PREDICTIONS FOR 2012:
UPSIDE DOWN AND INSIDE OUT

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PREFACE:
UPSIDE DOWN AND INSIDE OUT

Planet finance has a propensity to turn itself upside down and inside out. It's up to its old tricks again.

In 2012, the euro poses question number one. Those on the dark side think the single currency will divide into a collection of national or multi-national coinages. If the euro does break up, the toll on jobs, economic activity, freedom of movement and social cohesion would be huge. And that's why it probably won't fail.

The bright-siders at Breakingviews prefer to put a number on the odds of survival rather than extinction for the euro. Let's say there's a nine out of 10 chance that European monetary union will weather the storms of 2012 and beyond. Then the big question becomes, "How much will it cost, and how long will it take, to nurse the euro back to full health".

Stateside, meanwhile, it is election year, and Barack Obama has a fight on his hands to stay in the White House. Financial markets will be on alert for swings in the presidential race and in the make-up of the new U.S. Congress. It is not just about the winners, but also about how successfully the world's largest economy will deal with its budget gap and political gridlock.

Financial firms are likely to be under severe stress, with second-tier banks especially challenged. On both the sellside and the buyside of financial markets, it's going to be tough. Investment banks may have to alter their business models and adapt to changes in customer demands, regulation, and capital requirements. M&A deals could be thin on the ground – but Chinese acquirers may prove the exceptions.

For investors, 2012 might be both good and bad. Sustained low stock prices might make it another classic year to accumulate stocks. It does not follow, however, that markets will rise. If euro-related fears persist, global equity prices may stay at basement levels. Despite some institutions' faith in them, hedge funds could struggle, again, to deliver decent returns. And in the worst case a portfolio for the paranoid consisting of hard, portable assets, could prove the most valuable.

Planet finance will also continue to give us quirky stories in 2012, and Breakingviews columnists will look at the important business, economic and financial stories from all angles. This, in fact, is how our collection of predictions for 2012 seeks to set the financial agenda: from the bright side, the dark side, Stateside, the buyside, the sellside – and the flip side.

Robert Cole
Assistant Editor, Reuters Breakingviews
January 2012

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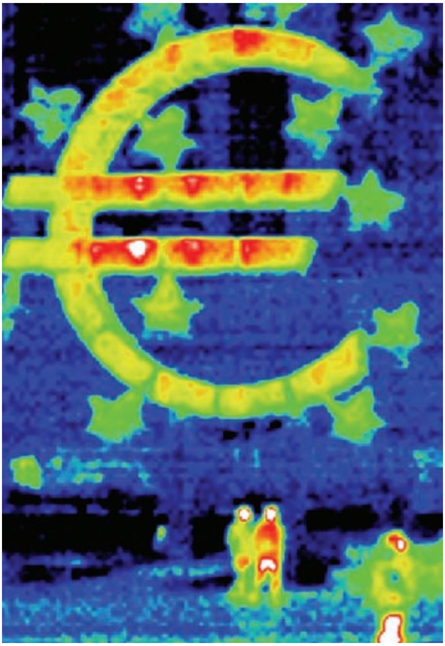
BRIGHT SIDE

NEW CURRENCY UNIONS COULD YET SEE THE LIGHT OF DAY

BY EDWARD HADAS IN LONDON

Before the euro crisis, talk of currency unions was becoming common around the world. The Gulf had a plan and there were serious suggestions for South America and Asia. Right now, exhausted European governments might advise wannabe unifiers not to bother. But if the crisis lifts and Angela Merkel's "more Europe" ideas bear fruit, monetary unions could well come back into fashion.



A picture taken with a thermographic camera shows people passing the illuminated euro sign in Frankfurt.
REUTERS/Kai Pfaffenbach

There are good reasons to maintain currency autonomy, as any euro-sceptic economist can explain. When countries with their own fiscal authorities join forces monetarily, the projects can easily end in tears – especially if weak members cannot get help from strong ones in a downturn. But such discussions of "optimal currency areas" are academic. They do not take into account the persuasive power of monetary facts on the ground.

Sure, the euro zone was born too soon to survive on its own. Like an infant marsupial, a new currency needs the warmth which only a mother can provide. In Europe's case, mum proved a bit immature. But she is much more likely to grow up for the sake of her offspring than she would if she delayed having children until she was totally ready. The crisis is forcing members of the euro zone to make some adult decisions about fiscal policy and bank support.

The delicate present health of the European single currency should not obscure its conceptual appeal. Compared to the sum of its national parts, a robust euro zone would be more efficient. It would be better able to negotiate and compete with global economic powers, too. The stronger members gain access to larger home market. Weaker members are obliged to live up to high fiscal and regulatory standards.

These advantages are appealing to Bahrainis, Argentines and Thais. Each other region will have to find its own ways of moving towards monetary union.

But if they wish to emulate the euro story, they should take note of the hundreds of precursor rules that built a single market for goods, labour and capital. And realise that plenty of patience is required. Hasty constructions will surely collapse.

Published on 20 December 2011

WHERE THE INVESTMENT BANKING JOBS MAY BE IN 2012

BY ROB COX IN NEW YORK

This is no time to be a plain vanilla investment banker. Trading commissions are unexciting. Companies aren't splashing out on big acquisitions. New regulations are taking a bite. So it takes more than a Hermès tie and a PowerPoint prepared by sleep-deprived associates to make a Maserati-sized living.

Not to fear. The crises of the moment, the biggest of them in Europe, are creating lucrative new opportunities for entrepreneurial financiers. Exchange rate and debt price volatility mean multinational companies have to worry like never before about hedging their exposure. That gives the currency, commodities and derivatives deskers at firms like Deutsche Bank a new way to access boardrooms, the traditional preserve of M&A bankers.

In Europe especially, corners of the capital markets could benefit as the continent's biggest banks seek to reduce their balance sheets by more than $2 trillion collectively. With bank lending harder to come by, companies will go to investors directly, creating underwriting business for bankers and investment opportunities for those with cash to deploy, particularly cash-rich private equity firms like KKR. Indeed, the buyouts industry has some $900 billion to deploy, according to Preqin.

If the European situation deteriorates badly, markets could seize up everywhere. But that still offers a silver lining for enterprising foreign exchange traders: the breakup of the euro would give them as many as 17 more currencies to trade.

Outside Europe there are other fee pockets to pick. While America's biggest banks are straitjacketed from getting bigger, their smaller brethren – regional banks like PNC, Fifth Third, SunTrust and Key Corp, plus the 7,000 or so that are littler still – are ripe for consolidation. Technology, too, could see more waves of M&A.

A traffic sign is seen in front of an office building of Swiss bank UBS in Zurich. REUTERS/Arnd Wiegmann

And activity in emerging markets won't dry up. South American companies see chances to create regional businesses, in part by acquiring assets from retreating Europeans. This year saw a record number of intra-Latin American takeovers, according to data from Thomson Reuters. And Chinese industrial groups are on the prowl for Western assets. These acquirers may be less magnanimous with their fees, but their ambitions still mean business – and relatively gainful employment – for bankers.

Published on 27 December 2011

SOUTH-EAST ASIA COULD BE 2012'S SAFEST GETAWAY

BY WAYNE ARNOLD IN HONG KONG

South-East Asia offers an enticing getaway in a stormy 2012. Growth will slow along with the global economy, but Asia's emerging economies should still outpace developed neighbours. That's likely to cool stocks, but as interest rates fall to offset slower growth, government bonds should benefit. The biggest risk is that retreating European and other foreign funds tug currencies down and push bond yields higher. But the risks look balanced. Malaysia, the Philippines and Thailand stand out as the region's safest harbours.

Even a slowing developing Asia should still manage 6.6 percent growth in 2012, according to Nomura. Economies most reliant on exports, particularly of electronics, will be hit hardest, like Singapore, Taiwan and Malaysia. But these and other developing Asian governments have finances Europe can only envy – even Malaysia and the Philippines have less debt relative to GDP than either Germany or France. That means they can afford to spend and cut interest rates, which should lure more local investors into their bonds.

Foreign investors drove Asian bonds in 2011 by using cheap dollars to snap them up in the first half, then selling as the United States tightened its monetary policy and Europe's troubles mounted. Emerging Asia is particularly susceptible to ebbing foreign capital because it still relies on external credit, particularly for short-term working capital and trade finance. And roughly three-fifths of the offshore borrowing in Southeast Asia comes from European banks. The biggest risk to Asian bonds, therefore, is that more of this capital drains as euro zone banks pull back.

Not all would be equally exposed, though. Malaysia and Thailand have sizeable current account surpluses and foreign exchange reserves that buffer their currencies. And both Thailand and the Philippines have relatively low exposure to short-term foreign credit. Investors in Philippine bonds earned a 12 percent return in 2011, yet the bonds still pay a higher yield than most regional peers – about 5.7 percent for 10-year bonds. And though they yield less, Malaysia and Thailand rely heavily on exports, meaning their interest rates are likely to fall and drive their bonds up. If 2012 gets tough, smart investors will head to the beach.

Published on 20 December 2011

GERMAN ECONOMY WILL PLOUGH AHEAD IF EURO HOLDS

BY MARTIN HUTCHINSON IN NEW YORK

The Bundesbank's forecast of a German economy growing a paltry 0.6 percent in 2012 may be pessimistic. If the euro zone stays in place, its troubles may redound to Berlin's advantage. The euro will stay weak, while Germany will enjoy a finance cost advantage over its neighbours. 2012 may thus see German exports surging and economic growth resilient.

Germany's economic trajectory in 2012 depends on the euro zone's fate. If it undergoes an orderly split, Germany may lose competitiveness as its part of the euro strengthens against other currencies. If the euro breaks up altogether, massive European debt defaults may cause a Europe-wide recession severe enough to drag down even resilient Germany. If, however, the euro remains in place – which currently appears most likely, even if possibly losing Greece and/or Portugal – Germany will be in an excellent competitive position. Both France and southern Europe, important competitors, will suffer financing costs significantly above German levels, while the euro will remain weak enough to keep German exports competitive in the United States and world markets.

Given this reality, the Bundesbank growth forecast looks too low. While public sectors may well suffer increased financing costs, Germany has a projected budget deficit of less than 1 percent of GDP and hence will suffer less from this than its neighbours.

Global growth is projected at 4 percent in 2012, while U.S. growth appears more resilient than a few months ago. Hence German exports should continue growing at a healthy rate. Domestically, gross wages are expected by the Bundesbank to rise by about 5 percent this year and 3 percent in 2012, while unemployment is forecast to continue declining. That should bolster demand and counterbalance modest public sector austerity. Both internationally and domestically, German growth should prove the Bundesbank's caution excessive.

There are risks to this forecast. Even if financial collapse is avoided, the euro zone's demands on Germany's public purse could weaken its economic position, while calls for Germany to reduce its export surplus also threaten. But Chancellor Merkel, facing a difficult election in 2013, has become an expert in saying "Nein". That's a crucial skill to preserve the health of the German economy.

