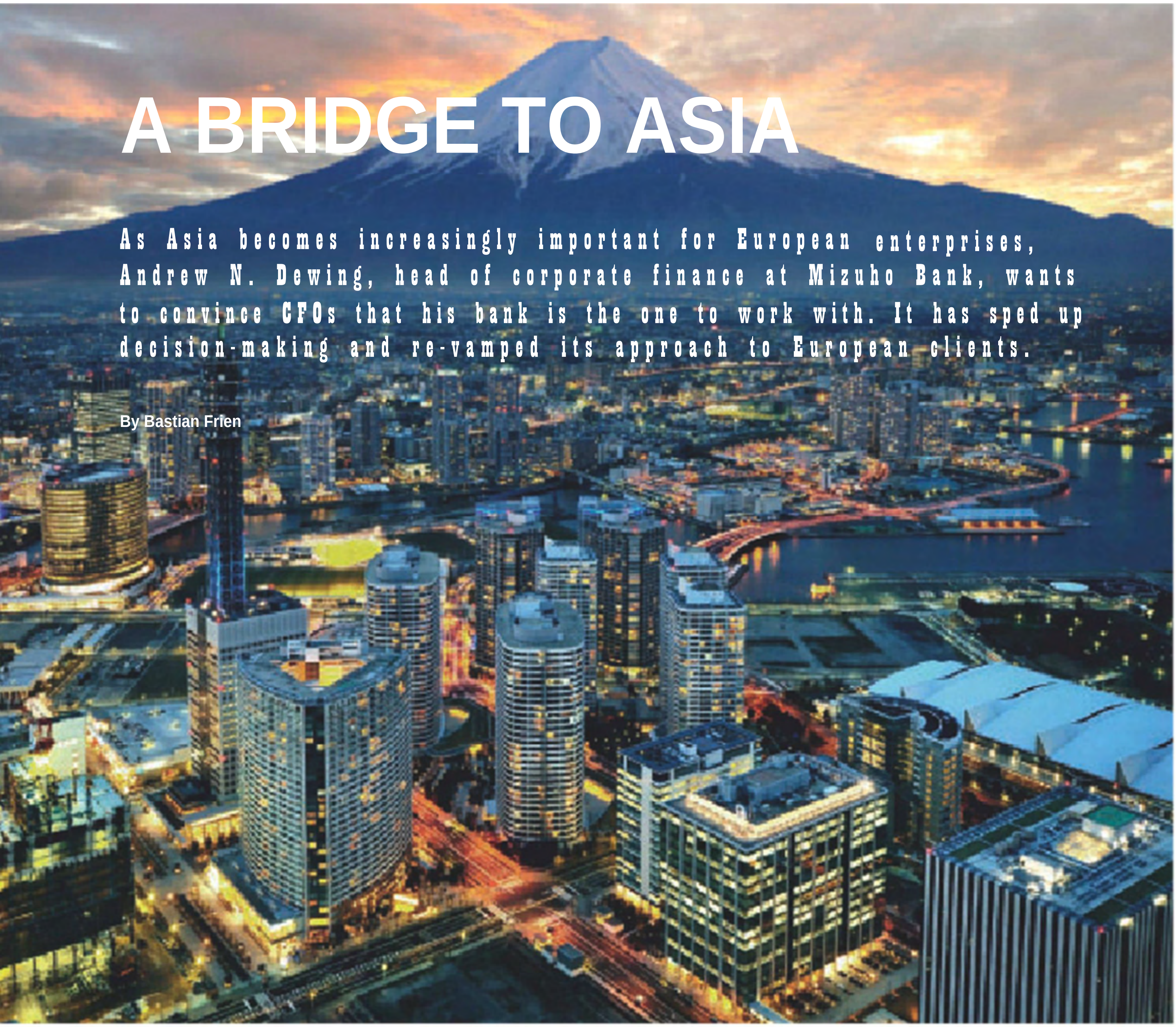
Richard Fisher (2012): Comments to the Harvard Club of New York City on Monetary Policy, September 19, 2012.

William White (2012): Ultra Easy Monetary Policy and the Law of Unintended Consequences, Federal Reserve Bank of Dallas, Working Paper no. 126.

A BRIDGE TO ASIA

As Asia becomes increasingly important for European enterprises, Andrew N. Dewing, head of corporate finance at Mizuho Bank, wants to convince CFOs that his bank is the one to work with. It has sped up decision-making and re-vamped its approach to European clients.

By Bastian Frien



iStock

// Mr Dewing, why would a Japanese bank take an interest in Europe? There are so many opportunities in Asia …

Fair question. Japanese business opportunities are becoming more challenging because of the demographics and the nature of the Japanese economy over the course of the last decade. So growth and profit need to come from elsewhere. We clearly have a strong commitment to our growing international franchise, especially in Asia excluding Japan. Europe, even with all its problems, remains the world's largest economic block and boasts a significant number of global companies. Supporting these multinational corporations (MNCs) globally is at the heart of our strategy.

// Whom do you target?

I am responsible for non-Japanese corporate clients and non-bank financial institutions for "mature" Europe. This excludes private equity, Japanese clients, project finance and the emerging markets business, which are managed in other divisions.

// Are you also responsible for corporate clients from central and eastern Europe?

No. They are still covered by our emerging markets division, even though one might indeed argue that countries like Poland and the Czech Republic are part of "mature" Europe these days.

// What does your ideal client look like?

I arrived at the bank in June 2007, so I had only three months to review our European

Corporate Banking Strategy before the crisis broke out. The key question that I asked was, "What makes us relevant to our clients?" We decided that we want to primarily support clients with a global footprint and, in particular, MNCs with a significant or growing focus on Japan and Asia. This meant cutting our number of clients.

We had well over four hundred fifty clients in this division. Today we have around one hundred fifty, but a much bigger and more multilayered business. The majority of our clients are global companies with multiproduct needs and a strategy for Asia. We are not a regional bank. We are an international bank with a growing global platform, but with a strong regional focus in Asia.

»We had well over 450 clients in this division. Today we have around 150, but a much bigger and more multilayered business.«

// With your approach, you compete with the bulge bracket. Competition on that level is fierce. Furthermore, Japan is notorious for its sheltered economy, so many companies have very little business there.

How can you win over potential clients?

We work very hard to be a reliable partner and to differentiate ourselves from others whenever we can.

Let me point out again that our home base is in Asia and most major multi-national corporations have a separate strategy for Asia. We have been active in China since the late 1980s when Japanese companies started to invest there and well before many European and American companies did. Besides, Japan is still the world's third-largest economy, and much business goes on between Japan and Europe.

// Are you interested in taking on risky European corporate credit?

What is interesting to see is that margins have widened over the past few months, particularly for corporations in the crossover segment. There is also, clearly, a north-south divide in Europe with pricing for southern European corporates up significantly in parison to similar corporates in northern Europe. »

»The Japanese are extremely good at monitoring whether you deliver on your promises. That is important in a Japanese bank. You must not fail very often.«

» **// But it does not sound like crossover corporations were your major target group …**

You're absolutely right. Non-investment-grade corporates are not our sweet spot. But client relationships are also not static. If relationships do not work out over time, you have to be prepared to move on. If relationships do work out, you may have to allocate more capital to them than you might wish and support your clients through difficult times. Do we buy an asset simply because it is attractive and provides a good economic profit? No, this is not the way my division goes about its business.

// So how do you go about your business?

First and foremost, we seek to develop a sustainable, long-term profitable business, including ancillary business with creditworthy clients. It is important to maintain an open and honest dialogue at all times with our clients and to monitor the relationship over time. We carefully analyse how we best fit into the client's banking group. Usually CFOs and treasurers define their core banks as those participating in the top tiers of their syndicated loan. When we look at new clients, we study the company's growth strategy and Asia is often critical. Then we ask which banks will support the Asian strategy and more often than not the company has limited choices. There are many international banks, but few Asian ones with global reach. That makes it quite easy for us to engage with clients.

// Japanese banks have a reputation for slow decision-making processes. Rightly so?

We have made great strides in speeding up decision making. Understanding a client's needs and then managing the bank internally to deliver for the client can be hard work but, if we get it right, it pays off. Today, we try to be the first to respond on deals and facility requests. Getting back to a client early makes a huge impression. We regularly bring Japanese senior management to our European corporate clients. By bringing management closer to our clients, we can ensure we get the backing when we need it.

