On the Street – G20: Build Confidence At Any Cost
3 April 2009

The pressure on G20 members was very high given the divergences of goals, while failure was not a possible option. A failure to forge a consensus might have set back the world’s economy and markets just as they’re showing signs of shaking off the worst financial crisis in decades. That’s what happened in 1933, when US President Franklin D. Roosevelt torpedoed a similar conference in London by rejecting its plan to stabilise currency rates and in the process scotched international efforts to lift the world out of a depression.

However, at the end of a summit in London, policy makers from the Group of 20 yesterday delivered a regulatory blueprint that French President Sarkozy said turned the page on the Anglo-Saxon model of free markets by placing stricter limits on hedge funds and other financiers. The leaders also pledged to triple the resources of the International Monetary Fund and to hand China and other developing economies a greater say in the management of the world economy.

Action
In term of increasing the support to Multilateral Financing Institutions (MFIs), leaders agreed to the following support:
- $750 billion in funding for the IMF through both a new $250 billion Special Drawing Right allocation and $500 billion more for the New Arrangements to Borrow.
- $100 billion for the World Bank.
- $250 billion in trade finance through MFIs and national export credit.

Conciliation
In a conciliation effort, President Obama soft-pedalled earlier US demands that the summit agreed on a specific target for fiscal stimulus in the face of opposition from France and Germany. Instead, he settled for a vague pledge that the leaders would do whatever it takes to revive the global economy. The President also signed on to a communiqué that Nobel Laureate Joseph Stiglitz said repudiated the previous US-led push to free capitalism from the constraints of governments. “This is a major step forward and a reversal of the ideology of the 1990s, and at a very official level, a rejection of the ideas pushed by the U.S. and others,” said Stiglitz. “It’s a historic moment when the world came together and said we were wrong to push deregulation.”
In bowing to that view, the leaders conceded in a statement that “major failures” in regulation had been “fundamental causes” of the market turmoil they are trying to tackle. To make amends and to try to avoid a repeat of the crisis, they pledged to impose stronger restraints on hedge funds, credit rating companies, risk-taking and executive pay.

Harmonization
Citi economists Don Hanna and Jurgen Michels called the summit agreement “a boon to emerging markets”, as a result of the recognition of the greater importance of Emerging Countries in the world economy. This recognition is reflected through the increase of the Special Drawing Rights as these allocations can be drawn down without conditionality.

Special Drawing Rights is the artificial currency that the IMF uses to settle accounts among its member nations. The move is similar to a central bank such as the Federal Reserve effectively creating money out of thin air, except it’s on a global scale.
The increase in Special Drawing Rights will allow countries to tap IMF money without having to accept changes to economic policies often demanded as a condition of aid. The cash is disbursed in proportion to the money each member-nation pays into the fund. Rich nations will be allowed to divert their allocations to countries in greater need. Furthermore, the G20 said they would couple the financing moves with steps to give emerging economic powerhouses such as China, India and Brazil a greater say in how the IMF is run.

Finally, a new Financial Stability Board will be established to unite regulators and join the IMF in providing early warnings of potential threats. Once the economy recovers, work will begin on new rules aimed at avoiding excessive leverage and forcing banks to put more money aside during good times.

**Missing Pieces**

Although the summit outcomes were beyond markets expectations, our analysts observe that the G20 did not agree on additional fiscal measures, probably reflecting the resistance by continental European summit participants. Furthermore, in their view, the G20 leaders did not properly address the ongoing problem in the financial system. Instead of approving a “global bank rescue plan” the G20 leaders only agreed to say in the communiqué that they “are committed to take all necessary actions to restore the normal flow of credit through the financial system and ensure the soundness of systemically important institutions, implementing our policies in line with the agreed G20 framework for restoring lending and repairing the financial sector.”

*Note:* The G20 members are Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, South Korea, Mexico, Russia, Saudi Arabia, South Africa, Turkey, the USA, the UK and the EU.

**Important Disclosure**

“Citi analysts” refers to investment professionals within Citi Investment Research, Citi Global Markets and voting members of the GWM Investment Strategy Committee.

“We” refers to Citi Global Consumer Group Investments.

This document is based on information provided by Citigroup Investment Research, Citigroup Global Markets, Citigroup Global Wealth Management and Citigroup Alternative Investments. It is provided for your information only. It is not intended as an offer or solicitation for the purchase or sale of any security. Information in this document has been prepared without taking account of the objectives, financial situation or needs of any particular investor. Accordingly, investors should, before acting on the information, consider its appropriateness, having regard to their objectives, financial situation and needs. Any decision to purchase securities mentioned herein should be made based on a review of your particular circumstances with your financial adviser. Investments referred to in this document are not recommendations of Citibank or its affiliates.

The document is not to be construed as a solicitation or recommendation of investment advice. Subject to the nature and contents of the document, the investments described herein are subject to fluctuations in price and/or value and investors may get back less than originally invested. Certain high-volatility investments can be subject to sudden and large falls in value that could equal the amount invested. Certain investments contained in the document may have tax implications for private customers whereby levels and basis of taxation may be subject to change. Citibank does not provide tax advice and investors should seek advice from a tax adviser.