Published on 20 December 2011

FIAT MAY FIND CHRYSLER DEAL IS TICKET OUT OF ITALY

BY ROB COX IN NEW YORK

Italy is a global leader in fashion, food and art but comes up short on multinational corporations. That's likely to change as Fiat plots a full takeover of Chrysler. Going global, though, comes at a price: Fiat's Agnelli family may need to put pragmatism over sentimentality and move its headquarters from Italy.

Fiat is already becoming less Italian. This marks the first year the company is not a dues-paying member of Confindustria, the federation of Italian employers. Just a couple of years ago, when Fiat's chairman led Confindustria, this would have been unthinkable. Chief Executive Sergio Marchionne withdrew Fiat largely to forge its own destiny with labor unions.

But the bigger catalyst for Fiat's global graduation lies ahead. The launch of the Fiat-engineered fuel-efficient Dodge Dart allowed Fiat to raise its stake by five percentage points to 58.5 percent this week. Buying the remainder of Chrysler from a trust established to fund healthcare costs for retired UAW workers comes next, but will be far trickier.

The two sides are supposed to work out a deal in the first quarter of 2013. Though negotiations have yet to begin, they're already far apart on price. Moreover, even if Fiat could snag a valuation in line with the price it paid for a 16 percent stake last year, it would cost around $3.3 billion. But given Fiat's debt is nearly 6 billion euros – dwarfing its market value of 4.8 billion euros – that would be tight.

That suggests the best option would be to offer a combination of equity, with some cash, to the UAW trust as part of a full merger. The net present value of synergies that could be squeezed out – estimated by Breakingviews at some $17 billion – might also appeal to the trust. But it's hard to imagine it would want its primary asset to be in Italian stock.

The solution, then, seems relatively simple. The companies combine and the trust gets shares in the new group, which transfers its incorporation and primary stock listing to the United States. Fiat becomes Italy's first global company. It's just not very Italian any more.

Published on 5 January 2012

NEW ISLAMIST DEMOCRACIES WILL BE OPEN FOR BUSINESS

BY UNA GALANI IN DUBAI

The Arab revolutions have altered perceptions of the region. The new regimes may have democratic foundations but they won't look like anything the West or liberals may hope for, especially in Egypt. Still, even if they end up being governed or dominated by Islamist parties, the new regimes that have sprung up along the Mediterranean may look more like Turkey than Iran.

The new governments, chosen by popular vote, will find it a struggle to shake off the deposed autocrats' legacies. Several months of protests, and elections, can't eliminate decades of corruption. Nor can they consign still-powerful armies to their barracks. Even if elections are free and fair, protesters in varying numbers and of different stripes will keep coming to Egypt's Tahrir Square. Meanwhile, exacerbated tribal differences will delay Libya's transition.

An anti-government protester gestures inside Tahrir Square in Cairo.
REUTERS/Amr Dalsh

It will be a painful adjustment for business. Dictators provided relatively safe and stable investment climates. Economic growth flourished while rampant cronyism ensured riches were held by a lucky few. True, private enterprise was stifled in Libya, but foreign oil companies were kept happy enough. The discrepancy between rich and poor will continue to widen in 2012 and cause more unrest. But it should narrow over time as politicians set policies that will help meet, at least partially, the economic aspirations of the poor that were at the heart of the revolution.

Education, wealth and demographics will decide how that is achieved. Libya's riches will enable the country to open itself up to foreign investment and maintain a generous social net for citizens. In Egypt, new and higher taxes will help government finances, some privatisations will be reversed, but reform of subsidies could remove market distortions and present new business opportunities. Tunisia will come closest to the Western concept of a free market.

The rise of political Islam will be a source of concern for some but shouldn't undermine the economy. Egypt will continue to welcome foreign investments. Islamic finance will boom alongside conventional banking. But hard line Islamists should be kept in check by the unlikely alliance of liberals and the army.

The idea of an Islamist democratic free-market government may run counter to usual assumptions – but it could be one of the ultimate surprises of the 2011 Arab Spring.

Published on 29 December 2011

GDP-LINKED DEBT COULD MAKE FINANCE SAFER

BY EDWARD HADAS IN LONDON

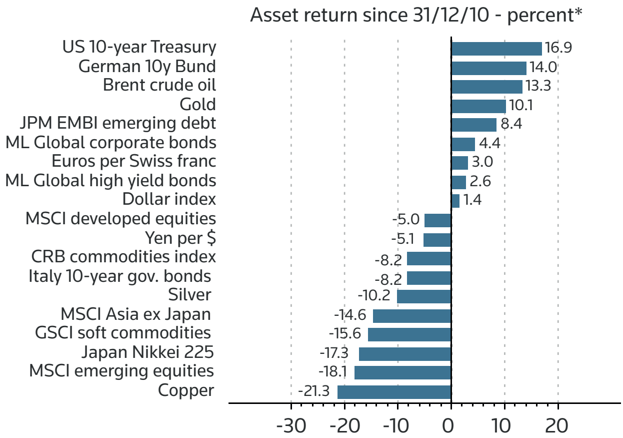
The financial crisis showed that there are serious problems with the architecture of all of the main investment types. A new instrument – bonds with payments that vary with GDP – could prove a happier medium.

Consider the weaknesses in the current set-up. The real return of ordinary fixed-interest securities can be savaged by inflation. Besides, these bonds lure borrowers to take on too much leverage in good times, while making default more likely in recessions. Inflation-linked debt, as the name implies, protects investors from increases in the cost of living. But they offer almost no exposure to economic expansion. Equities provide growth, but are altogether more risky.

Nominal GDP forms a far superior base for investment. It captures both inflation and real growth, so brings the advantages of inflation-linked bonds and equities. As a national measure, it is less variable and more predictable than the corporate profits which underlie share prices, but grows roughly as fast as them over time. And because nominal GDP is exactly as cyclical as the economy, it is less likely than any fixed-payment arrangement to make borrowing either too tempting or too burdensome.

Robert Shiller, the economist who has promoted the concept, suggests an instrument he calls the "trill" (crediting the name to co-author Mark

ASSET RETURNS IN 2011



*Total return in local currency except currencies, Gold, silver and copper which are spot returns
Reuters graphic/Scott Barber - data to close of 2011
Source: Thomson Reuters Datastream

Kamstra). A trill would pay an annual coupon equivalent to one-trillionth of the previous year's GDP (about $14 in 2012, for the United States).

Corporates as well as sovereigns could issue GDP-linked debt. As with any market instrument, investors would decide how much they were willing to pay for the anticipated stream of payments. As with stocks, both the payment and the price could and would change. As with bonds, the failure to pay the dividend would have all the dire consequences of default.

Some "trills" have been issued, but only by countries that have already defaulted. Indeed, there has been some talk of "GDP-kickers" on restructured Greek debt. To succeed, bond investors would have to be willing to give up some nominal certainty for the sake of a real guarantee. Traders and asset managers would have to develop new pricing models too. But GDP-linked bonds could serve issuers and investors well, while showing that the past years of financial crisis can bear good fruit.

Published on 6 January 2012

SELLSIDE

CHINA'S M&A DRAGON WILL BLOW HOT IN 2012

BY JOHN FOLEY IN HONG KONG

China's M&A stars will align in 2012. If asset prices fall, and bank credit remains tight, the Year of the Dragon will give state-owned companies a chance to play to their two strengths: cheap financing and a mandate to acquire.

The value of deals involving Chinese buyers has tripled since 2006. The $49 billion haul in 2011 outbound deals nears the previous year's record. Targets are often producers of materials China needs to grow, such as oil, iron and gas. On a smaller scale Chinese bidders have also rescued benighted firms such as the car-maker Volvo and the PC business of IBM.

Resources deals will continue apace. Sinopec's $2.5 billion purchase of a stake in Devon Energy's shale projects – on the same day rival PetroChina bought out minorities in a patch of Canadian oil sands – set the tone. Just days before, dam-builder Three Gorges paid a 53 percent premium for a 21 percent stake in EDP of Portugal, and threw in 20 years' worth of low-cost credit from a state bank to boot. With so many developed world banks in trouble, offers of solid financing may be hard to refuse in 2012 – even from regimes with low transparency and poor human rights records.

Elsewhere, faded telecoms equipment makers like Nokia – whose shares fell 51 percent in 2011 – or Research In Motion could excite interest. A telecoms tie-up, say between cash-rich China Mobile and Spain's Telefonica, could also make sense, given Beijing's penchant for Latin American connections. Further ahead, an acquisition of UK-based emerging market lender Standard Chartered by a Chinese megabank like ICBC remains a dream deal for M&A practitioners.

State-backed Chinese buyers' low cost of capital gives them lots of ammo. Many state-owned enterprises don't need to borrow from banks at all, after a 50 percent growth in earnings in 2010.

REUTERS

Yet it's Chinese savers who ultimately foot the bill. China's M&A engine relies on banks funneling cheap lines of credit to buyers and targets, leaving China's depositors with below-inflation returns on their savings. State-enterprise profits are also still pumped up by low wages and an undervalued currency. The days of that arrangement are surely numbered, but for now it leaves China in the M&A box seat.

Published on 4 January 2012

Chairman and CEO of CNOOC Ltd. Fu Chengyu during a news conference in Hong Kong. REUTERS/Bobby Yip

LBO DEBT GLUTTONS HAVE NOW GORGED ON EQUITY TOO

BY JEFFREY GOLDFARB IN NEW YORK

Leveraged buyout kings renowned for their debt gluttony have now gorged on equity, too. They're sitting on nearly $400 billion of cash committed by investors, according to Preqin, or more than $1 trillion of purchasing power. A big slug of it belongs to mega-buyout funds that are already at or approaching their use-by date.

For a fourth consecutive year in 2011, private equity firms have been starved of larger acquisitions. Apax's $6.3 billion purchase of Kinetic Concepts was among the few big deals this year. In 2007 alone, the volume of global leveraged buyouts larger than $500 million each was $450 billion, according to Thomson Reuters. For the last four years combined, it was around $300 billion.

Meanwhile, limited partners – the pension funds and other investors in private equity – keep bellying up to the buyout bar in hopes of securing better returns than are available elsewhere. And LBO firms have mostly been happy to accept the funds and the lucrative management fees they bring.

The typical buyout fund has five years to invest the capital committed to it. That means voracious fundraising in the boom years of 2006 to 2008 is still having an effect. Some $125 billion from the era remains to be deployed, Preqin estimates. Blackstone's sixth fund, for example, first closed in 2008 with about $7 billion. It now has some $16 billion, but didn't invest any of it until this year.

The firms have options. They can ask investors to extend the life of funds. They can also return capital, as Oaktree did earlier this year when it gave back some $3 billion of a $10 billion distressed fund. But it takes unusual financiers to surrender so much fee income. Instead, there's a real risk that discipline is lost as private equity dealmakers try to deploy their so-called dry powder before it goes poof.

The sight of buyout firms falling over themselves for a minority stake in beleaguered Yahoo looks a possible case in point. And KKR writing an equity check for more than half the price of its $7.2 billion acquisition of

Samson could be another. The eyes – and cash piles – of buyout barons may have grown too big for their stomachs.