// Is there nonetheless a Japanese way of banking that is also reflected in the way Mizuho goes about business?

The Japanese concept of relationship banking is an interesting one. Japanese banks support their Japanese clients globally and will look at return over many years. You have to understand the system and how to make it work for you. For example, the Japanese are extremely good at monitoring whether or not you deliver on your promises. That often works to our advantage because we try to under-promise and over-deliver. That is important in a Japanese bank. You must not fail very often.

// How does this influence your work?

My challenge is making our client coverage global and continuing to work with our product divisions to build relevant products that can sustain our relationships with our corporate clients. There is a lot more scrutiny now than there was in the past. Also, there are many more synergies and opportunities now between our Japanese business and my division. That is partly because the yen is so strong and Japanese corporations are looking for international assets. But it is also because Japanese investors are increasingly looking for opportunities and financial assets abroad.

// Good point. Japanese investors expect practically no return on debt and the yen is strong. Could that be a source of funding for European corporations?

Absolutely. A few months ago, we brought a Japanese investor to Europe and they met with approximately forty of our corporate clients. As a result, we have completed over ten private debt transactions to date. Generally speaking, the Japanese investors look for single-A-quality issuers or better, but we are beginning to see increased interest in gradually moving down the credit curve. For those without yen needs, the swap rates are currently unattractive for long-term financing, but arbitrage opportunities can be identified. Rates up to two years are possible. «

bastian.frien@cfo-insight.com

The banker...

Andrew N. Dewing was appointed general manager, head of corporate finance for Mizuho Corporate Bank in Europe in June 2007 and promoted to executive officer in April 2011. Based in London, Mr Dewing is responsible for developing and growing Mizuho Corporate Bank's non-Japanese corporate banking business in Europe, leading a team of 62 in London, Paris, Amsterdam, Frankfurt, Milan and Madrid. Prior to joining Mizuho, Mr Dewing was a leading banker with Bank of America for more than 22 years. He earned his MBA with distinction from NYU's Stern Business School and the London Business School.

...and the bank

The Mizuho Financial Group is one of the largest financial institutions in the world, with approximately 57,000 staff working in roughly 980 offices inside and outside of Japan and total assets of over USD 2 trillion (as of March 2012). The group was formed in September 2000 through the establishment of a holding company of its three predecessor banks Dai-Ichi Kangyo Bank, Fuji Bank and Industrial Bank of Japan. It offers a broad range of financial services from banking and asset management to credit cards and venture capital through its group companies.

Mexico,

Country Report: **The Voters Hope for a Wonder of Reforms**

After the confirmation of the controversial result of the elections through the Supreme Election Court, the future President must dissipate deeply rooted distrust.

By Mauro Toldo

Now it is officially confirmed: The Party of the Institutionalized Revolution (PRI) returns to power in Mexico after having been in opposition for twelve years. The Supreme Election Court of the country has rejected the protest against the election result of July by Andrea Manuel López Obrador, the candidat of the left wing party of the Democratic Revolution (PRD) and it has confirmed the election result.

The winner of the election, Enrique Pena Nieto, had only received 36,2 % of the votes on July 1, 2012, 5 percentage points more than López Obrador. The loser of the election reproached the winner for purchasing votes and falsification of the election. This seems though to be indeed the case, as fraud of the election and purchases of votes have been proven at all three big parties – also at the party of López Obrador. But in the view of the judges, the irregularities have been of such an order of size that they have not led to a decisive falsification of the outcome.

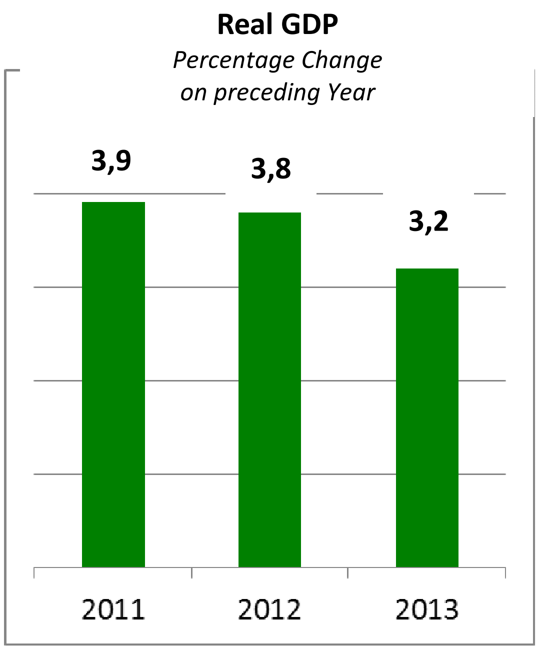
Co-Guilt of the Blockade

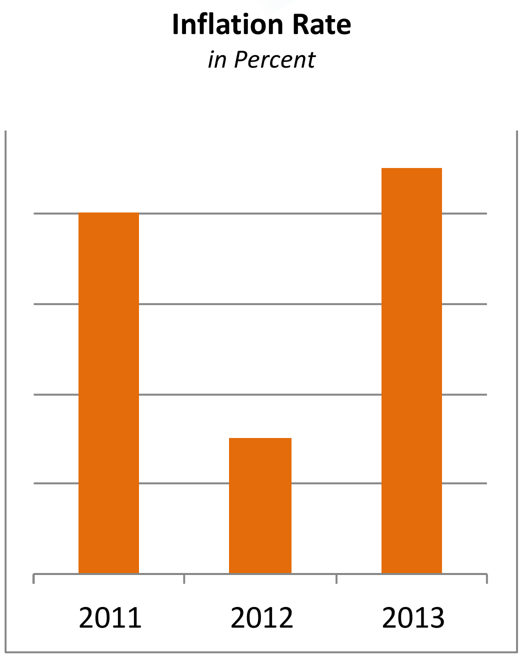
On the other hand, the result was not a surprise. In July, the Mexicans had gone to the voting-desks in order to punish the current Government party – the Conservative Party of the National Action (PAN) – for the political stand-still of the past years. However, they have brought such party back into power instead, which has been responsible for this stand-still through its blockade attitude during opposition. In addition to that, the PRI Mexico was governing from 1929 until 2000 uninterruptedly and was known for corruption and clientelism in that time. Many Mexicans therefore regard the return of the PRI to power as very critical. In Enrique Pena Nieto, who is selling himself as a renewer of the party and as a reformer, they see something like the "wolf in sheep's clothing" who is still only an instrument of the supposed power hungry and corrupt PRI.

But what is really to be expected when Enrique Pena Nieto now will be new Mexican President as of December,1 ? Has the PRI changed itself in the twelve years of opposition? The current coalition of PRI with the Greens has no majority in the Parliament and must make negotiations with the opposition parties. On the one hand, this is positive because the other parties have possibilities of control. On the other hand, it is open how the cooperation with the opposition will be. From today’s point of view, a constructive cooperation with the PRD seems to be excluded. For the announced reforms of the labour market, the tax reform and the opening of the oil sector a co-operation with the still governing Concervative Party PAN would probably be thinkable. However, it is to be questioned whether the PAN will now – as an opposition party – support popular reforms, when at the same time the PRI, when it was in the opposition, was not ready for a co-operation. It would be desirable to Mexico, when pragmatism would win. But one should remain sceptical.

Despite of the unachieved reforms during his term, the still acting president Felipe Caldéron can also show successes. For example, the antitrust legislation has been reformed successfully. The so far existing monopolies had the result of excessively high phone tariffs. Carlos Slim Helú, who owns the telephone giant Telmex, among other things, is in the meantime the richest man in the world. The new laws will achieve more competition and lower prices. Beyond these reforms Calderón has led the country in a largely stable way through the great economic crisis.

Country Report: Mexico





Strong Growth

Mexico is presently growing faster than many other countries in the region. Following last year's growth of 3,9 %, the Mexican economy might grow in 2012 by still 3,8 %. A stable labour market, a low debt level of the private households and a solid banking system are suggesting that the private consumption will remain the solid pillar of domestic demand for some time.

In the meantime, also the exporting economy is in a more solid shape than a few years ago. The modest development of wages, their strong increase in the competing countries (especially in China), the devaluation of the Mexican Peso and the geographical closeness to the USA which is ever more valuable in view of the increased transport costs, have all led to an increase of the competitiveness.