Published on 23 December 2011

EUROPEAN IPOS MAY NEED BIG BACKERS TO TURN CORNER

BY QUENTIN WEBB IN LONDON

“Cornerstone” investors could become a necessary evil for European IPOs in 2012.

Giving powerful backers guaranteed shares in return for large, early commitments to support initial public offerings would get short shrift in good times. But Europe’s new-issues market is dysfunctional. And commodity trader Glencore’s $10 billion float showed the technique can get deals away in tricky markets.

It would be hard to design a worse backdrop for IPOs. The euro zone crisis has made the continent’s economic outlook both murky and gloomy, and has frightened investors away from riskier-looking bets. Spain’s flagship lottery privatisation and the flotation of Osram, a huge lighting firm owned by Siemens, rank among the biggest of this year’s many postponed equity deals.

In London this also follows a major breakdown of trust between IPO buyers, sellers, and the banks that put deals together. Cue months of squabbling about everything from the poor after-market performance of debutants such as Ocado and Betfair, to the optimum size of bank syndicates and the worth of pre-deal research.

Introducing cornerstones is one simple way to improve the prospects of big deals. The method, imported by Glencore from Hong Kong, relies on a small band of heavyweight hedge funds and other backers. When a prospectus is published, they commit to investing a fixed amount wherever in the price range a deal is struck, and to holding stock for at least six months. That takes some of the pressure off the main book-building process.

Of course, the setup can't do anything to improve the macro picture or allay general fears about the European IPO process. Moreover, it eats up management time, shifts the emphasis from company fundamentals to deal momentum, and creates two classes of investors – early-birds who get guaranteed share allocations, and everyone else. That could prove controversial if a stock soars soon after listing.

That said, lots of companies remain keen to list. Cornerstones can extract big allocations – at potentially good prices – for helping these issuers bridge the demand gap. They could be the envy of the market.

Published on 29 December 2011

MORE CORPORATE CARVE-UPS TO DELIGHT M&A BANKERS

BY JEFFREY GOLDFARB IN NEW YORK

News Corp Chief Executive and Chairman Rupert Murdoch leaves his home in London. REUTERS/Andrew Winning

In mergers and acquisitions, 2011 will go down as the year of the spinoff. Activity is on pace to hit $230 billion – six times 2010's total and approaching a whopping 8 percent of global deal activity, according to Citigroup. With rocky economic conditions unlikely to give chief executives much reason to go shopping, 2012 could bring still more splits.

The market has been in an anti-diversification mood. Just seven months after Motorola completed its spinoff of Motorola Mobility in January, Google saw fit to pay $12.5 billion for the newly independent mobile phone company, a 63 percent premium to where the stock had been trading. Shares of Motorola Solutions, meanwhile, have gained 25 percent in a flat year for the S&P 500.

The trend hasn't much discriminated by industry or country of origin. Fiat, ConocoPhillips, Kraft, ArcelorMittal and McGraw-Hill were among big companies that sought to shed non-core units in the hope of eliminating valuation discounts. Their spinoffs will inspire others to follow suit. Maybe even other large holdouts will, too.

In the oil patch, the value gaps between integrated operators and independents are getting harder to miss. Carve-ups should pressure the likes of Exxon Mobil to consider seriously the benefits of separating exploration from production. Similarly, it might be time for Pepsi to spin off its salty snacks. That business is leading the company's shares to trade more like a slow-growth food company than its better performing beverage peers.

The ranks of true conglomerates also have been thinned by three-way breakups at ITT and Fortune Brands. General Electric's shareholders might be envious. With GE stock down by half over the last decade, investors probably wouldn't miss the refrigerators-to-credit cards model. Meanwhile, succession plans at Berkshire Hathaway have reopened questions about whether Warren Buffett's motley collection of assets might fare better separated.

For News Corp., a split would come better late than never. Boss Rupert Murdoch may love newspapers, but they detract from the value of his more attractive TV and satellite businesses. And Goldman Sachs won't tolerate its stock trading below book value forever. The bank likes to boast of its triumphs over crises. Pulling off another may require something bold like a breakup.

Published on 28 December 2011

BOND MARKET WILL GROW AT BANKS' EXPENSE

BY PETER THAL LARSEN IN LONDON

Can the bond market take the place of banks? That question will be partially answered in 2012, as borrowers seek to bypass strained lenders in search of cheaper sources of credit. For big companies, tougher regulation of banks has accelerated a long-term shift to seeking funds directly from investors. But small companies and consumers won't find it so easy to make the switch.

The notion that bonds can provide cheaper and wider access to credit is hardly new. In the United States, big companies have long relied on bond markets for the majority of their financing needs. The development of securities backed by mortgages and credit-card debt promised to democratise credit for consumers as well. Indeed, the credit boom was based largely on the belief that banks were mainly in the business of repackaging loans and selling them on – the so-called originate-to-distribute" model. Regulators bought into the argument that spreading the risk around made the system safer.

The financial crisis that started in 2007 revealed this theory to be disastrously wrong. Far from shifting risk out of the banking system, it turned out that lenders had been shuffling risky loans between themselves, or had shunted them into unregulated off-balance sheet vehicles. Many of these "shadow banks" were guaranteed – implicitly or explicitly – by regulated institutions. Regulators have now responded by demanding that banks hold bigger buffers of capital and liquid assets, while closing loopholes that enabled lenders to pretend risks had been transferred.

While necessary, these reforms will make credit more expensive. Standard & Poor's reckons that for companies with investment-grade credit ratings, the cost of borrowing will rise by 55-70 basis points as a result of new regulations. Junk-rated borrowers will pay an extra 110-165 basis points. Add in the funding strains caused by the euro zone financial crisis, and it's clear that bank lending will become costlier and scarcer. This is particularly the case in Europe, where three-quarters of corporate funding is still channeled via the banking system, according to the European Central Bank.

REUTERS

For big companies, the bond market may offer better terms. After all, bond investors have plenty of spare cash looking for a healthy return. And a shift from bank to bond market financing is already underway. The amount that European companies borrowed from the bond markets in 2011 was 33 percent of what they borrowed from banks, says Oliver Wyman. At the peak of the credit bubble in 2007, the figure was just 20 percent. Until the recent market turmoil choked off demand, junk bonds were particularly popular. In the second half of 2009 and early 2010, more sub-investment grade bonds were sold in Europe than in the equivalent period of 2006/07.

For individuals and small companies, however, the shift is less straightforward. Small and medium-sized enterprises (SMEs) don't have direct access to the bond market. Some fund managers have responded by setting up loan funds aimed directly at SMEs, but it's still too early to say whether these can provide a cost-effective alternative to banks. For consumers, tapping the bond markets depends on reviving the discredited market for mortgage-backed securities. Even then, investors will probably still depend on banks to sort out good borrowers from bad ones.

The expansion of bond markets isn't entirely bad news for banks. True, less borrowing by companies means that loan books will have to shrink, squeezing revenues and forcing banks to cut costs even further. However, even ignoring the cost of new regulation, the vast majority of corporate loans were probably unprofitable anyway. That's because banks underpriced corporate credit in the hope of securing investment banking mandates that would justify the cross-subsidy. Such "relationship lending" is now unsustainable – especially as investment banking fees have dried up amid the market turmoil. So while corporate lending will shrink, the pricing of what remains should become more rational. What's more, investment banks' debt capital markets and trading businesses would be a beneficiary of any secular uptick in bond issuance.

The upshot is that post-crisis regulation should give a boost to the bond market, which in turn could prove a silver lining for investment banks' debt businesses. The big losers could be consumers and small enterprises whose access to credit is an essential building block of economic recovery. Not what policymakers intended.

Published on 22 December 2011

GLOBAL BANK CAPITAL RULES ADD "G-SIFI ENVY" TO MIX

BY ROB COX IN NEW YORK

The G20's decision to designate 29 banks as global systemically important financial institutions will introduce a new competitive dynamic to international finance in 2012: "G-Sifi envy." Banks that made the list last month will be required to hold more capital. But they will also benefit from being codified as banks that are effectively too big to fail. That puts smaller rivals at a disadvantage. It's a race to the top, but not in the way regulators envisaged.

In November, the G20's Financial Stability Board identified those banks whose failure "would cause significant disruption to the wider financial system and economic activity." The list, based on a series of measures including size, international reach and interconnectedness, included the usual suspects: Wall Street titans like JPMorgan, Goldman Sachs and Morgan Stanley; Switzerland's big two; the largest commercial lenders in Europe, the UK, the United States and Japan; and custodial banks like State Street and Bank of New York.

But the list may be more notable for its omissions. For instance, no Canadian institution made the cut. And while Bank of China was added at the request of Chinese regulators, its immediate rival ICBC was not. Similarly, HSBC made the grade, but not Standard Chartered, with whom it competes tooth and nail in Asia. In Europe, Spain's Santander and UniCredit of Italy are G-Sifis – but their cross-town rivals BBVA and Intesa are not. Nomura is a no-show, though Sumitomo, Mizuho and Mitsubishi UFJ appear.

Though most of the big banks fought against the G20 initiative, they are now expecting to benefit from the designation. From the start of next year, banks on the list will be forced by their national regulators to hold extra equity ranging from 1 percent to 2.5 percent of risk-weighted assets, depending on how big an impact their default might have on the financial system. Their resolution regimes – plans that allow big lenders to be wound down if they run into trouble – will also be subject to international scrutiny.

The extra capital will hit returns. But this is not such a disadvantage in countries like the UK, Italy and Spain, where regulators have already set higher capital hurdles for the biggest local banks. Moreover, in the eyes of credit rating agencies and customers, banks with a G-Sifi label will be deemed stronger counterparties. In certain businesses, particularly foreign exchange, credit derivatives, cash management, transaction processing and even equity and fixed-income trading, this competitive edge could outweigh the cost of holding more capital.

Lower funding costs may also accompany the halo effect of being too big to fail. That has certainly been the experience in the United States since the government stepped in to prop up the country's biggest banks in 2008. Smaller U.S. banks pay almost 50 percent more than the top 100 lenders for deposits, the most stable form of funding, according to the Federal Deposit Insurance Corp's most recent industry report.

Banks just below the G-Sifi radar may have to maintain even higher levels of capital in order to compete with their larger rivals for international business. Some may even pursue acquisitions in order to improve their chances of being added to the G-Sifi list when it is next reviewed.

Being a G-Sifi is not a one-way bet. The sliding capital scale means banks will have to hold more equity as they expand. In order to discourage the biggest banks from making themselves even more systemically important, regulators have also reserved the right to expand the capital buffer to 3.5 percent. And when regulators eventually draw up credible plans to wind down big lenders, the benefits of size should be diminished.

Those not on the list can equally try to make the case that they don't need a label from the G20 to be deemed safe. Canadian banks, for instance, might be in a position to argue that the nation's regulatory regime proved its superiority during the financial crisis.

Nevertheless, now that they're stuck with it, some of the big banks are gearing up to make the G-Sifi label a central plank of their pitch to clients. It's hardly what regulators had in mind when they first set out to tackle the too-big-to-fail problem.