But the closeness to the USA has also its reverse side: Four fifths of the Mexican exports go over the northern border of the Rio Grande into the USA, whereby economical problems of the great neighbour are being felt quickly as well in Mexico.

In Mexico, a big problem is the violence of the drug cartels since years. In the last years, in the violent disputes more than 120.000 people have been killed. Many corporations are holding back capital expenditure because of the security problem. Still, the exchange of goods with the USA has not been tempered by the violence so far. The efforts of the government for the containment of the violence remained unsuccessful so far and therefore, also the new government will find it difficult to reach success in this field.

Inflation under Control

Contrary to the security policy, the monetary policy is moving smoothly: Inflation is not a serious problem for Mexico since years. The central bank has achieved a very good reputation. On the other hand, the danger of inflation has recently somewhat increased. Because of bad weather conditions there are dramatic losses of harvest. A similar development has caused the Tortilla-crisis in 2007. At that time, the population went on to the street in order to demonstrate against too high food prices. Since June the inflation rate moves above the target range of the central bank of 3 % + - 1 percentage point. However, this lapse might exist only for a short term. It is to be expected that in the medium term the inflation rate will develop into the target frame again. The high credibility of the central bank might make sure, that the inflation expectations will remain under control. The monetary policy will probably not react to this

Country Report: Mexico

	Figures given for 2011
Capital	Mexiko-City
Population	113.8 millions
Currency	Peso
Euro Exchange-Rate (September 7, 2012)	16.50
Monetary System	Free Floating
Nominal GDP	1154 Billion Dollar
GDP per capita (in purchasing power parities)	17120 Dollar

	2011	*2012*	*2013*
Government Balance *as a share of GDP*	-2.5	-2.4	- 1.4
Dept Level *as a share of GDP*	35.4	36.4	36.2
Current Account Balance *as a share of GDP*	- 0.8	- 1.1	- 1.7
Foreign direct Investments *as a share of GDP*	1.7	1.6	2.0
Foreign Depts *in Billion Dollars*	211.1	218.7	228.5

Ratings of Foreign Currency Bonds:

- S&P BBB
- Moody's Baa1
- Fitch BBB

Source: DekaBank

passing by increase of inflation. Still until late into the coming year it is expected that the central bank leaves the interest rate unchanged at 4,5 %.

The central bank profits from that the government is making no experiments with fiscal policy. The budget deficit was on average of the past 10 years less than 1 % of the gross domestic product (GDP). Since years, Mexico has collected positive points with this responsible fiscal policy from investors. Already in 2006 the country had introduced the “Law for Fiscal Responsibility” with a deficit limit.

Inspite of this, the state-budget remains vulnerable. The main cause is the dependence on the oil income. Oil makes about 1/3 of the state-income. The state-owned oil-company is really financially squached which reduces the manouvering room for necessary capital expenditure and therewith the future producing capacities significantly. Already in the past 10 years the oil production has dramatically decreased. Without an opening of the oil sector for private investment it is to be expected that the oil production will shrink further.

The weakness on the income side of the state is also shown in the tax base which is the lowest of all the OECD-states with 10 % of GDP. A tax reform is therefore necessary in order to safeguard a more stable fiscal situation in the long term. The discipline of expenditures has though prevented that the public debt has swollen over a level of 35 % of GDP, but an improvement is not probable without a real comprehensive tax reform.

Stable debt structure

Also as the income situation has not improved significantly, Mexico has turned other screws to stabilize the state financing. So one has emphasized the structure of public debt as well as the tools of financing. The share of the local public indebtedness has increased to 80 % of the total public indebtedness. In addition, the average maturity of indebtedness in the last year has steadily increased. These factors reduce the susceptibility for crisis. Also regarding the external financing of the country, Mexico is in a more solid position than in the past. The international reserves have doubled in the last 5 years up to 150 billion US $. In addition, the availability of flexible credit line (FCL) of the International Monetary Fund amounting to 73 billion US $ has in addition lowered the risk of an external financing bottleneck.

Problems in the Oil Sector

Because of the uncompleted reforms of the Calderón-government, the rating agencies have taken a wait and see-position since years. For Moody’s the country is with “Baa1” three steps above the bottom level of investment grade, for Standard & Poor’s and Fitch it is two steps. Presently the rating outlook at all three agencies is stable. Should reform projects of Pena Nieto be carried out, then new manouvering room for increasing the rating will be opened.

First of all, the opening of the oil sector for private investors would be important because with this the country could finance important projects. The oil production would increase and would safeguard income and jobs. In addition, the upcoming tax reform should enlarge the tax base and thereby should create more stable state income which would lower the dependency from the volatile oil market. And finally, the labour market reform, long desired by the corporations, would lead to a higher flexibility in the labour market and would make Mexico more attractive for investors. It remains to be hoped that the new government and the opposition will show to be cooperative and pragmatic in the upcoming negotiations, and that the new president Pena Nieto will be the renewer indeed and not a wolf in sheep’s clothing.

Mauro Toldo is Head Emerging Markets/Country Risk Analysis in the Macro Research Department of the DekaBank, Germany.

Source: DekaBank, Frankfurt am Main, Germany . Responsible for translation: GEFIU; translator: Helmut Schnabel

MARKET MONITOR

Billy Cortez

Hall of shame: D. Kozlowski

Crises play out this way sometimes.

In May 2002, Dennis Kozlowski, then CEO of Tyco, one of America's largest conglomerates, delivered a speech to the graduating students of St. Anselm College in New Hampshire. He said, "You will be confronted with questions every day that test your morals. Think carefully, and for your sake do the right thing, not the easy thing." Today, the former chief of Tyco is known as New York State inmate #05A4820.

Mr. Kozlowski was convicted of stealing hundreds of millions of dollars from Tyco, when he and his accomplice, Tyco CFO Mark Swartz, went on a growth strategy based on acquiring other companies and pushed Tyco to be the next General Electric. The two engineered company's acquisitions but in the process they got greedy and engaged in accounting scandals, grand larceny, fraud that accompanied the company's aggressive acquisition drive. Both are now serving prison sentences of 8-and-1/3 to 25 years. Ironically, in 2001, *Businessweek* featured Kozlowski on its cover, extolling him for "being the most aggressive CEO" and for his "willingness to test the limits of acceptable accounting and tax strategies."

Kozlowski and Swartz introduced a practice known as "spring loading: a financial manipulation in which the pre-acquisition earnings of the target company were underreported to give the newly-merged company an artificial profit boost. As one Wall Street analyst, Albert Meyer of David W. Tice and Associates wrote then, Tyco, with Kozlowski and Swartz orchestrating everything, booked excessive acquisition-related charges, which were later released to inflate profits, rendering it impossible 'to calculate Tyea's real organic growth (outside of its corporate acquisitions).

The company's modus operandi was to slash and burn acquire companies and cut costs by downsizing to inflate short-term profits. Eventually with its overly aggressive accounting practices and ill advised acquisitions, Tyco overextended itself, triggering cash flow problems.

Tyco financed these mega-deals primarily through equity. The acquisitions were mostly financed by Tyco share's, which predictably went up following a deal announcement, thus paving the way for more takeovers and future acquisitions. Along the way, the company started piling up billions of debt on its balance sheet, and began experiencing difficulties in concealing the fact it was not actually making real profits – only paper profits. Strong earnings when cash flow deteriorates is a sign of trouble.

What was also hard to take was the failure of the Tyco board to call a halt to the firm's poor acquisition strategy; it also didn't check Kozlowski's avaricious behavior, his scheme to enrich himself through share option and reload option plans (Kozlowski brought home over $450 million in compensation, share options, and large, unauthorized bonuses). The US SEC alleged that both Kozlowski and Swartz granted themselves hundreds or millions of dollars in loans, large compensation and unauthorized bonuses without disclosing them. The market saw all these, lost faith in Tyco's top management and its financial numbers, causing its market share price to plummet.

To paraphrase philosopher Santayana, if you don't learn from the mistakes of the past, you're likely to commit the same mistakes in the future, This holds true both in the world of business and politics. The lessons we could glean from Tyco's case are the following:1) weak internal control (internal audit reported only to CEO rather than to the audit committee; blurred reporting lines left gaps in the control system); 2) weak risk assessment of acquisitions; 3) lack of information given to the board of directors, leading to the board's failure to act as a check to the CEO's activities (by the way, only the CFO submitted SEC filings rather than the legal department); 4) always do a thorough analysis on where the company's growth driver is coming from, don't depend management's press releases, accounting techniques and footnotes; and 5) share option schemes, with their limited downside potential, should be avoided.

The Tyco case highlights to us one problem. During a market boom period, when their stock prices are high, it's not easy to challenge companies' numbers. But when the economy or the financial markets fall, top management's failures become highly visible. Now that's a thought, coming at this time when "risks for a serious global slowdown are alarmingly high," according to the IMF's World Economic Outlook report released last week.

In his famous novel, *Bonfire of the Vanities*, author Torn Wolfe- wrote: "Greed is one of the seven deadly sins ... If you feel you are a master the universe, then a lot of rules don't apply."

Mr. Cortez is the IAFEI Secretary. He's a former FINEX president and former co-chairman of the Philippine's Capital Market Development Council.

Building Networks for Finance Professionals

by Dr. Conchita Manabat

"Call it a clan, call it a ***network****, call it a tribe, call it a family. Whatever you are, whoever you are, you need one!"*

— Jane Howard

Business networking has emerged as one of the 'must have' soft skills necessary for finance professionals to succeed in the competitive marketplace of today.

Given the unprecedented 'equalization' of global skills and competencies, and the competitiveness of the finance job in the marketplace, one aspect where finance professionals contribute uniquely is their distinctive professional network, the '*informal chain of contacts usable for mutual assistance and support*'. In today's world, it is not just 'what you know', and 'where you learnt it', but also 'who you know' that counts increasingly in one's professional progress.

Why Do Finance Professionals Need to Network?

Venda-Raye Johnson, author of the book 'Effective Networking' says it best as: *"We live the age of knowledge and change. The right information, the best resources, and the strongest support are needed to keep focused in the midst of change. Effective networking helps us keep our balance and perspective in a world of change"*.

Finance professionals benefit from networking in myriad ways, and some key advantages are:

1. **Access to Information, Ideas & Contacts**

   Through a network of contacts, finance professionals can have access to far more people than they can reach on their own. By developing and then staying in touch with contacts in the government, regulatory bodies, professional institutions, competitors, customers, and service providers, one is able to have greater access to information, ideas and contacts.

2. **Opportunities (job, career, business, personal)**

   The people in one's network expand one's scope and outreach, creating new avenues and links to new opportunities, both at the personal and professional level. Reputations precede people and networks help propagate positive perceptions across people, companies, industries and even countries.

3. **Results and Accomplishments**

   Your network enhances and expands your results and accomplishments. By working together effectively with others, obtaining speedy, useful information and opportunities, you can accomplish more than you could accomplish by yourself.

4. **Friendships and Professional Relationships**

   Some of the people you connect with through networking can potentially become great friends and powerful professional allies. Through networking, one develops partners and advocates and a support system that is as committed to your success as you are.

Where do finance professionals network?

In their book "Make your Contacts Count", Ann Bayber, and Lyne Waymon identify three key platforms where networks can be built, outside the immediate zone of contacts:

- **Make the Most of Memberships**

  Joining organizations and actively participating in them is the best way to come in contact with a multitude of people in the finance profession. In the Philippines, the national level association for finance professionals is the Financial Executives Institute of the Philippines (FINEX). FINEX provides finance professionals a platform to stay informed, build relationships and participate in advocacy, not available in any other forum.

  At the international level, an organization that can bring unprecedented global networking and information opportunities at the door of finance professionals is the International Association of Financial Executives Institutes (IAFEI).

  IAFEI is a private non-profit, and non-political international association, which (as its name suggests), is an international association of finance associations – a 'federation of federations'.

  Along with the financial executives institutes of eleven other countries, FINEX shares the honor of being one of the founders of IAFEI in the year 1969, and is active in IAFEI's committees, congresses and advocacies. As members of FINEX, professionals in the Philippines have immediate access to the networks and opportunities of IAFEI, including information access, global networks and opportunities to participate in global congresses and advocacy.

- **Connect at Conventions**

  An excellent way of widening one's circle of contacts is local and international conventions. Professionals must actively participate in conventions to benefit from information interaction and inspiration. IAFEI will hold its '2012 World Congress' next month, November 14- 17 in Cancun, Mexico to be attended by a number of delegates from nations across the world, including the Philippines, thereby providing vast networking opportunities to finance professionals. This year's IAFEI World Congress theme is "The Role of the Financial Executive as a Key Player of the Corporate Governance and Responsible Management".

- **Plug into technology**

  With the advent of computer applications and internet based tools and websites, contact information can now be organized and developed via special interest websites, email access and web based programmes.

As a way of life, networking incorporates attitude, awareness, and action. You can be very aware of people and opportunities, and yet it is only when you take action to bring those people and opportunities together that results happen. Remember, ***"you don't make progress by standing on the sidelines. You make progress by implementing ideas."***

Dr. Conchita L. Manabat is the President of the Development Center for Finance and a Trustee of Holy Name University. A past Chair of the International Association of Financial Executives Institutes (IAFEI), she is a member of the Advisory Council of the said organization. She is also a member of the Consultative Advisory Groups of the International Auditing & Assurance Standards Board and the International Ethics Standards Board for Accountants. She can be reached at clm@clmanabat.com .

FANCY A SPIN WITH A CONVERTIBLE?

IT IS ESSENTIAL TO GET YOUR TIMING RIGHT WHEN YOU ISSUE THIS TYPE OF BOND. MARK DALTON EXPLAINS WHY

I have heard a number of treasurers and CFOs joke that a banker will happily tell you whether or not it is possible to issue a convertible, but if they believe that you can, they will almost always also tell you that you should. So how can a company identify the right time to issue a convertible? And what are the elements that make for a good opportunity in this market?

What do investors want in a convertible?

First, let's think about who buys convertible bonds and what drives their investment decisions. The first group are the 'long-only' or 'outright' funds, which buy convertibles because the combination of downside protection and upside exposure appeals to their investors. The second are the convertible arbitrage funds, which buy convertibles based more on technical factors, and which actively hedge the share price exposure (and possibly the credit exposure as well). These two groups are currently of similar importance and size.

The box [right] provides a rundown of the features each group cares about when looking at a convertible.

In short, the 'perfect' issuer for a convertible bond should be a large company, looking to raise $500m or more, with a strong credit rating, a volatile stock price, no dividend and a strong stock story.

But can this really be correct? Such an issuer would meet many of the criteria desired by a convertible arbitrage fund, but would probably pay a very low coupon, and also insist on a high conversion premium (the amount by which the conversion price exceeds the stock price when the bonds are issued).

In fact, what you find in practice is that investors (especially outrights) would often prefer a company with a slightly weaker credit rating, and which pays a 2-3% dividend yield, such that the convertible they issue will actually pay some coupon and have a more moderate premium (say 25-30% above the stock price). In practice, we see that the convertible market is frequently used by small- to mid-cap issuers, often those who have less access to other bond markets and may be unrated.

What makes a convertible a good idea for the issuer?

For an issuer, different considerations come into play when deciding whether the timing is right for a convertible:

- Use of proceeds – are the funds being used for a specific investment, or is the convertible for balance sheet management/refinancing?
- Share price relative to historic levels – would the conversion price be set at (or above) the highest level at which investors would have bought into the shares (ever, or at least in recent years)?
- Equity valuation – are the shares trading at a strong valuation relative to their historic trading multiples?
- Interest rates and credit spreads – how expensive would it be to issue a non-convertible bond?
- Alternatives – does the company have an ability to raise bank debt, issue bonds, or sell new equity, and how does the pricing stack up?

In other words, as an issuer, the ideal timing to issue a convertible is when either (a) the absolute terms are very appealing (high prevailing share price, high conversion premium, low coupon) or (b) the relative pricing (compared with issuing equity or debt) makes a convertible attractive for the issuer.