Published on 20 December 2011

STATESIDE

FOR OBAMA'S 2012 HOPES, IT REALLY IS THE ECONOMY

BY RICHARD BEALES IN NEW YORK

Bill Clinton's campaign advisers are still right: For Barack Obama, it really is the economy, stupid. One respectable forecasting model puts the U.S. president with a hair over half the two-party vote on Nov. 6, 2012. A Breakingviews calculator shows how even slight changes in the economic growth rate before then could tip the result dramatically.

Among the best economic indicators for American elections are measures of personal income. The unemployment rate, which fell sharply in November but at 8.6 percent is still worryingly high for a sitting president, is a favorite of pundits – but it's not well correlated to election votes. The rate of change of unemployment may be better, but that's probably already reflected in income growth.

Ray Fair of Yale University has developed a model that predicts the vote share reasonably well when tested on the 24 presidential elections since 1916. Its main inputs are the real growth rate of per capita GDP in an election year and inflation throughout the ending presidential term. Fair has a third input to incorporate the "feelgood factor" of short periods during the term when growth is particularly robust.

The Breakingviews calculator is based on Fair's model, but simplifies it and turns the result into a probability of winning. Assuming 2.5 percent annual GDP growth from the last quarter of 2011 until the election and inflation running just under 2 percent, Obama's share of the two-party vote comes out at 50.3 percent. (This ignores the potential distortions of an independent candidate, and of the electoral college that actually chooses the president.) That slim-looking margin converts into a probability of winning of about 54 percent.

For more evidence that things are on a knife-edge 10 months out, consider figures from Intrade. On Wednesday, the prediction market gave Obama a

52 percent chance of re-election. His approval rating – around 45 percent as of Jan. 2, according to Gallup – seems to bode less well. It is early to read too much into that, and Obama's approval has lately edged upward, but he will be in trouble if it stays too far below 50 percent.

Breakingviews has built a "swing factor" into the calculator to incorporate users' own adjustments. But the economy is the key. For instance, if growth hits 3 percent, the Democrat Obama's probability of winning veers to 70

Breakingviews calculator: Will Obama get re-elected in November 2012?

percent or so. Conversely, weaker growth than hoped could easily put a Republican opponent – let's call him Mitt Romney given his Iowa win – in the White House.

Published on 4 January 2012

MAIN STREET BONUSES MAY AGAIN OUTDO WALL STREET

BY ANTONY CURRIE IN NEW YORK

Wall Street bosses aren't necessarily a shoo-in for the most egregious pay packages of the year. True, many enjoyed compensation boosts that outpaced returns to shareholders this year. But America's regional banks are giving the big boys of finance a run for their money. New rules giving shareholders a say on executive pay means they may finally have the wherewithal to push for better value for their investment.

Several of the country's midsized banks justify paying a lot simply because their competitors do. Key Corp, Huntington Bancshares and Fifth Third – all based in Ohio – lavish their CEOs with base salaries before bonuses of $3 million apiece. That's almost as much as John Stumpf gets for running Wells Fargo, which is five times the Ohio Three's combined size.

Meanwhile, bonuses for the top executives at Fifth Third, Key and Southern lender SunTrust have of late been based on low targets for earnings, equity or asset returns or other measures. In 2010, their CEOs only had to beat negative return targets yet ended up with total pay packages of $5 million, $7 million and $10 million, respectively. SunTrust's boss took home almost as much as his predecessor in 2006 when the bank was profitable – and far more after factoring in a hefty pension award.

In fact, several regional bank bosses are taking home more than they or their predecessors did at the height of the boom, despite much worse financial performance. Wall Street's too-big-to-fail CEOs, at least, are only making a fraction of their peak paychecks.

Improving results this year will make it hard to resist paying regional bank bosses even more despite the fact that many of their institutions are still struggling to earn their cost of capital. The better option, at least for shareholders, might be to sell out or merge with a rival, taking out duplicative costs. Yet with so many overpaid bosses relatively new to their jobs, few own enough stock to make that much of an incentive.

Thankfully, shareholders are better equipped to assert their interests. For instance, new Securities and Exchange Commission rules oblige companies to give shareholders a say on executive pay. The votes may not be binding, but the fear of investor, if not public, opprobrium may minimize bank boards' willingness to splash out the cash for decidedly mediocre performance.

Published on 27 December 2011

BRAZIL'S ITAU IS THE BANK TO WATCH

BY ROB COX IN NEW YORK

Brazil's Itaú Unibanco bills itself as the "The Global Latin American Bank." Thing is, it's not. Or at least, it's not yet. That may change in the coming year. Itaú's solid finances, robust market valuation, searing ambitions and a wealth of opportunities from the misfortunes of global rivals make it the bank to watch in 2012.

As many U.S. and European lenders struggle to emerge from their crisis funks, Itaú will increase earnings by at least 10 percent this year and next while return on equity will surpass 20 percent, JPMorgan estimates. Though Brazil's biggest bank may not be a household name on Wall Street, its attractions haven't escaped investors. They value the group led by Roberto Setúbal at almost 2.2 times book value, or assets minus liabilities.

As a result, Itaú's market value exceeds $80 billion, making it 50 percent bigger than Bank of America and more than Goldman Sachs and Morgan Stanley combined. That gives Itaú an attractive currency with which to scour the globe for acquisitions.

A security guard walks at the entrance of Itau Unibanco bank on Sao Paulo's Avenida Paulista. REUTERS/ Nacho Doce

South America, where Itaú has beefed up its presence, comes first. It isn't cheap, particularly in faster-growing markets like Colombia, where Spain's Santander was a recent seller. But moves by European regulators to force banks, including Santander and cross-town rival BBVA, to raise more capital will lead to further divestitures in the region. Moreover, Santander has shown a willingness to exchange assets for equity. A smaller stake in a faster-growing Itaú could be an attractive option.

It's not clear where Itaú's broader global ambitions lie. When Merrill Lynch was raising funds during the crisis – and before selling to BofA – Itaú proposed taking control of its Latin American businesses. Should UBS or another firm consider selling its investment bank, Itaú would certainly take a look.

Of course, the fastest-growing area of global banking is in facilitating capital flows between emerging markets, particularly Asia and Latin America. At $50 billion, Standard Chartered would make for a big gulp. But with a superior valuation, the stated ambition of its slogan and many potential bidders out of the picture for now, Itaú demands to be watched far beyond its homeland.

Published on 23 December 2011

INVESTORS MAY FIND CITI'S THE JOKE ON THEM IN 2012

BY ANTONY CURRIE IN NEW YORK

Investors may soon find that the joke's on them about Citigroup. The bank has managed to step into every financial mess of the last few decades. In the boom, its business model lagged behind rivals in profitability before it lost tens of billions of dollars on mortgages in the bust, leading to a double government bailout. Any hint of financial distress anywhere seems to send the stock lower; it trades at just over 40 percent of book value. But 2012 may be the year when investors believe this time it's different at Citi.

That's because the institution, led by Vikram Pandit, may be in a position to start handing back more cash to shareholders over the next few years than almost any of its rivals. Granted, JPMorgan is already serving up a tasty $4 billion a year in dividends, and its chief executive, Jamie Dimon, is hoping the Federal Reserve will give him permission to bulk up the offering after the latest round of stress tests.

If he can return to paying out around a third of its net profit in dividends by 2013, that could reach $7 billion, based on the consensus earnings estimate of sell-side analysts.

So by comparison, Citi's symbolic 1 cent-a-share payout barely qualifies as an amuse-bouche. And with the remnants of the group's foray into questionable assets still on course to cut some $2 billion off 2011 earnings, it's hard to see how Pandit can come close to matching his rival's lavishness, let alone outperforming it.

But Citi has a couple of tricks up its sleeve. First, it still has around $250 billion of unwanted assets in Citi Holdings, almost half of which is composed of the bank's remaining bad mortgages and the rest a collection of nonbank lending businesses mostly accumulated by one of Pandit's predecessors, Sanford Weill. Selling or running these off may free up around $25 billion of capital. Citicorp, which houses its regulated banking businesses, is already well capitalized. So unless that money is returned to shareholders it will sit on the balance sheet, dragging down returns.

Vikram Pandit delivers remarks at the Bretton Woods Committee International Council conference in Washington.
REUTERS/Jonathan Ernst

More for shareholders, though, should come from Citigroup's $50 billion in deferred tax assets, a consequence of losing so much money over the years. Regulators allow only around $11 billion of this asset to count toward common equity. If the remainder did too, Citi's Tier 1 common ratio would near an exceptionally robust 15 percent. Calamities aside, Citigroup would probably not need that surplus capital, which means there could be an additional $39 billion for shareholders to feast on over time.

There is, of course, one rather large sticking point with both pots of gold. First, Citi Holdings will take several more years to fully wind down. And Citigroup needs to actually earn money to monetize the deferred tax asset because it tapped into some $2 billion in the first nine months of this year, and various triggers ought to allow it to speed up the pace from 2012. Myriad different tax requirements in the more than 100 countries in which it operates makes this exceptionally difficult to model.

But using an admittedly back-of-the-envelope approach, assume it takes 10 years to pass on all the benefits. That makes for an average of $6.5 billion of excess capital to hand back to shareholders every 12 months. If Citigroup can also start paying a dividend from its core business' earnings, investors' total windfall could top $12 billion a year, which would be almost double JPMorgan's potential payout.

There's just the not-so-small matter of convincing investors that it can survive any fallout from Europe's debt woes, another recession in the United States or a possible slowdown in emerging markets, where Citi leads its

American counterparts. And savvy investors would want some assurance that Citi won't use its newly found riches to splash out on excessive bonuses for employees or value-destructive acquisitions.

Investors are unlikely to see much of this El Dorado from Citi over the next 12 months. But they will begin to see evidence of whether Pandit has put the bank on a trajectory to cashing in these chips. As that confidence increases, Citi shares should pull ahead of the pack.