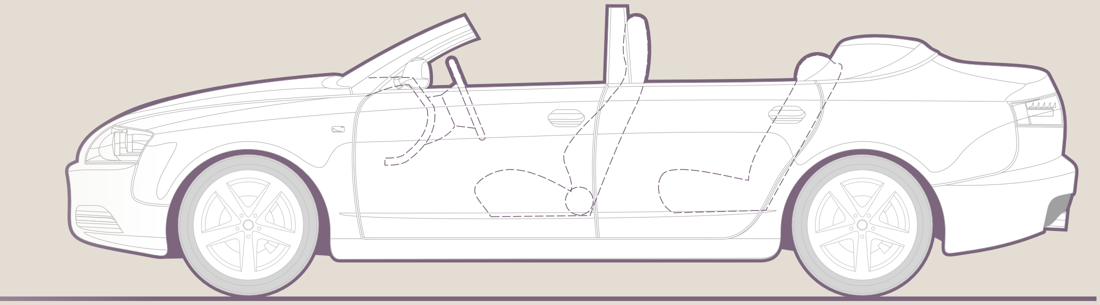
The question of 'absolute' terms is relatively easy to analyse. If the stock is strong, the company needs money and the coupon is attractive (ie low), then it is probably a good time to seriously consider issuing a convertible. This is not driven by the strength of the convertible market (or how appealing the issuer is to convertible investors on any technical basis), but rather by the strength of the company. In some cases, issuers have been known to sell convertibles in such an environment even without a clear use of proceeds, just to lock in the terms.

However, it can be harder to identify when the terms are 'relatively' appealing, so I like to think about the potential all-in costs of various financing tools to decide when a convertible can make the most sense relative to alternatives.

As an issuer, consider three options: (i) issue a

WHAT IS A CONVERTIBLE BOND?

A bond that can be converted into a predetermined amount of the company's equity at certain times during its life, usually at the discretion of the bondholder. SOURCE: INVESTOPEDIA



INVESTOR CONSIDERATIONS WHEN BUYING CONVERTIBLES

What do long-only funds want?
- Upside potential in the stock price
- Attractive (higher) coupons
- Low credit risk

What do convertible arbitrage funds look for?
- Higher share price volatility
- Ability to borrow and sell short the underlying stock at a low cost
- Fairly priced credit risk

What do both groups want?
- Good transactions size
- Good after-market liquidity
- Low dividend yield on the shares (convertible investors only benefit from upside in the share price… they forego any return to equity holders that is paid as a dividend)

non-convertible bond, (ii) issue new shares, or (iii) issue a convertible. In each case, think about the returns that the new investors will earn as being the 'cost' of the instrument to your current shareholders. (In the case of the bond and the convertible, it also makes sense to adjust these costs for the tax benefit to the company.)

On a graph, plot the return that a new investor would earn against a range of potential future share price performances.

For equity, if you pay a 2% dividend yield, and the stock rises 10% per annum, the new shareholders will be making 12% per annum. If the stock falls 10% per annum, the new shareholders' return will be -8%. (Equity is also likely to be sold at some discount to market, which we ignore here.)

For a bond, so long as the company is able to repay it at maturity, the share price does not impact on the total returns to investors. So, if the coupon were 5%, that will be the return to investors, and with a 30% tax rate, that becomes a 3.5% after-tax cost for the company.

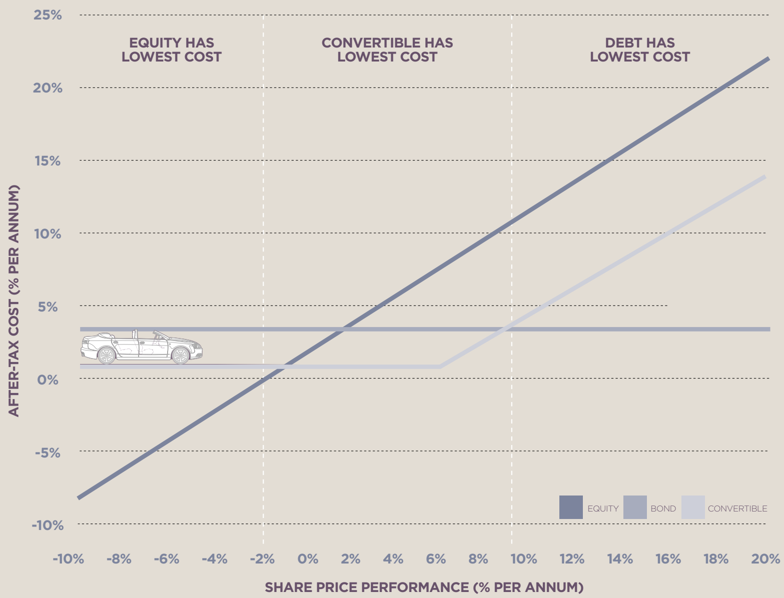
Now, plot a convertible on the same graph. So long as the return to shareholders does not result in the stock price exceeding the conversion price, the bonds will not convert, and the cost is simply the coupon less the tax shield (which in many jurisdictions is based on the issuer's normal cost of debt, not the coupon). So for a company that might pay a 5% coupon on straight debt, and would pay a 2% coupon on a convertible, the after-tax cost ends up around 0.5%. If the share price performs strongly and the bonds do end up converting, the stock price still needs to go quite a bit higher than the conversion price before the all-in cost exceeds that of non-convertible debt. In this example, a convertible with a 35% premium actually needs the stock to rise by 9.5% per annum (a return to shareholders of 11.5% p.a.) before the convertible has a higher cost than straight debt.

The chart [right] shows this example. What you can see is that if the share price falls, equity will be the 'cheapest' financing tool. If it rises materially, straight debt will be cheapest. However, if the stock has a modest positive performance, the convertible will be cheapest. For an issuer, then, the time to consider issuing a convertible due to its 'relative' appeal is when there is the greatest range of potential share prices in which the convertible will be the 'cheapest' source of financing for the transaction.

So when will this be at its greatest? Clearly, the more appealing a new convertible is to the widest group of investors, the better the terms (coupon saving and conversion premium) that can be achieved. If this also coincides with a time when the 'absolute' terms are appealing, it is probably the right time to think seriously about a convertible.

Mark Dalton is the founder of Conv-Ex, an independent advisory firm specialising in convertibles and equity derivatives. Email mark.dalton@conv-ex.com. Web: www.conv-ex.com

EXAMPLE OF A GRAPH COMPARING THE COST OF CONVERTIBLES COMPARED WITH EQUITIES AND BONDS



WHEN BUSINESS CYCLES GO AWOL

The politicisation of risk may be damaging investor confidence, argues David Bowers

Central bankers should be getting worried. Three years after some of them embarked on quantitative easing (QE), there is no sign that the business cycle has been restored and is back in the driving seat. That's not to say that there haven't been variations in economic activity during that period. But what is striking now is the lack of confidence investors and companies have in assessing where we are in the business cycle, and what might happen next. This lack of transparency about the business cycle has its origin in a disrupted monetary cycle. The uncertainty surrounding the monetary transmission mechanism ('just how exactly does QE work?') and the absence of a credit cycle continue to present serious challenges to businesses and investors alike.

It is leading to some significant changes in behaviour. In the investment community, the loss of confidence in the business cycle as a reference point is leading to a polarisation in investment process. Some investors are responding by focusing on short-term sentiment cycles, scalping a few basis points of performance where they can. Others are responding by becoming more long term, more thematic, focusing on the next two to five years.

In contrast, investment approaches that rely on reading and projecting where we are in the business cycle are very much out of favour. In the corporate space, there are also signs of a shift in focus. Gone are the days of riding the business cycle. Instead, companies are focused on providing predictable earnings streams that can sustain steady dividend growth, which is much favoured by investors in this low interest-rate environment. Companies have changed tack: instead of running themselves 'for growth', they are now running themselves 'for cash'.

The lack of confidence in the business cycle stems from a widespread perception that we have had a credit bubble that has created a debt overhang, which will take many years to resolve. Faced with the need for multi-year deleveraging, how can a credit cycle get re-established in the developed world? The situation is aggravated by the rise in political risk that tends to accompany any debt workout. In the run-up to the credit crunch, the markets called the shots and politics was a sideshow. The balance has now swung the other way, as debt overhangs are often accompanied by battles between creditors and debtors over who is going to bear the burden for excessive borrowing and inappropriate lending. The stand-off between northern European creditors and southern European debtors is a classic example of how the politics turns more toxic the longer it takes to reach a resolution. One consequence is 'the politicisation of capital markets', where political event risk becomes ever more pervasive in finance. This also 'muddies' the business cycle 'waters'.

As we head into the autumn, there is plenty for the bears to fret over… from euro break-up to hard landings in China to the 'fiscal cliff' and the possibility of a renewed recession in the US. They are also overlooking a lot of positives – such as the potential for lower inflation to trigger an aggressive easing of monetary policy in the developing world, more unorthodox monetary easing in the developed world, and the lagged effect of a major decline in energy prices. If US politicians can come to their senses over fiscal policy before the year end, people may suddenly see the economic glass as 'half full' rather than 'half empty'.