Published on 27 December 2011

COURTS MORE WILLING TO SECOND-GUESS WALL STREET

BY REYNOLDS HOLDING IN NEW YORK

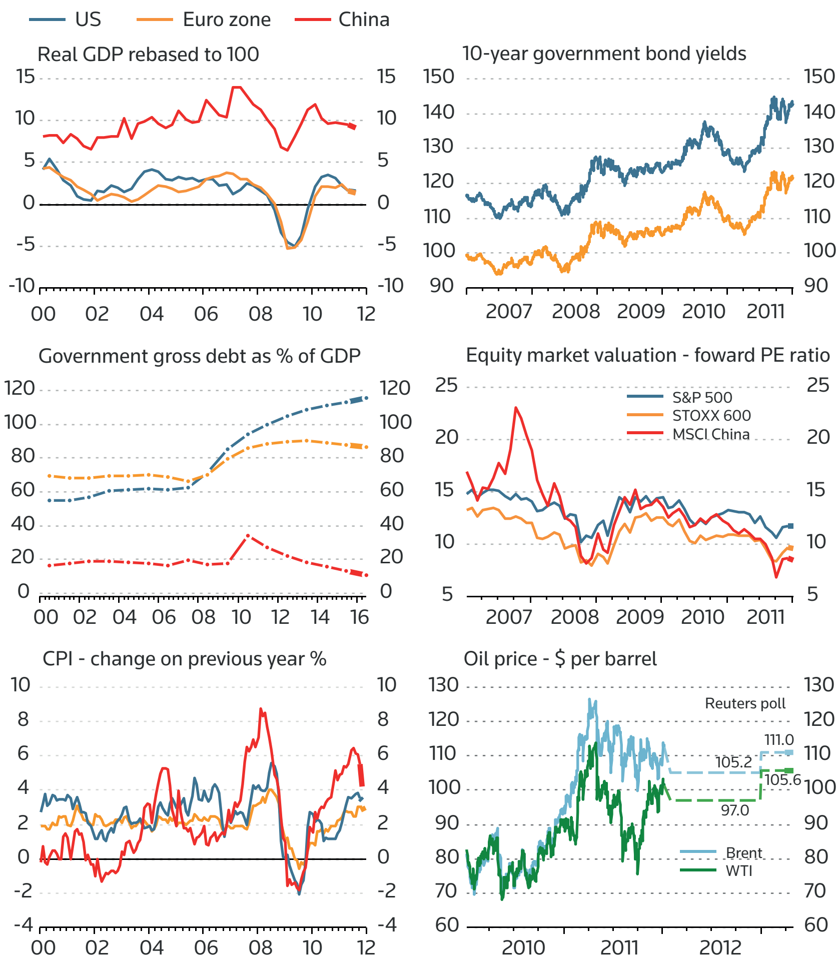
U.S. courts are growing bolder about second-guessing Wall Street. They have typically trodden softly over corporate financial disputes and settlements for fear of ruffling markets. But the rejection of the Securities and Exchange Commission's recent $285 million deal with Citigroup is the latest sign that times are changing.

In the late 1970s, a jittery economy led courts to say they wanted to avoid throwing credit markets into confusion or creating "undefinable instability" or "untold and unknown consequences." So they respected private agreements and refused to rule, for example, that lenders had any obligation to disclose onerous credit terms to borrowers.

In recent years, the approach has left some investors feeling cheated. Several federal courts in the past year alone have stretched to find technical reasons for dismissing complaints about how collateralized debt obligations were sold. But other judges are starting to raise questions.

In 2008, Supreme Court Justice Anthony Kennedy – far from a wild-eyed liberal – berated his colleagues for approving Kentucky's higher tax rate on out-of-state bonds, arguing it was unconstitutional despite the majority's desire not to "upset the market." Last September, a federal judge shocked creditors by refusing to bless their reorganization deal with bankrupt

Breakingviews barometer



Source: Thomson Reuters Datastream. IMF, Reuters poll Reuters graphic/Vincent Flasseur 10/01/2012

Washington Mutual, ruling it was tainted by possible insider trading. And in August, an appeals court forced investors, against precedent, to cough up gains from the Bernard Madoff Ponzi scheme.

But no jurist has lately roiled the status quo more than U.S. District Judge Jed Rakoff. In bouncing the SEC-Citi CDO settlement last week, he defied legal precedent by refusing to defer much to the regulator's judgment. His opinion showed little fear of creating market uncertainty, arguing that the public interest is better served by holding companies' feet to the fire than by quietly settling disputes without any admission of wrongdoing.

The financial sector has been successful at pressuring Congress and regulators like the SEC to blunt rulemaking under last year's Dodd-Frank law and other financial reforms. And aside from a few biggish settlements, not much blame for the economic crisis has been attached to the industry and even less to the people in it. Maybe it's not surprising that some in the judiciary are now keen to see more of the sector's machinations exposed to scrutiny.

Published on 5 December 2011

DARK SIDE

ANOTHER YEAR OF LIVING EURO-DANGEROUSLY

BY IAN CAMPBELL IN LONDON

Fear of euro zone breakup became the world's leading terror in 2011. That calamity can be avoided in 2012, even if the zone may well shrink later. This year's global question is whether the world can keep growing while Europe ails. Probably it can, but uneasily.

Evolution of the European crisis will again drive markets in 2012. Italy may provide the year's first big test. The euro zone's third-largest economy has over 200 billion euros in debt to refinance and currently faces 7 percent yields despite some European Central Bank bond buying. The risk of a blowout in spreads is high.

The markets fancy the easy option to avoid that: large-scale bond buying by the European Central Bank. Germany, and the ECB, are reluctant. Such purchases are against the ECB's rules, might encourage debtors to soft-pedal on fiscal and structural reform and could bring future losses to the ECB and its member central banks. The Dutch central bank has put provisions aside for that very purpose.

Germany and the ECB think euro zone governments should support their peers, using funds raised through the EFSF or ESM or obtained from the IMF. But this route has a blatant cost, burdening core economies that are at risk themselves of ratings downgrades – as France currently laments.

The best option is the simplest – Italy, a rich country which has long had excessive debt but also has high private savings, should help itself more. The proposed spending cuts of the new Italian government of Mario Monti amount to only about 2 percent of GDP over three years, less than Ireland is contemplating in one year. It might take a financing emergency in 2012 and a passive ECB to push Italy towards tough but fruitful change.

Even Italian progress would leave Europe with continuing serious problems. In the euro periphery of Portugal, Ireland, Greece and Spain, the problems have different roots: deficits and debts have worsened since formation of the euro. Despite one bailout, Ireland has among the worst public finances in Europe. It will need more help. The other three have large fiscal and trade deficits, look uncompetitive and may need external support for years. Supporting the periphery will test Europe. Years of austerity will test the periphery. Eventually, one or more of these economies may leave the zone – and creditors – behind. But the euro itself should survive.

In 2012, European slowdown will be a global drag. Central and eastern Europe will feel it most strongly. Hungary will need an IMF deal.

Outside Europe the world looks better – but not great. The United States is finally adding jobs and the housing market is improving but the fiscal deficit is enormous and must begin to be brought down. Signs of moderate growth mean the U.S. Federal Reserve seems less likely to embark on a third round of quantitative easing, or money printing. That the Fed shuns QE3 may be important for global growth.

For in 2011, money printing in the United States helped drive up oil and commodity prices, making for higher inflation – and growth-slowing policy tightening – in China, India, Brazil and other emerging economies. In 2012, the biggest challenge for them should shift away from inflation towards sustaining growth, with Europe importing less and investors less willing to send capital in their direction. Less frothy commodity markets would permit monetary easing in emerging economies, leading to more rapid growth in consumer spending.

That would be healthy. The world needs the BRIC consumer to emerge further. China and other countries running big trade surpluses need to rebalance. The best way to do that is to allow currencies and imports to rise. Cheaper, more abundant imports will help change the structure of emerging economies – and provide Europe, the United States and Japan with more open export markets.

The outlook for 2012 is neither promising nor hopeless. Collapse of the global financial system, a return to the 1930s, a new depression, deflation –

each threat to the world economy since 2008 has been real and has so far been averted. Euro collapse is the next threat. Policymakers will have to be resourceful again. That the world is still just about recovering shows that unlike in the 1930s they haven't got everything wrong.

Published on 5 January 2012

2012: THE YEAR CITIZENS WILL PRONOUNCE ON THE EURO

BY PIERRE BRIANCON IN LONDON

Euro zone governments want to save their currency. In 2012, citizens must decide whether they agree. Forget for a moment about the ECB's bazooka or other instruments of mass disruption. Ignore Italy's 7 percent bond

Men wear masks during Occupy Berlin protest denouncing current banking and financial industry practices in front of the Reichstag in Berlin.
REUTERS/Thomas Peter

yields, and debt topping 125 percent of gross domestic product. After a series of national crises or rebellions, and government changes across the European landscape, the euro zone is nearing the crucial moment when its citizens from Lisbon to Leipzig must choose whether they're ready to do what it takes to keep the single currency alive.

The euro was a political creature from the start, willed and conceived by France and Germany to strengthen Europe after the end of the Cold War. For 10 years it allowed its members to live in a soporific felicity fostered by low interest rates and markets' insouciance. Waking up from that deceptive torpor has been painful. Austere public spending cuts and higher taxes are on the cards everywhere. The euro zone's richest countries are being asked to help their profligate partners. And reforms designed to boost growth in the long term are perceived as heralding even more sacrifice in the short term.

Worse, pain is not perceived as being equally shared. The hard-pressed many feel they are paying for the excesses of a few. Ever-higher bankers' bonuses jar beside pension benefit cuts. These are the issues at the core of the Occupy Anywhere movements that are meeting with sympathy in the United States and Europe.

Some of the citizens of the euro zone – those in Ireland, Portugal and Spain – have already voted to change their governments. The French seem ready to fire President Nicolas Sarkozy in May – though they are not yet prepared to anoint his untested and inexperienced socialist opponent François Hollande. Italians, too, should have an opportunity to choose a new government after unelected Mario Monti ends his term as "technocratic" prime minister. Most critically, many euro zone governments may submit a new EU treaty to referendums.

The euro sits at the centre of these acts of democracy. Politicians must convince citizens that a euro zone breakup would be much more painful than the reforms now under way.

Published on 3 January 2012

PUTIN IS ON A COLLISION COURSE WITH CHANGE

BY JASON BUSH IN MOSCOW

For 12 years, Vladimir Putin has presided over a Potemkin democracy. And everyone, especially Putin himself, seemed strangely convinced that he could keep up the charade indefinitely. But in 2011, Russians' patience with Potemkin politics unexpectedly snapped. In 2012, the big question will be how Putin responds.

The recent mass protests against election-rigging reflect a deep yearning for change. Young Russians, and the growing middle class, are especially disgusted with the absurd parody of politics and the system's flagrant corruption. The fledgling movement is still too immature to prevent Putin winning presidential elections in March 2012, in which he will probably run as the only credible candidate. The more salient question is whether Russia's strong man will be able to reinvent himself in response to society's demands for democratic reform.

No one should hold their breath. The next government, which is expected to be headed by outgoing President Dmitry Medvedev, may well have a more reformist flavour. But it's hard to believe that this reconfiguration of the same old "tandem" heralds any breakthroughs. The changes will be superficial and disappointing - just as they were after previous Russian elections.

Old autocrats seldom learn new tricks. And Putin has already wasted too many years, during which he could have built a modern political system. If anything, his methods of manipulation and control have become more crude and desperate. The Russian prime minister's first, Pavlovian reaction to popular protests was to blame the West.

Faced with rising popular discontent, the Russian government will react not with outright repression, but with its usual tactics of legal chicanery, political manoeuvres and disinformation. But these Soviet-style methods are rapidly losing their power in the face of 21st century technology. The rapidly-spreading internet has provided the opposition with a potent tool for bypassing the state's smothering control of information.

Having exposed electoral fraud to such devastating effect, it will turn its attention to the corruption of the ruling elite. Putin's third term will be punctuated by scandals that will create a vicious circle of mounting public anger, declining investor confidence and stagnating economic growth. Only with Putin's departure will real modernisation in Russia become possible.