At the height of the credit boom in 2007, investors were seduced into thinking that the business cycle was dead – and mispriced credit/risk too cheaply as a result. The irony is that, five years later, investors could be making the same mistake in believing that the business cycle is dead – only this time, 'risk' has been mispriced in the opposite way. The biggest surprise out there could be that the business cycle makes a comeback.

What is striking now is the lack of confidence investors and companies have in assessing where we are in the business cycle

FACTS AND FIGURES

£375bn
THE AMOUNT OF QUANTITATIVE EASING THAT THE BANK OF ENGLAND HAS COMMITTED TO SINCE 2009
SOURCE: BBC

$600bn
THE VALUE OF TREASURY SECURITIES BOUGHT BY THE US FEDERAL RESERVE BY JUNE 2011 DURING ITS SECOND ROUND OF QUANTITATIVE EASING (QE2)
SOURCE: BBC

JPY 70tr
THE SIZE OF JAPAN'S ASSET PURCHASE PROGRAMME BY JUNE 2013
SOURCE: NEW YORK TIMES

$221bn
THE INCREASE IN US TAX PAYMENTS IN THE 2013 FISCAL YEAR, FOLLOWING THE EXPIRATION OF THE BUSH TAX CUTS
SOURCE: ABSOLUTE STRATEGY US POLITICAL BRIEFING 2012

David Bowers is a director at Absolute Strategy Research. For more information, visit www.absolute-strategy.com


The lack of confidence in the business cycle stems from a widespread perception that we have had a credit bubble that has created a debt overhang, which will take many years to resolve
CHINA HARD LANDING
US FISCAL CLIFF
DEBT OVERHANG
POSITIVE OUTLOOK
GREEK EXIT

BEWARE THE INVESTMENT DESERT

It is not the assets that you think are risky that tend to damage your portfolio, warns David Bowers, but the ones you believe are safe

When a legendary hedge fund manager returns $2bn to investors, it is time to sit up and take notice. Louis Bacon – founder of the hedge fund Moore Capital – did just that back in August. Why he made such a move tells us a lot about the state of the world that we are in.

According to press reports, Bacon described market conditions as an 'investment desert'. He went on to say: "Disaster economics, where assets are valued based on their ability to withstand a lurking disaster as opposed to what they may yield or earn, is now the prism through which investors are pricing markets." The world he describes is a world where investors are increasingly obsessed not so much by the return on capital, but rather with the return of the capital. Investors – including some corporate treasurers – are now prepared to pay governments to keep their cash safe for the next two years. At the end of August, two-year government bond yields were negative in Germany, Denmark and Switzerland.

This assessment by Bacon goes straight to some of the concerns we have voiced in this column. We are in a world where large government budget deficits have their counterpart in unusually high corporate saving. 'Black swans' seem to lie around every corner and under every bush. The lack of policy visibility combined with lacklustre consumer spending means that companies are being increasingly run 'for cash' rather than 'for growth'. That unholy trinity of eurozone break-up, Chinese hard landing and American fiscal cliff is creating a deep-seated risk aversion that is keeping the lid on corporate spending. Policymaking remains highly politicised. Even if quantitative easing has supported economic growth – as US Federal Reserve chairman Ben Bernanke would have us believe – it has been at the cost of a massive distortion of financial markets.

Now it could be that this 'investment desert' is temporary. As I argued last month, the biggest surprise – certainly in the investment world and probably for corporates, too – would be that the global economy does not fall into recession next year, and instead an organic recovery gets under way. There could be some easing of the strains in the eurozone; China could ease monetary policy aggressively to head off a hard landing; and worries about the US fiscal cliff might be reduced in the event of a Romney-Ryan victory in November. Optimistic? Maybe. Impossible? No.

Paradoxically, this positive turn of events could cause some serious headaches for corporate treasurers. It would almost certainly be accompanied by an improvement in risk appetite and expose just how expensive some of the 'defensive' assets have become – particularly in the fixed-income space. It is not the assets that you think are risky that tend to damage your portfolio; rather it is the ones that you think are safe that cause the problems.

It is, of course, possible that the 'investment desert' is here to stay, confirming a fundamental change in the way the global economy operates. There is no going back to the business cycle as we have known it. Maybe we are at the start of a generational shift whereby the growth 'baton' is being passed on from the credit-sozzled baby boomers to something altogether different. Maybe the financial landscape is changing so radically that some of the fundamental tenets of finance are set to be challenged. In short, maybe we are at the start of what Richard Florida describes in his book as 'The Great Reset', where he argues that prolonged downturns are often periods of creative destruction, rich in technological innovation, that end up redrawing the world's 'economic geography'.

I think the challenge for corporate treasurers – and for investors – is to work out which of these two worlds we are in. Are we experiencing a temporary hiatus before the credit and capex cycles reassert themselves? Or are we embarking on a multi-year transition to a world whose economics become ever more unfamiliar? By the end of this year, we will have a much better idea of where we are more likely headed.

FACTS AND FIGURES

-0.04%
WAS GERMANY'S TWO-YEAR GOVERNMENT BOND YIELD AT THE END OF AUGUST 2012

-0.11%
WAS DENMARK'S TWO-YEAR GOVERNMENT BOND YIELD AT THE END OF AUGUST 2012

-0.21%
WAS SWITZERLAND'S TWO-YEAR GOVERNMENT BOND YIELD AT THE END OF AUGUST 2012

SOURCE: THOMSON REUTERS DATASTREAM

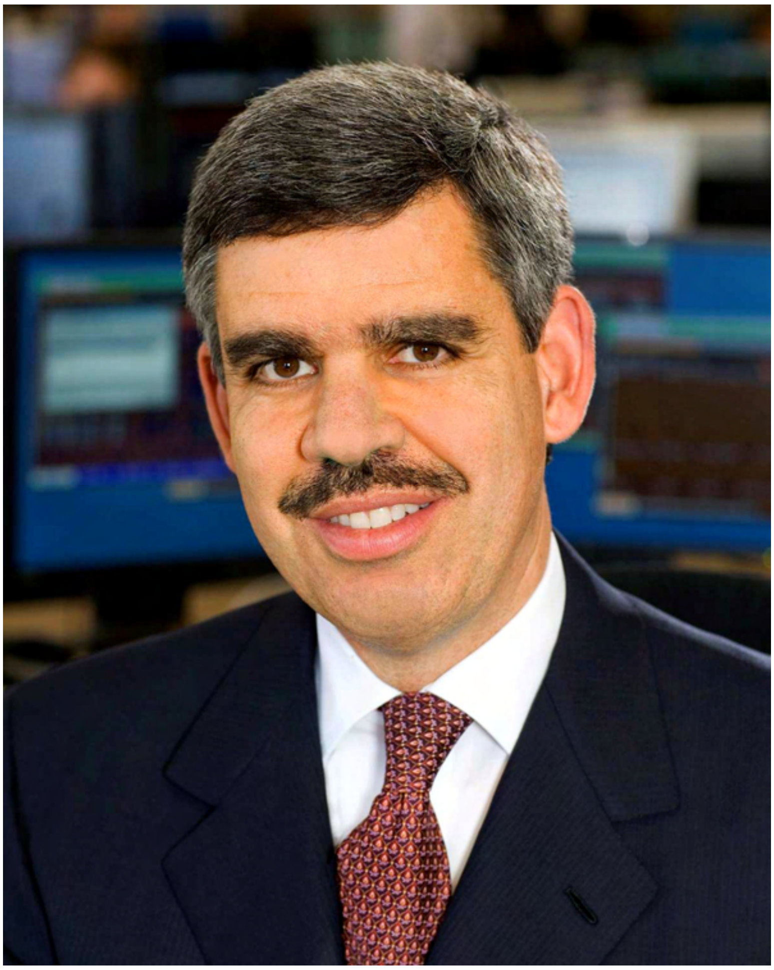
36%
THE PROPORTION OF US HOUSEHOLDS THAT THINK THAT EQUITIES HAVE A ROLE TO PLAY IN RETIREMENT SAVING (35% NOW THINK EQUITIES ARE UNSUITABLE)

SOURCE: ABSOLUTE STRATEGY SURVEY OF US HOUSEHOLD FINANCES, SEPTEMBER 2012

David Bowers is a director at Absolute Strategy Research. For more information, visit www.absolute-strategy.com

USA, Interview: **"The Central Banks Make Me afraid"**

Mohamed El-Erian, head of the world's largest bond-investor Pimco, regards Europe as a barrel of shooting-powder. Investors are in great danger.