Published on 21 December 2011

FRANCE IS HEADING FOR A MAJOR SPRING CRISIS

BY PIERRE BRIANCON IN LONDON

France is heading for a major political and financial crisis in the spring that could dwarf the big Italian euro scare of 2011. Next May's quasi-simultaneous elections of a new president and parliament may well spark the conflagration.

Neither of the two main presidential candidates seem able or willing to convince the French that they need serious reforms to avoid a major financial storm. Worse, the possibility of political gridlock caused by a divided government must now be taken seriously.

The most likely election scenario, according to year-end opinion polls, is that socialist François Hollande will sweep to victory. If he does win, France would then have a president with no prior cabinet experience for the first time in more than 50 years. They would also be saddled with a president who appears ill-equipped to deal with the current global economic problems.

Hollande didn't include a single word on the euro crisis in the electoral manifesto he published with much fanfare on Jan. 3. This is in line with the silence he has kept on the matter for several months and adds to the legitimate concerns his candidacy raises over the French left's tax-and-spend insouciance. Not only will Hollande struggle with coming up with solutions to euro mess, but he could also add to the French economy's problems.

If, on the other hand, Nicolas Sarkozy manages to keep his job, it is more than likely he will have to face a parliament dominated by the socialists. He would then have to appoint an opposition prime minister who would govern for all practical matters – except on foreign policy, a presidential preserve. This distinction, though long-standing, is a recipe for disaster in the context of the euro crisis, where diplomacy and finance can't be separated.

Add to this the impact of the likely recession on France's finances, the downgrade of the country's credit ratings, and the fact that both the right and the left are embroiled in a string of corruption scandals. Before long, France could look and smell like Berlusconi's Italy, without the bunga-bunga.

Published on 4 January 2012

GANDHI-HAZARE NEXUS IMPORTANT TO INDIAN ECONOMY

BY JEFF GLEKIN IN MUMBAI

The Gandhi name continues to cast a spell on India. Though unrelated to the icon of the nation's fight for independence, Rahul may well succeed his mother Sonia as head of the ruling Congress party. One of his challenges is to claim the anti-graft message of Anna Hazare, a present-day activist and follower of the Mahatma, before the opposition does.

News reports of Sonia Gandhi's poor health have brought speculation that Rahul will take over the party leadership in 2012, and may even be Congress' candidate for prime minister at the next general election in 2014.

If that happens, he will have a job on his hands. The current government of Manmohan Singh is in turmoil. It is riven by corruption scandals and a faltering economy and embarrassed by its inability to deliver long-promised economic reforms. In December, Jim O'Neill, the Goldman Sachs economist who coined the idea of the BRIC economies, called India the most disappointing of them.

Crucially, the government's efforts to tackle corruption with the so-called Lokpal bill have failed to satisfy Hazare, whose decision to start another fast threatens a repeat of the mass protests of the past summer. The Lokpal bill was first proposed decades ago, and no government has ever taken it this

Indian social activist Hazare gestures while sitting in front of a portrait of Mahatma Gandhi while fasting in New Delhi.
REUTERS/Adnan Abidi

far. But Hazare says the proposed law is not tough enough.

The Congress party has failed to embrace Hazare's message. Rahul still has time to correct that. He could make the powerful case that the best way to fight corruption is to remove the opportunities for civil servants and politicians to profit from bureaucratic complexity. That would mean rolling back state control, breaking up monopolies and pursuing other reforms rather than backtracking on promises to open sectors like retailing to foreign competition, as Singh's government did recently.

A more determined push to open up the Indian economy might not be something the socialist Mahatma would have readily endorsed. But it's a course that could benefit from Hazare's momentum, attract investment and boost growth – all while giving Rahul Gandhi his own message.

Published on 27 December 2011

WEIBO SET TO GET DULLER BUT MORE VALUABLE

BY JOHN FOLEY IN HONG KONG

Sina Weibo was China's unruliest child in 2011. The Twitter-like social network, with 250 million users and counting, proved a thorn in the side of the ruling Party, and spawned at least one large protest. Comeuppance comes with plans by Beijing's city government to force microbloggers to use their real names. Other cities are likely to follow. Expect 2012 to be the year Weibo is firmly brought to heel.

Two-year-old Weibo resembles its U.S. cousin Twitter, except it carries images, videos and plenty of censorship. Searches for dissident artist Ai Weiwei, or premier Wen Jiabao, draw a blank. Surveillance neuters the traffic. But news and views spread fast, helped by users' relative anonymity.

Social networks don't cause protests, but they do make them more visible. An ongoing siege by angry villagers in the town of Wukan was widely Weibo-ed. In 2012, there may be more to protest about, from rising prices to a property bubble soon likely to pop. With a new premier and president named in 2012, order will be bought at any cost.

There are two ways Weibo can be tamed. First, the state can block content and create diversions. It can run self-styled offensives against "drug-like" rumours that poison society, and lock up "rumour-mongers". A quaint offshoot of this is China's return to old-style propaganda – including mass singalongs. It's no surprise that government accounts on Weibo tripled in 2011.

The second taming tool is profit. Weibo could be a gold mine for Nasdaq-listed owner Sina Corp if it plays by the rules. Consider Facebook's mooted $80 billion valuation, equivalent to $100 a user. Adjust it for real income per capita, and a Weibo user might be worth $16. That's already a $4 billion valuation, more than Sina's market capitalisation. Add a premium for more and richer users, and it could be double that.

Dullness is the danger. Overzealous censorship, as well as being authoritarian, makes the likes of Weibo less vibrant. Users may switch off. But while the state remains in charge, competitors will be equally straitjacketed – and in China, being favoured often pays more than being innovative. Even if Weibo loses its shine, it shouldn't lose its financial allure.

Published on 16 December 2011

INVESTMENT BANKING DREAMS MAY DIE IN 2012

BY MARGARET DOYLE IN LONDON

Will there be fewer investment banks at the end of 2012? Brutal market conditions forced almost all wholesale banks to cut costs and jobs in 2011. New regulations will force further shrinkage simply to generate acceptable returns. Unless the market picks up soon, smaller players may conclude they're better off out of the game altogether.

Banks cut thousands of jobs from their wholesale divisions in 2011, as revenues collapsed amidst the euro zone crisis. And new regulations will halve average expected return on equity (ROE) across global investment banks in 2012 to 8.3 percent, according to analysts at JPMorgan, well below the 13 percent needed to cover their cost of equity.

To reach that required return, banks have to shrink further. Even factoring in further headcount reductions of up to 20 percent and a 5 percent cut in non-compensation costs, returns would still be too low. To reach a 13 percent ROE, banks will have to slash pay, too – by a hefty 23 percent per head on average, JPMorgan reckons.

Those cuts will not just remove fat, they will also undermine revenue. The most vulnerable banks are those that are already sub-scale. JPMorgan analysts estimate that 2011 revenue at Royal Bank of Scotland, UBS and Societe Generale will be barely half that of industry leaders Goldman Sachs and Deutsche Bank. Nomura, too, faces a tough call – its investment bank is losing money in Europe, while the threat of a ratings downgrade could undermine its counterparty status.

No one is yet contemplating quitting – publicly, at least. Nomura reckons that its capital strength and liquidity position will allow it to gain from euro zone turmoil. UBS' new chief executive, Sergio Ermotti, insists its smaller investment bank is essential to its private bank.

However, there are signs of retreat. The UK government, RBS' major shareholder, made clear in December that it wants to shrink the investment bank faster. And SocGen has installed its chief financial officer at the head of its investment bank, suggesting a tighter focus on costs.

Closing investment banks is easier said than done. One banker likens them to nuclear plants – the toxic waste has to be managed by expensive staff. So while few banks will kill off their wholesale arms, 2012 may be the year they decide to starve them to death.

Published on 3 January 2012

CHINA'S GROWTH MAY DIP BELOW 8 PERCENT

BY WEI GU IN HONG KONG

China's growth may dip below 8 percent in 2012. Yet most China watchers are still predicting close to 9 percent growth. There are three things that could push the country's GDP growth to a 10-year low: falling house prices, a slump in property investment and slowing exports. Last time, Beijing stimulated the economy; it can ill afford a second round.

A property market crash is the biggest risk. A handful of developers had slashed new unit prices by 20 percent by mid-December after years of pricing mostly increasing. Most people believe the growth-obsessed policymakers will come to the rescue soon. But the authorities risk losing credibility completely if they allow the housing bubble to grow further. Some provinces have even been told to put purchase restrictions back after quietly lifting them.

A slump in property investment would deal a big blow to fixed-asset investment, which provides about half of China's GDP growth. Developers are already slowing down construction to preserve cash. They can't expect much help from banks, who are strapped by increased capital ratio requirements. Provinces and cities can commission affordable housing to keep developers busy, but with local government revenue falling, it's not clear they have much firepower.

Trade may be a negative contributor to GDP growth. The trade surplus shrank rapidly in 2011, and China could conceivably post a trade deficit in 2012 in more than one quarter. Its Asian neighbours are gaining competitiveness from their depreciating currencies, and Beijing can't let the yuan fall far, for fear of trade friction with the United States.

There are other less predictable drags on growth. Falling home prices would hurt sales of cars, furniture and household appliances. Beijing can try to boost them by cutting taxes and imports tariffs. But in a slowdown, the government may already be facing pressure on its tax haul.

At best, China will muddle through 2012 with sub-par growth. But the real unknown is confidence. If house prices start falling sharply and homeowners and consumers start to despair, even another government stimulus might struggle to prop up the economy. In that scenario, even an 8 percent GDP increase might start to look optimistic.

Published on 3 January 2012

STOCK UP ON GOLD, TINNED FOOD AND SHOTGUN SHELLS

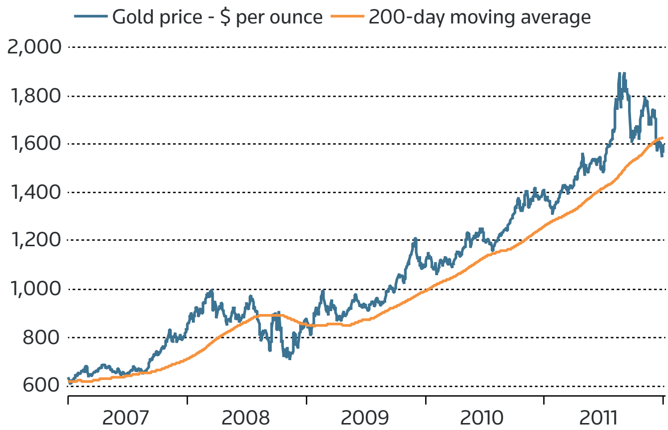
BY WAYNE ARNOLD IN HONG KONG

Hard times bolster the case for hard assets. Printing money to generate growth provides a tempting way out. But that undermines the value of financial assets, and civilisations that depend on workable means of monetary exchange. Servicing sky-high national borrowing without raising taxes, cutting benefits or deepening unemployment is a political nightmare. And while social pressure could undermine financial systems, seized-up finance could send societies into a new dark age. Gold, canned food and shotgun shells may be the safest bets in 2012.

Scared investors may be tempted to buy bonds from governments likely to withstand the worst, like Canada, Sweden or Norway. But if the global financial system breaks, who is to know if the assets are retrievable? Capital controls and other nationalist regulation might keep savings locked inside foreign countries.

The same, at least in part, goes for equities. They are paper securities. But shareholders have ownership rights that are comfortingly real – if corporate cashflows survive the meltdown. Utilities like Germany's E.ON and personal care companies like Procter & Gamble outperformed in the early months of the global crisis. Their attractions may well endure.

Gold price



Scott Barber 03/01/2012
Source: Thomson Reuters Datastream

Cigarettes and hard liquor, as well as being in dark-age demand, might quickly become new currencies. Investors worried about recession and currency debasement tend to stick with hard commodities whose price doesn't depend on consumption. Precious metals such as gold tend to rise with inflation whether it's being driven by booms or busts. Gold rose 20 percent in the year after Lehman's failure and, as dangers grew in 2011, rose again. Year-end falls give gold some allure of value: but investors who buy gold-related futures or exchange-traded funds might find themselves on a hiding to nothing. In an extreme crisis, when payment systems fail, such paper-electronic securities could prove worthless.

The concrete nature of built property, though not portable, would prove valuable. In a new dark age, agricultural land will be the thing to have. Diamonds are easier to carry – ounce for ounce, uncut stones are worth roughly 10 times gold. If it came to that, though, can openers could prove still more prized. You might have to forage for yourself, too. So don't go short of shotgun shells.

Published on 30 December 2011

BUYSIDE

LONG LIVE THE GLOOM – IT'S A GREAT TIME TO BUY STOCKS

BY ROBERT COLE IN LONDON

It is the oldest saw in the investment handbook: buy low and sell high. But with global shares at their cheapest in a generation, confident equity investors are a rare breed.

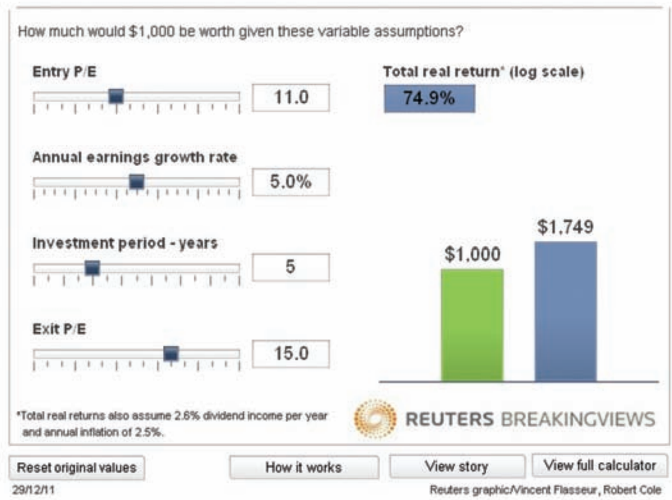
Back in 1999, share buyers were everywhere, clambering over themselves for any old variety of equity – and plenty of the new-fangled dot-coms too. Even a sober investor, one that bought a diversified basket of S&P 500 equities, would have got in at a price in excess of 20 times forward earnings. Now the forward PE ratio is just above 11.

Those that bought in the high old times around the turn of the century have not lost as much as might be imagined. Increases in corporate earnings have cushioned the pain caused by the compression of valuation multiples. And dividend payments have bolstered total returns. The all-in value of a portfolio of $1,000 worth of S&P 500 shares acquired at the turn of the century is now just in the black – in nominal terms – despite the intervening crisis.

A new Breakingviews calculator works out what happens if, over the coming years, valuation multiples rise again. Say an investor buys in at 11 times earnings and sells in five years' time at the 25-year average S&P 500 PE ratio of 15 times. Meanwhile, suppose companies manage to increase their earnings per share at a 5 percent annual rate. Bears might think that is optimistic – and short term it may be. But the longer term earnings trends suggest this is a modest assumption.

Each $1,000 invested now would be worth more than $1,740 in five years. Dividends, currently running at a 2.6 percent yield on the S&P 500, will add an extra fillip. But inflation will reduce the real gain. Assuming 2.5 percent is a reasonable outlook for inflation, that's roughly a wash with dividends.

Breakingviews calculator: What price earnings?



Stocks are of course risky. History may not repeat itself. Global banks could fail, currencies could spiral, poverty could descend on the world's consumers and markets could suffer a long financial winter. But savers confident enough to believe that better times will roll again within a few years should hope the gloom lasts a bit longer yet. It's a great time to buy equities.

Published on 30 December 2011

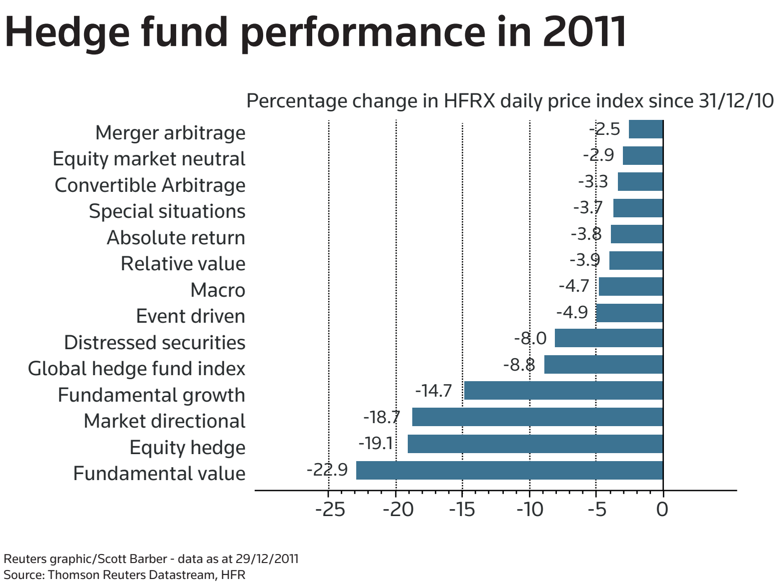
THE POORLY PERFORMING MUST-HAVE 2012 INVESTMENT

BY RICHARD BEALES IN NEW YORK AND NEIL UNMACK IN LONDON

The improbable must-have holding of 2012 is hedge funds. The typical fund has lost 4 percent this year through November, according to Hedge Fund Research. But that poor performance isn't deterring institutional investors.

Eleven months into 2011, even the S&P 500 had managed a 1 percent gain including dividends. HFR's chosen bond index returned nearly 8 percent. The average hedge fund is a loser by comparison.

One problem has been that the superior analysis hedge funds claim to offer has turned out to be almost useless. Government actions – from Europe's inconclusive gatherings to Washington's brinkmanship – and knee-jerk reactions by investors have overwhelmed the fundamentals focused on by pickers of stocks and other assets. Ingrained habits, like selling losing positions, have proved disastrous. Some hedge funds have been smart or



lucky. Others, including big names like John Paulson, just got the year badly wrong.

More than the usual number of pension fund managers and the like are disappointed with hedge fund performance, according to a Preqin survey. But the number intending to hand over still more money for hedge funds to manage far outweighs those planning to withdraw cash. It’s a bit of a paradox.

The rationale is that they desire yearly returns of, say, 8 percent. Bond yields are low – no more than about 2 percent for safe 10-year government paper – and the prospects for equities dim with developed-world growth anemic at best. Unless these investors lower their expectations, they have little choice but to bet that more rational conditions will return and that hedge funds armed with brains, flexibility and hopefully judicious leverage will again deliver double-digit returns.

For those funds that don’t, there are warning signs. Some 213 of them closed in the third quarter, according to HFR. That’s the most since early 2010, though still far from the 778 shuttered in the fourth quarter of 2008.

Overall, hedgies look well positioned to get a pass for their poor 2011 showing. But while big investors may give them another chance, they shouldn’t be surprised if markets continue to be erratic in 2012 and prized managers again struggle to prove their worth.

Published on 22 December 2011

GRAY MARKET TRADING SUCKING LIFE FROM IPOS

BY ROBERT CYRAN IN NEW YORK

Facebook's initial public offering will grab headlines in 2012. But as Zynga's tepid debut shows, multiple private investment rounds and the ability to trade shares before going public means slim pickings when public market investors finally get their chance to own a slice of Silicon Valley's emerging heavyweights. That's one reason the average IPO in 2011 has wound up trading some 10 percent below its offer price.

Mark Zuckerberg speaks to reporters at Harvard University in Cambridge.
REUTERS/Brian Snyder

Companies such as Zynga and Facebook increasingly avail themselves of so-called "D round" deals. These are very late-stage investments where companies, in addition to possibly selling some new stock to fund growth, also allow existing shareholders to cash out. At the same time, emerging private exchanges like SecondMarket allow qualified investors to buy stock from insiders in private firms without conducting an IPO.

Consider Zynga. The online gaming company raised money in multiple rounds at ever-rising valuations, allowing insiders, including CEO Mark Pincus, and other backers to sell along the way. While it was valued at about $4 billion in early 2010, its worth on gray markets had tripled by early 2011. More recent signs of slowing growth meant the company fetched just a $9 billion market value when it finally went public.

What's odd is that private market values have historically come at discounts to public prices, generally a reflection of less liquidity and disclosure. Yet for select firms, like Facebook or Zynga, this no longer seems to apply. Lots of investors want in to a few hot companies – about 80 percent of trading on gray markets is in five firms – and are willing to pay up, even if there is little financial information available.

For the companies involved, a private market in which they fetch robust valuations may be great. But it's not clear how this benefits capital markets more broadly, particularly if it means by the time companies go public their fastest growth is behind them and their valuations are already full. Zynga shares fell below their offering price on their first day of trading Friday. Taken as a whole, this trend is sucking the life out of the IPO market.

Published on 16 December 2011

CORPORATE BONDS PUSH FOR SOVEREIGN STATUS

BY AGNES T. CRANE IN NEW YORK AND NEIL UNMACK IN LONDON

Finance directors may start giving finance ministers a run for their money. The woeful state of national balance sheets will push risk-averse investors into highly rated companies like Microsoft and other cash-rich issuers best positioned to withstand uncertain times. Corporate bonds could prove more attractive than even top quality sovereigns.

Sovereign debt from developed world nations used to be considered one of the surest bets for safety-conscious investors. States' powers of taxation, and the printing presses in countries that controlled their own currencies, made default almost inconceivable. That's clearly no longer the case. The euro crisis that began with Greece has cast doubt on the region's bigger economies, such as Italy, Spain and even France. Even the United States' full faith and credit is no longer stain-free after 2011's congressional mud-slinging over long term deficits.