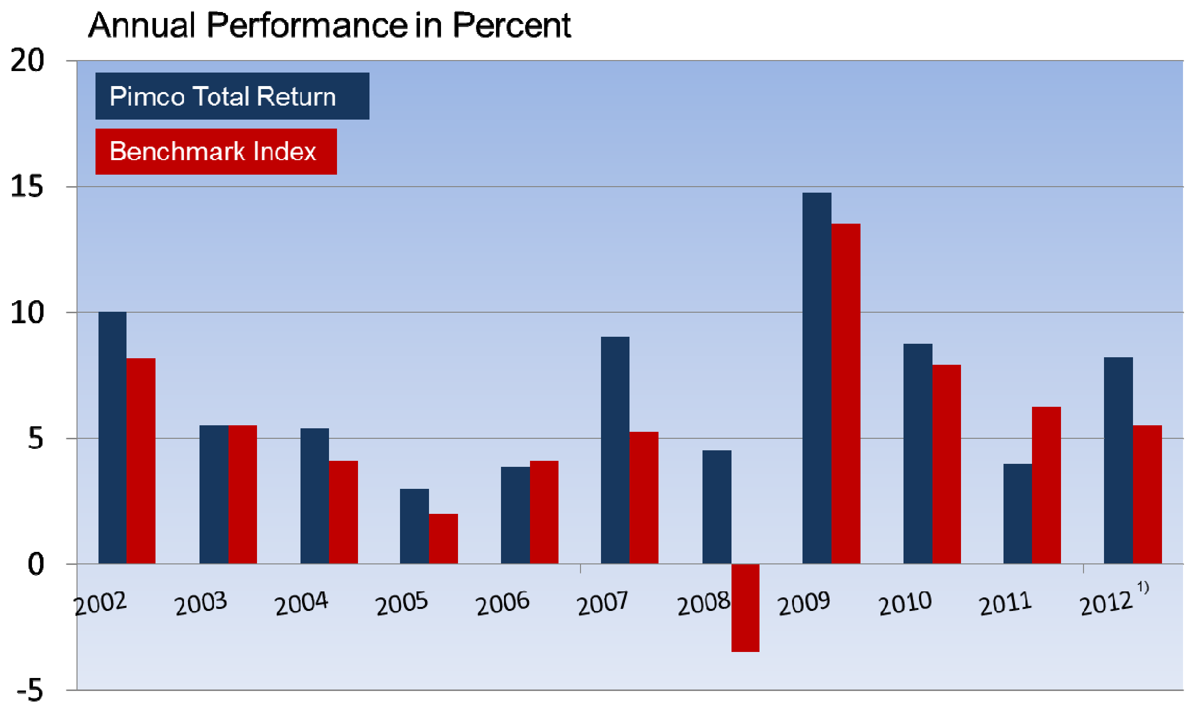
Mr. El-Erian, you are the head of the world's largest bond-investor. Pimco is managing 1.800 billion US-$. Are you still daring to invest the money of your customers in European government-bonds?

Yes, indeed. But we only invest when one decisive precondition has been met: the debt ratio of a country has to be in order. And naturally, the level of return must be acceptable as well.

Then there is not much choice for you in Europe.

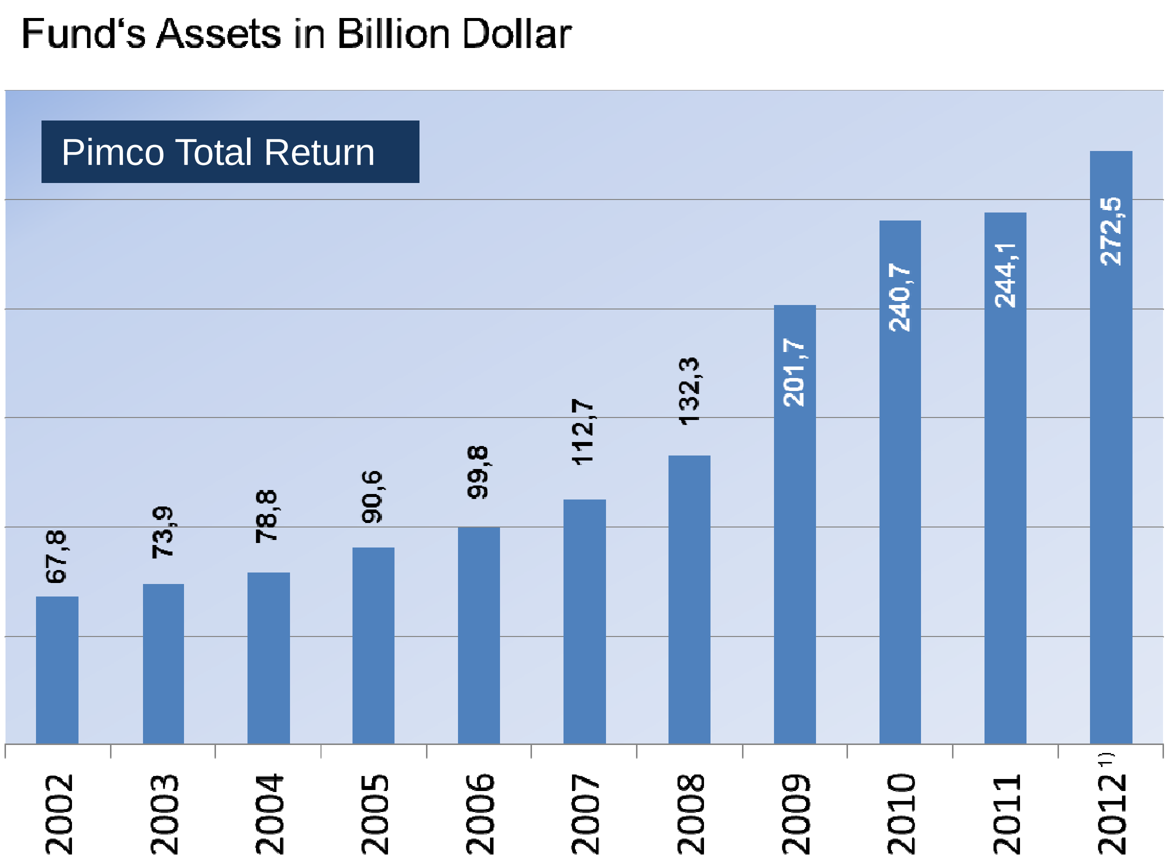
Certainly, the possibilities presently are limited. Within Europe we only have unrestricted trust in countries like Germany, Austria, Finland. Here, however, the rates of return are low.

The Biggest Equity Fund in the World



1) Status: August 8, 2012

The Biggest Equity Fund in the World



Source: Companies / F.A.Z.-Grafik Piron

But do not forget: Europe is more than the Euro-Zone. I regard Norwegian and Swedish government bonds as highly solid. It looks totally different in Southern Europe: Bonds from Greece and Portugal are too risky. We invest, though, in Italian government bonds, but not large scale.

The European Central Bank (ECB) wants to buy in an unlimited fashion bonds of weak European countries, in order to support the currency of the Union. So therefore you might be a bit more courageous.

For this it is still too early. I know that the ECB President Mario Draghi has been criticized strongly for his decision in Germany, and I must say to this: From his position I regard the measure as absolutely right. Just look back only a few weeks ago. In July Europe stood still close at the brink. The rate of the Spanish bonds was at more than 7 %, at the same time Switzerland received capital inflows from the entire Euro-area to the degree of 20 % of its GDP – within one month only. This is as if you are stearing in a small canoe with high speed into a waterfall. At some point of time the power of the water is so strong that you lose the control of the boat. Believe me, Europe was shortly before that. Now, however, the situation has at least become a bit quieter.

Quieter? Spanish government bonds are still traded at a return of roundabout 6 %.

This had not to be expected differently. Even when some analysts say something different: It is not so that the pure announcement of a purchasing program for bonds will satisfy the market once and forever. No: The indebted states will have to deliver, the creditors want to see actions after the words. The announcement of the ECB measures also encompasses a great danger. Because they can seduce some of the close to illiquid Euro-states into the "Moral Hazard".