In fact, investors are already much more comfortable with corporate credit. An index created by Markit which measures how expensive it is to insure a basket of investment-grade corporate bonds – excluding financial companies – showed it cost twice as much to protect against defaults of European sovereign bonds in early December. In Europe, companies including Enel, Electricite de France, Siemens and Vinci all have had lower credit spreads than their respective sovereigns. Meanwhile, U.S. companies with top ratings like Microsoft have seen credit spreads on their bonds actually drop since the beginning of the year.

There's some logic for putting companies on still higher ground. France, one of Europe's stronger sovereigns, had debt equivalent to 166 percent of revenue (mostly tax revenue) compared to the average of just 48 percent for highly-rated companies, according to JPMorgan. The 12-month trailing default rate for U.S. companies considered investment grade is just 0.6 percent, according to Standard & Poor's.

Corporates can't hope to replace official fiscal authorities in terms of providing the market with the same amount of easy-to-trade debt. Companies also aren't immune to the sovereign crisis: troubled governments may try to raise revenues by increasing taxes, or curry favour with voters by toughening up regulations. Yet corporate debt can act as antidote to the violent ups and downs hitting sovereign debt and their proxies, financial institutions and broad stock indexes. At the very least, such bonds introduce a valuable element of diversification.

Published on 21 December 2011

FLIP SIDE

IMAGINED GOLDMAN SACHS MEMO THAT WOULDN'T SHOCK

BY ROB COX IN NEW YORK

It has been a rough year for Goldman Sachs. With the environment still difficult, big changes can't be ruled out. Breakingviews envisions some of the possibilities in an imagined memo to shareholders during 2012.

Fellow shareholders:

2011 was a period of strong performance for Goldman Sachs in the context of a challenging year. Despite continuing uncertainty in the global economy and the ongoing sovereign debt crisis in Europe, an unwavering focus on clients allowed us to generate net revenue of $40 billion with net earnings of $8 billion.

That was on a par with the previous year at a time when many of our competitors have struggled. But the 46 percent decline in our share price is

Goldman Sachs Chairman and CEO Lloyd Blankfein gestures during his testimony in Washington. REUTERS/Jason Reed not what you have come to expect from us. We are changing our business and management in ways that we believe will create value for our shareholders.

Among these changes has been the separation of the chairman and chief executive roles. While joining the two positions made sense in the early years of our public market listing, the regulatory and political climate that has emerged since 2008 necessitates a new approach to managing your company.

Chairman Gerald Corrigan's experience at the Federal Reserve positions him to lead our efforts in shaping and complying with the new framework of the global financial services business. Mr. Corrigan's new role will give Michael Evans, our new chief executive, unprecedented freedom to focus on our operations, which are also undergoing transformation. As co-chairs of our Business Standards Committee, which reported early in 2011, Messrs. Evans and Corrigan are uniquely qualified to lead our fundamental re-commitment to clients.

None of these important changes would have been possible without the support of Lloyd Blankfein, our former chairman and CEO, who now chairs Partners Capital LP, the independent asset management and securities trading business we spun off earlier this year to allow the remainder of our businesses to focus on our clients and the regulated functions of a bank holding company.

Being nimble is a very large part of our culture and our success story. Staying close to our clients and adapting our business and management to meet their evolving needs will remain a cornerstone of our long-term success.

Published on 28 December 2011

SURVIVING ANIMAL FINANCE: BEAR WITH THE BULL

BY ROBERT COLE IN LONDON

Just as a picture is better than a thousand words, an apt zoological metaphor conveys financial insight more effectively than the most comprehensive spreadsheet. But conjure the wrong creature out of the hat and confusion multiplies more quickly than a wrack of rabbits.

Financial zoology has evolved fast in recent years, way beyond the traditionally optimistic bulls and pessimistic bears. Bubble-blowing stags were seen padding around under-priced share issues. We were then told that if you paid peanuts to corporate executives, you'd get monkeys; and not expect too much of institutional investors, for they were no better than sheep.

We became familiar with several breeds of turkey stupid enough to vote for Christmas; with chickens that sometimes came home to roost and sometimes played daringly risky games with one another; with cats that got among pigeons, or bounced when dead; dogs that failed to bark; and camels that found it easier than bankers to get through the eyes of needles.

So far, so illustrative. But it is a jungle out there, and mistaken or mixed animal metaphors have a nasty habit of returning to bite the careless analyst, scribe or policymaker. Clueless simians abounded in executive suites despite the better grub. The gnomes of Zurich, speculating against poor defenceless currencies, stretched the imagination. And euro pioneers put a Snake in a Tunnel. As with many previous and subsequent exchange rate mechanisms, that analogy proved to be more a beast of burden than a bird of paradise.

A colony of gentoo penguins rest on a minefield at Kidney Cove, a stretch of beach across the Falklands Islands
REUTERS/Enrique Marcarian

For the careless, an unseen elephant in a room in old Europe does the same job as an 800 pound gorilla hunkered down in the United States. But the attentive financial zoologist should know that an elephant unseen is friendlier, and more predictable, than our heavy homininaean cousin. Both are less dangerous than either a lazy donkey or one of the feckless PIIGS.

When explaining complex financial transactions with zoology it is essential to pick the right horses for the right courses. There is only so much bull that an audience can bear. It is the fittest animal metaphors that survive.

Published on 23 December 2011

NEXT DIGITAL TIDAL WAVE TARGET: 3D OBJECTS

BY ROBERT CYRAN IN NEW YORK

The digital tidal wave up-ended the music, book, film and newspaper industries. The rise of new printing technology now threatens to wreak similar havoc on producers of three-dimensional objects. While this shift will take years, 2012 is shaping up as the year the technological hype hits the mainstream.

A 3D printer takes digital blueprints or scans and recreates them one layer at a time. Layers of plastic, metal or other compounds are bonded together to produce an object. If a rare car breaks down in a remote area, for instance, a suitably equipped local workshop might be able to produce the needed part immediately from a downloaded file instead of waiting for it to be shipped.

So far, only a few materials can be used, the process can take a long time and items need to be assembled afterward. But 3D printing is already changing manufacturing around the edges. Additive manufacturing, as it is formally known, is currently most widely used in making prototypes. Barclays estimates this and other specialized markets such as dental fillings add up to about $2.5 billion a year at the moment.

As printers become cheaper, new materials become available and machines can handle more complex tasks, the impact will increase. Local manufacturing will cut down on time and shipping costs. Companies will need to hold less inventory. Customization – of orthopaedic parts tailored from digital scans of patients for example – will become far simpler. Manufacturers will be able to switch or modify parts more easily, and pioneers will find new products that only printers can make.

But anything involving just a digital file and a readily available printer will encourage copying and piracy. The day may well come when teenagers can scan or download their friends' designer sunglasses and print a copy.

Listed companies that produce 3D printers, such as Stratasys and 3D Systems both valued in the $600 million to $800 million range, offer immediate plays on the sector, and other producers are considering IPOs. Related companies, such as $6.8 billion design software firm Autodesk, may also benefit. But the technology is developing rapidly. Opportunities will abound, but investors should beware hype in the coming year – and look out for disruption to traditional manufacturers over the next several.

Published on 28 December 2011

BRICS RAISE REGULATION RISK FOR EUROPEAN SOCCER

BY IAN CAMPBELL IN LONDON

Global wealth is shifting south and east and the world's best soccer players appear to be following. Nicolas Anelka is on his way from Chelsea, the top-flight London club, to Shanghai. Samuel Eto'o, meanwhile, is heading to the Russian North Caucasus region, having starred for Internazionale of Milan and a Barcelona side which is one of the finest to grace the stadiums of western Europe.

Is this another sign of Old World decline? To a degree, yes. The BRICs are coming. But the shift in economic power is yet to rob Europe of its champion-league status. Anelka is a very good player and Eto'o, a swift Cameroonian who has been African player of the year four times, is one of the sport's modern greats. His Italian owners sold him – in a worrying echo of wider financial issues – to help salve deficit problems. But the telling point here is that both Anelka and Eto'o are over 30 years old. In that context, Eto'o's rumoured 20 million euro per year new wage is extremely generous. It makes him one of the world's highest paid players.

But young stars still prefer the most competitive leagues: Spain, England, Italy, Germany and France – probably in that order. And until emerging nations host leagues that are the envy of the world, money is only likely to

Chelsea's Torres passes team mate Nicolas Anelka after a substitution during their Champions League round of 16 second leg soccer match against FC Copenhagen in London.
REUTERS/Toby Melville

buy stars whose abilities are on the wane, or soon will be waning.

Europe has the heritage, the money (still), and the nightlife to attract the best young talent. Among the BRICs, Brazil is a notable resource-rich supplier. In the 2010 to 2011 season, Brazil had 123 players in Europe's top five leagues. Argentina supplied 106 players – and Uruguay 37. Exports of home-grown players generate important revenues for Latin American teams.

That flow might reverse if Brazil and Argentina were to get richer and more BRIC billionaires were to create not just domestic super teams but super leagues that rival Europe's best. When the best soccer in the world is played in Shanghai and Sao Paulo – then the global economic order will really have changed. For now, Europe's football supporters can slump easily on their couches.

Published on 30 December 2011

1912ERS WOULD FIND THE WORLD STRANGELY FAMILIAR

BY MARTIN HUTCHINSON IN NEW YORK AND EDWARD HADAS IN LONDON

An awakened sleeper from a century ago would be delighted with 2012 technology and not too surprised by the globalised economic system or unstable power structures. But the gigantic public sector would be puzzling, and gold-less banking and persistent fiscal deficits distressing. The world is changed, but not utterly.

Much happened between 1912 and my new now. The fragile European peace I remembered was broken by huge wars and then restored, but the can-do spirit of my earlier era is hardly present in Europe and – this really surprised me – is in decline in the United States.

In some ways, though, the world feels familiar. Passports are not necessary for travel in much of Europe, and capital movements are almost entirely free. Foreign investment takes up a comparable share of GDP (a useful measure that we did not have in my old life). And while the great powers have changed, I find it easier to understand the multiple competing blocs than the nap-time arrangements of Cold War stasis and uni-polar dominance.

I'm delighted with all the new technology, but not too surprised (I used to read what is now called science fiction). Modern pharmaceuticals, computers and the internet all surpass my pre-sleep dreams. But I have to admit to some disappointments: planets are not colonized and people still rarely live past 100 years.

One thing really bothers me – the expansion of governments. This whole "welfare state" business may sound good, better welfare than warfare and all that, but states are expected to do much too much. I'm not surprised that governments don't seem to manage very well, either their operations or their finances.

Maybe that judgment reflects my training as a banker; I love sound money and strong markets. And that's another thing I don't like about the new world order – the financial system. Why on earth did they abandon the Gold Standard? With governments in total control of the monetary system, inflation and financial crises are inevitable.

I must say, banks now are grossly over-leveraged and these persistent government budget deficits are pernicious. The whole monetary system is gimcrack. New experts tell me that fiat money and leverage are good for the economy and society, but I simply don't see it. It's time for a monetary and finance refresher course.

Published on 30 December 2011

ABOUT US

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ON THE COVER
Left handside: Thierry Roge
Top right: Kevin Lamarque
Middle right: Tony Gentile
Bottom right: Eduard Korniyenko