This must be explained by you.

Imagine the following situation: You are standing at a bus stop and somebody asks you to lend him money for the ticket. He says that he has forgotten his money, but he must urgently go to a meeting for an application. How do you want to make sure that he will not go with the money and prefer to drink a coffee? Europe therefore must take much attention that the ECB supports will not lead to, that Southern European countries will relent in their efforts for reforms. The purchases of bonds are meant to facilitate reforms, and are not meant to substitute for them. But there is just a narrow line between the two.

Many Germans would rather be afraid that Southern Europe prefers to have a coffee.

As said: In the shorter term, from my point of view, the ECB has no other option. But whether its measures will have a long term success, depends also on other factors. Certainly: Mario Draghi alone will not be able to save Europe.

What then – in your opinion - is necessary in addition?

You know, here I have a personal remembrance. With friends we were as guests at the East Coast – in the garden they had installed a hammock. I have tried to lie myself into it, but I could not manage to find a stable position. Even worse: when I wanted to get up again, I would almost have fallen on my nose. Please pardon the comparison, but quite similar it is with the Euro-area.

Already when the currency-union had been established, it was clear that it was an uncompleted structure. To talk in pictures, at the beginning, the Europeans have accepted the shaking of the hammock, at the end, however, the swings have become increasingly fierce, the danger of a crash is as big as never before. At the beginning the politicians have not recognized that the currency-union, without a common fiscal policy, without a strong common banking supervision and without a political union, cannot function continuously.

This means: Every Euro-state is liable for the debts of the others. The European treaties are not allowing for this.

I am aware that the Germans reject this and at the end it is a decision of the Europeans alone. But this decision has to be made. To say it quite clearly: Either the members of the Euro-area, most of all Germany, are paying for Greece for many more years, or one allows the country to leave the currency area. But the longer one defers the decision, the more expensive it will become. And the more serious the market turbulences will be, if Greece has to leave the Euro-area, because the population does not accept the fiscal austerity any longer. Therefore the policy must make a decision finally. It cannot be that it stays out and hopes for that the central bank will solve the problems of the Euro-area.

Also in America the policy is letting the central bank going ahead. The American central bank purchases in an unlimited way more mortgage bonds.

Yes, and also look at Japan as well as England: All over the world the central banks are flooding the markets with money. Everywhere they try to take over the job of the politicians and to solve the crisis. In my view this is the largest bet which has ever been made in the financial markets. And it is totally unclear whether the bet will be won. And obviously there is no historic precedence what so ever.

Are you afraid?

Yes, this is so. We live in a world of massively over extended balance sheets. Firstly the balance sheets of the banks got into disorder, as a consequence of Lehman bankruptcy, and then the states intervened. This rescue action has increased the indebtedness of many countries in such a way, that now the central banks must help out with the printing press.

But there is a limit up to which the balance sheets of the central banks can be alienated from their purpose. And when this massive bet will not be won, the consequences can be grave: Our children will then be worse off than ourselves. The growth would be low, the unemployment high, also the inflation. There would not be a hyper inflation though, but to save would not be worth it anymore. All this is threatening when the central banks are losing the bet.

Pimco has certainly a problem: You manage with your Pimco Total Return Fund the largest bond fund in the world, but you cannot really advise to your investors to invest in bonds, isn't it?

Yes, indeed, bonds remain important. Bonds with the inflation protection are interesting, as well as bonds from solid states like Canada and Australia. To look into emerging markets is worthwhile doing as well. Here we invest for example in Brazil and Mexico. But naturally we do not only look any longer at bonds. Who wants to protect ones money also needs equities and raw-materials as well.

Your board member, Pimco-founder Bill Gross, has a different opinion. Lately he said that the cult of equities is dead.

Bill did not say that equities are dead, but he spoke about the dying cult of equity. With this he meant: Also with equities, investors should not expect to receive in the long run returns between 8 – 12 % p. a. any longer. For equities and bonds the future is: Investors must satisfy themselves with significantly lower returns.

As a head of the largest bond house, you could exercise an influence that things will be less bad. Many governments are looking for your advice.

We have no influence. We follow a stringend rule: We are never entering into contact with governments upon our own initiative, we ask no questions. However, we like to answer questions, if somebody wants to hear our evaluation.

How often the White House is calling you?

We presently get many calls from around the world. From whom exactly, I will not say.

The interview was conducted by Dennis Kremer.

The bond giant

The funds firm Pimco is an investment house of superlatives: The Americans are managing the Pimco Total Return Fund – with a total volume of 272.5 billion US $, the largest fund of the world.

Since 2007, Mohamed El-Erian is at the head of Pimco. Before that, the son of an Egyptian diplomat headed and managed the foundations fund of the elite-university Harvard.

Pimco is a subsidiary of the insurance group Allianz.

{ US FISCAL CLIFF }

JEREMY WARNER

The winner of next month's presidential election has to prevent huge fiscal contraction in the US, argues Jeremy Warner

Most economic catastrophes are self-inflicted to some degree. Failure to check excesses in the boom is frequently followed by an inadequate or harmful policy response in the bust. But some are more self-inflicted than others. The US's so-called 'fiscal cliff' is one such case of it.

If US policymakers do nothing, a number of temporary tax cuts will expire and big, across-the-board federal spending reductions will kick in on 1 January 2013, resulting in a huge fiscal contraction likely to plunge the US economy back into deep recession.

All attempts at avoiding this squeeze have so far failed. American politics has proved too polarised to allow for compromise. To make matters worse, the US will again start bumping up against its self-imposed 'debt ceiling' towards the end of the year, threatening a complete shutdown of government.

American politics has proved too polarised to allow for compromise. To make matters worse, the US will again start bumping up against its self-imposed 'debt ceiling'

A Republican win in November's presidential election is more likely to result in happy resolution than a second term for President Obama. If only because a Republican president can expect a less hostile Congress than his Democrat opponent and is therefore more likely to be able to forge a less harmful fiscal settlement.

Even so, big uncertainties remain. Already, the economy is suffering the consequences. Lack of clarity on what's going to happen next year is causing consumers, businesses and government agencies to hold back on spending decisions.

On the basis of Winston Churchill's famous observation that "Americans can always be counted on to do the right thing... after they have exhausted all other possibilities", outright catastrophe will presumably be avoided. Things may go to the wire, but some way of muddling through will surely be found.

Yet the wider question of what the US is going to do about ever more mountainous public debt is still an open book. Mitt Romney and his Republican running mate, Paul Ryan, talk the rhetoric of deficit reduction, but their plans are alarmingly short of detail and where they do get specific, apparently riddled with contradictions.

For the time being, the US can continue to borrow all it wants from international investors at astonishingly low rates. The dollar's traditional reserve currency, safe haven status, has been further enhanced by the eurozone crisis. For global money markets, there are few obvious alternatives to US treasury bonds. The upshot is that there is little in the way of market discipline to restrain US borrowing.

Even so, if long-term disaster is to be avoided, some way must eventually be found of bringing spending and revenue into line. Americans have acquired a taste for European levels of government expenditure, but have yet to come to terms with the fact that this requires a matching, European-style tax burden.

At some point, the US must confront this simple choice; does it opt for Europe's social model, or does it stay loyal to the small-state, low-tax tradition of rugged individualism? In part, that's what this election is about.

Jeremy Warner is assistant editor of ***The Daily Telegraph*** and one of Britain's leading business and economics commentators

November 14, 2012, Cancun, Mexico

IAFEI Executive Committee Meeting

November 14, 2012, Cancun, Mexico

IAFEI Board of Directors Meeting

42nd IAFEI World Congress, Cancun, Mexico, November 14 to 17, 2012

IAFEI member institute IMEF, Instituto Mexicano de Ejecutivos de Finanzas, will organise and host this 42nd IAFEI World Congress.

43rd IAFEI World Congress 2013, Poland

Hosting IAFEI member institute will be FINEXA, the Financial Executives Institute of Poland, in cooperation with Financial Gates GmbH, Germany/ CFO-Insight magazine
Location: Warsaw, Poland
Exact date not yet determined, but probably in October 2013.

44th IAFEI World Congress 2014, The Philippines

Hosting IAFEI member institute will be the Financial Executives Institute of the Philippines, FINEX. The exact location and date have not yet been determined.